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Ninth Circuit Reversal of FTC's Qualcomm *Win Highlights the Limits of Antitrust Enforcement in Standard Essential Patent Licensing*

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Introduction

On August 11, 2020, the US Court of Appeals for the Ninth Circuit reversed the Federal Trade Commission's (FTC) district court victory in its suit challenging Qualcomm's licensing practices for its standard essential patents. After earlier expressing skepticism regarding the FTC's theories in its decision staying the district court's injunction pending appeal and an unprecedented amicus brief by the Department of Justice opposing the position of its sister antitrust enforcer, the Ninth Circuit firmly rejected the FTC's theory that Qualcomm's alleged breach of commitments to standard setting organizations could constitute an unlawful refusal to deal and that its Apple supply agreement constituted unlawful exclusive dealing. The case illustrates the continued narrow application by courts of an antitrust duty to deal under *Aspen Skiing* and addresses important questions regarding the interface between antitrust and standard setting.

Background

In January 2017, the FTC filed a complaint in federal court seeking to enjoin Qualcomm's standard essential patent (SEP) licensing practices for certain technology used in wireless communications semiconductor microchips.[1] The FTC alleged that Qualcomm's practices constituted an unlawful maintenance of monopoly power and that its licensing and supply agreements constituted unlawful agreements in restraint of trade. The FTC brought its case under Section 5 of the FTC Act for conduct alleged to violate Section 1 and 2 of the Sherman Act.

Qualcomm's SEPs at issue relates to code division multiple access (CDMA) and premium long-term evolution (LTE) wireless communications technology, which is used in cell phones to allow devices to communicate with the cellular network. According to the FTC's complaint, as part of the relevant standard setting organizations (SSOs) incorporating Qualcomm's technology into the CDMA and LTE standards, Qualcomm agreed to license its SEPs on fair, reasonable, and non-discriminatory (FRAND) terms.[2]

Qualcomm uses its SEPs to make CDMA and LTE chips, but also faces competition from other firms that supply CDMA and LTE chips. Qualcomm chose not to directly license its competitors under its SEP patents. Rather, Qualcomm licensed its SEPs to original equipment manufacturers (OEMs) of cell phones and other devices—*i.e.*, the customers purchasing CDMA and LTE chips—and did so regardless of whether an OEM purchased Qualcomm's chips or those of a competitor, while promising its competitors that it would not assert its patents against them as long as they did not sell chips to unlicensed OEMs. Qualcomm, which had a leading position in CDMA and LTE chips, also would not sell its own chips to customers unless they had previously taken a license. This was referred to as Qualcomm's "no license, no chips" policy. Qualcomm structured the royalty in its licenses as a percentage of the OEM's device price.[3]

The FTC alleged that this practice harmed competition by forcing OEMs to pay "inflated royalties" and a higher "all-in" cost for using non-Qualcomm chips.[4] The FTC also alleged that Qualcomm's 2011 and 2013 agreements to supply Apple were anticompetitive de facto exclusive deals because the large amount of total rebates given to Apple based on the volume of chips purchased from Qualcomm foreclosed competitors from entering or expanding.[5]

District Court Decision

In May 2019, after a 10-day bench trial, the District Court for the Northern District of California found in favor of the FTC.[6] The court had previously granted partial summary judgment finding that Qualcomm's SSO licensing commitments required it to license competitors, not just OEMs.[7] After trial, the court found that Qualcomm's refusal to license its competitors was an exercise of its monopoly power designed to avoid patent exhaustion and charge an "unreasonably high" royalty relative to what it would be able to charge competitors under the FRAND standard required by the SSOs.[8] Under the patent exhaustion doctrine, "the initial authorized sale of a patented item terminates all patent rights to that item,"[9] so a license to Qualcomm's competitors would have allowed the competitors to sell finished chips to OEM customers without the need for the OEM to pay a royalty to Qualcomm for the SEPs practiced in the chip. The court found that Qualcomm's royalty determined as a percentage of the cell phone's price would be above the FRAND rate because, among other things, its SEPs are not a major contributor to technology incorporated in phones and the modem chip is but one component driving the total handset value.[10]

Based on Qualcomm's failure to license competitors under the court's interpretation of the SSO commitments and its finding that the royalty was not reasonable under a FRAND standard, the court found an antitrust violation under the Supreme Court's decision in *Aspen Skiing*.[11] As clarified by the Supreme Court's later decision in *Trinko*,[12] *Aspen Skiing* permits a finding of antitrust liability for a refusal to deal with competitors in narrow circumstances—only where there was a prior course of dealing between the competitors. The court found the required prior course of dealing in Qualcomm's earlier direct licensing of competitors, citing evidence from 1999.[13] In evaluating the extent of harm to competition under the Rule of Reason, the court rejected Qualcomm's proffered procompetitive justifications that the licensing scheme reduced transaction costs; it found these justifications were pretextual after assessing the credibility of live testimony at the hearing.[14]

The district court also agreed with the FTC that Qualcomm's supply agreements with Apple constituted unlawful exclusive dealing. The court held that the Apple supply agreements were de facto exclusive and harmed competition, in part, because other OEMs followed Apple's lead and purchased from Qualcomm given Apple's significance and because there was an advantage to being the incumbent chip supplier for future product sales.[15]

Ninth Circuit Opinion

On August 11, 2020, the Ninth Circuit unanimously reversed. Its decision did not depend on the lower court's summary judgment determination that Qualcomm's SSO commitments required licensing to competitors. As such, without reaching the merits of that issue, the Ninth Circuit not only vacated the lower court's injunction on Qualcomm's licensing practices, but also vacated the partial summary judgment interpreting SSO commitment language.[16]

A. The Ninth Circuit Rejects Refusal to Deal Claims Based on *Aspen Skiing*

The Supreme Court's decision in *Aspen Skiing*[17] marks the high water mark of the Supreme Court's acceptance of monopolization claims based on a refusal to assist rivals. In *Trinko* the Court characterized *Aspen Skiing* as "at or near the outer boundary of § 2 liability," and post-*Trinko* cases have narrowly cabined antitrust liability based on unilateral refusals to deal.[18] The Ninth Circuit's decision continues that trend, refusing to conclude that Qualcomm's alleged commitments to standard-setting organizations changed the refusal to deal analysis.

Consistent with the post-*Trinko* case law in the Ninth Circuit and elsewhere, the court held that even monopolists have no general duty to supply their rivals, and that antitrust liability may be imposed only when a monopolist "unilaterally terminates a voluntary and profitable course of dealing" and "the only conceivable rationale or purpose is to sacrifice short-term benefits in order to obtain higher profits in the long run through the exclusion of competition."[19] The Ninth Circuit's decision, however, also added another prerequisite not usually expressly stated in the post-*Trinko* cases, that "the refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers."[20] As noted in *MetroNet Services*, the Ninth Circuit decision on which the *Qualcomm* court relied, this prong of the test relates to whether a remedy compelling dealing would be administrable, rather than whether the refusal to deal should be deemed anticompetitive.[21] The court found that the FTC's claim failed all three prongs of the test. Indeed, while the district court had relied on *Aspen*, the Ninth Circuit's decision notes that the FTC conceded that the district court's application of *Aspen Skiing* was erroneous.[22] Rather, the FTC asserted that the *Aspen/Trinko* "heightened standard for claims challenging a simple refusal to deal has no application where, as here, a monopolist's refusal to license its rivals breaches its own voluntary commitments made to induce SSOs to include its patented technology in industry-wide standards."[23]

Applying *Aspen* and *Trinko*, the Ninth Circuit found that there was no prior course of dealing, and that Qualcomm's direct licensing of chip competitors back in 1999 was irrelevant, because Qualcomm changed its policies before it obtained monopoly power to reflect changes in the law of patent exhaustion. Qualcomm's conduct failed to satisfy the second prong of the test because its rationale was not to sacrifice profits for long-term gain, but to make greater current profits in both the short and long term. Finally, regarding the administrability prong, the Ninth Circuit found that because Qualcomm applied its policy "neutrally with respect to *all* competing modem chip manufacturers, the third *Aspen Skiing* requirement does not apply."[24]

B. Harm to Customers That Does Not Foreclose Competitors Is Not An Antitrust Concern, and a Breach of SSO Commitments Is Not Enough, Standing Alone, to Find an Antitrust Violation

US antitrust law reaches only exclusionary conduct by monopolists. Unlike law in, for example, the European Union, US law does not reach "exploitative" conduct in which a monopolist charges high prices or otherwise disadvantages customers, unless that conduct also excludes competitors (as might be the case if only customers that dealt with competitors were targeted for higher prices, or if the competitor is also a customer). The Ninth Circuit characterized Qualcomm's "no license, no chips" policy as a policy of "no license, no problem" as far as rival chipmakers were concerned.[25] Even if Qualcomm's policy allowed it to charge supracompetitive royalties to customers in breach of its SSO commitments, the Court held that the FTC had failed to explain how the policy "impairs the opportunities of rivals," because all OEMs paid the same royalty whether they bought chips from Qualcomm or one of its competitors. While the FTC argued that the policy discouraged entry and investment by rivals, the Ninth Circuit pointed to a history of entry despite the policy.

Although the lower court granted summary judgment to the FTC on the issue of whether Qualcomm's licensing approach violated its SSO commitments, the Ninth Circuit held that it did not need to reach that issue and vacated the lower court's interpretation as moot. It found that it need not reach the question of whether there was a breach of the SSO commitments because there was no exclusionary effect regardless.

The Ninth Circuit also distinguished this case from the facts of the Third Circuit's decision in *Broadcom Corp. v. Qualcomm*.[26] In *Broadcom*, the court found an antitrust violation based on a breach of SSO commitments because Qualcomm's deception induced the SSO to include Qualcomm intellectual property in the standard, which Qualcomm then licensed at "discriminatorily higher" royalty rates. The Ninth Circuit highlighted the key issue in *Broadcom* as the intentional false promise to license on FRAND terms and noted that there was no such conduct in the FTC's case because Qualcomm's competitors could practice its patents without paying any royalty at all.[27]

The leading appellate decision on the antitrust treatment of a patent holder's standard-setting conduct is the DC Circuit's decision in *Rambus*.[28] In that case the DC Circuit rejected an FTC challenge to Rambus's failure to disclose patents in breach of its commitment to an SSO, holding that the FTC failed to prove that Rambus had unlawfully obtained monopoly power because there was no evidence that the SSO would have chosen to incorporate alternatives to Rambus's patents had there been no deception. While the Third Circuit's decision in *Broadcom v. Qualcomm* predates *Rambus* and does not condition antitrust liability for deception of an SSO on proof that the deception allowed the IP owner to attain monopoly power, the Third Circuit noted that Broadcom had alleged that absent Qualcomm's conduct the SSO would not have standardized the Qualcomm technology, and "the allegations of the Complaint foreclose the possibility that [Qualcomm technology's] inclusion in the standard was inevitable." The Ninth Circuit's decision does not, however, address whether Qualcomm's technology would have been included in the standard even if the FTC had established that Qualcomm had engaged in deception.

Finally, the Ninth Circuit also noted the "persuasive policy arguments" that SSO and FRAND disputes are essentially contract disputes where caution should be taken in applying the antitrust laws.[29]

C. Exclusive Dealing Claims Failed for Lack of Foreclosure Effect

On the issue of Qualcomm's supply agreements with Apple, the Ninth Circuit acknowledged that the lower court's finding of de facto exclusivity had "some merit," highlighting that the volume discounts were contingent on exclusivity and not easily terminable.[30] The court, however, found that there was a lack of anticompetitive effect. According to the Ninth Circuit, Qualcomm had only one "serious" competitor during the period when the Apple agreements were in effect. That competitor won Apple's business in 2014, the year after Apple's 2013 agreement with Qualcomm, and the court found a lack of evidence that the competitor could have been a viable alternative at the time of Apple's 2011 agreement with Qualcomm.[31] The Ninth Circuit also held that the Apple supply agreements could not be the basis for the injunctive relief sought by the FTC, because Apple terminated them in 2015, two years before the FTC filed its complaint.[32]

Takeaways

- **Earning monopoly profits on patents is not an antitrust violation.** The Ninth Circuit characterized Qualcomm as engaged in profit-maximizing, "hypercompetitive behavior" and held that just because Qualcomm had "sharp elbows," that did not mean it had acted anticompetitively.[33] The decision is a reminder that high prices or high royalty rates alone—and even rates at a monopoly price—cannot form the basis for an antitrust claim against a monopolist.
- **Patent holders can design royalty systems to avoid patent exhaustion and choose where in the supply chain to extract their royalties.** The FTC's central contention was that the royalty charged by Qualcomm to OEMs acted as a surcharge on sales by Qualcomm's competitors and allowed Qualcomm to charge lower prices for its own chips. The Ninth Circuit, however, made clear that nothing in the antitrust laws prohibited Qualcomm from choosing where in the supply chain it wanted to license and there was no evidence that Qualcomm's chip prices were so low as to be considered predatory. The court characterized the FTC's arguments as a type of "margin squeeze" theory that was rejected by the Supreme Court in *linkLine*.[34] Even if SSOs clearly draft their patent policies to require IP owners to license component makers, a breach of that commitment does not raise antitrust concerns where component makers pay no royalties and there is no price squeeze.
- ***Aspen Skiing* applications remain limited.** Antitrust liability for unilateral refusals to deal remains disfavored. The Ninth Circuit's decision does not even cite its decision in *ITS v. Kodak*, in which the court held that a refusal to license patents can be the basis for antitrust liability where the justification for the refusal to deal is "pretextual."[35] Instead, antitrust liability attaches to a unilateral refusal to deal only if there was a prior course of dealing, the refusal involves a "profit sacrifice" and lacks any procompetitive justification, and a remedy would be administrable as shown by the fact that the defendant is currently selling to others.
- **Breach of a FRAND commitment does not constitute an antitrust violation unless there is foreclosure (and maybe not even then).** Because Qualcomm's licensing policies led to its competitors being licensed royalty-free and OEMs paying the same royalty regardless of where they bought their chips—and because there was no price squeeze—even if Qualcomm breached its FRAND obligations that breach did not foreclose competitors.
- **Volume discounts that are contingent on exclusivity risk antitrust claims if foreclosure can be established.** The Ninth Circuit did take issue with the structure of Qualcomm's supply contracts to Apple given Qualcomm's monopoly power. While it found the specific claims here failed because the facts did not establish the requisite foreclosure and the agreements had already been terminated, companies with high market shares considering similar provisions should proceed cautiously and engage in a careful assessment of market conditions before enforcing those provisions.

1. Complaint, *FTC v. Qualcomm*, 5:17-cv-00220 (N.D. Cal. Jan. 17, 2017) [Complaint], *https://www.ftc.gov/system/files/documents/cases/170117qualcomm_redacted_complaint.pdf*. The complaint was filed in the final days of the Obama administration after a 2-1 vote by the Commission, with Commissioner Ohlhausen issuing a dissenting opinion criticizing the timing, legal theory, and economic and evidentiary support for the claim. Dissenting Statement of Commissioner Maureen K. Ohlhausen, *In re Qualcomm, Inc.*, FTC File No. 141-0199 (Jan 17, 2017), *https://www.ftc.gov/system/files/documents/cases/170117qualcomm_mko_dissenting_statement_17-1-17a.pdf*.
2. Complaint at 2.
3. *FTC v. Qualcomm*, 19-16122, at 12-15 (9th Cir. Aug. 11, 2020) [Ninth Circuit Opinion], *https://cdn.ca9.uscourts.gov/datastore/opinions/2020/08/11/19-16122.pdf*.
4. Complaint at ¶¶ 137–44.
5. *Id.* at ¶¶ 8–9, 122–30.
6. Findings of Fact and Conclusions of Law, *FTC v. Qualcomm*, 5:17-cv-00220 (N.D. Cal. May 21, 2019) [District Court Decision], *https://www.ftc.gov/system/files/documents/cases/qualcomm_findings_of_fact_and_conclusions_of_law.pdf*.
7. *Id.* at 2.
8. *See id.* at 44, 128–29, 157.
9. *Quanta Comp., Inc. v. LG Elecs., Inc.*, 553 U.S. 617, 625 (2008).
10. District Court Decision, at 165, 169.
11. *See id.* at 134.
12. *Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP,* 540 U.S. 398 (2004)
13. District Court Decision at 127.
14. *Id.* at 132.
15. *Id.* at 146–51, 199–200.
16. Ninth Circuit Opinion at 56.
17. *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,* 472 U.S. 585 (1985).
18. *Trinko*, 540 U.S. at 409.
19. Ninth Circuit Opinion at 32.
20. *Id*.
21. *MetroNet Servs. Corp. v. Qwest Corp.,* 383 F.3d 1124, 1132–33 (9th Cir. 2004).
22. Ninth Circuit Opinion at 33.
23. Brief of the Federal Trade Commission at 30, *available at https://www.ftc.gov/system/files/documents/cases/144_2019_11_22_ftc_answering_brief.pdf*.
24. Ninth Circuit Opinion at 35.
25. *Id*.
26. 501 F.3d. 297 (3rd Cir. 2007).
27. Ninth Circuit Opinion at 39.
28. *Rambus Inc. v. FTC,* 522 F.3d 456, 466–67 (D.C. Cir. 2008).
29. *Id.* at 39.
30. *Id.* at 53.
31. *Id.* at 54–55.
32. *Id.* at 55.
33. *Id.* at 55.
34. *Id.* at 47 (discussing *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.* 555 U.S. 438 (2009)).
35. *Image Technical Servs. v. Eastman Kodak Co.*, 125 F.3d 1195, 1219 (1997).