Qualcomm's Licensing Practices Found Permissible In Ninth Circuit Ruling

I. Overview

A three-judge panel of the United States Court of Appeals for the Ninth Circuit vacated and reversed a district court ruling finding that Qualcomm's licensing practices violated antitrust law. *Federal Trade Commission* v. *Qualcomm Inc.*, 2020 WL 4591476 (9th Cir. Aug. 11, 2020). The unanimous opinion, authored by Judge Consuelo Callahan, reversed an injunction against the technology company and vacated the district court's finding that Qualcomm's standard essential patent ("SEP") licensing practices unlawfully monopolized cellular chip markets. The panel characterized Qualcomm's conduct as "hypercompetitive" – not anticompetitive – and found it played a "powerful and disruptive" role in the relevant markets.

Although the Federal Trade Commission (the "FTC") has not indicated whether it intends to seek *en banc* review or appeal the decision, the Ninth Circuit's ruling is a significant victory for Qualcomm and other patent licensors. The decision is also significant for the United States Department of Justice, which remarkably took a position opposite the FTC by filing a statement of interest in support of Qualcomm.

II. Background

Standard setting organizations ("SSOs") may incorporate patents into their larger standards for technologies, including cellular technologies. Firms, such as Qualcomm, that have patents included in these standards are typically required by SSOs to license their patents on fair, reasonable, and nondiscriminatory ("FRAND") terms. Qualcomm generates revenue by leasing its patents downstream to original equipment manufacturers ("OEMs") as well as producing and selling modem chips— components of cell phones that allow the devices to use code division multiple access ("CDMA") and premium long-term evolution ("LTE") technologies. According to the Ninth Circuit panel, OEMs that purchase Qualcomm's modem chips must follow Qualcomm's policy requiring customers to license Qualcomm's patents to buy its chips. Although Qualcomm refuses to license patents to competing chip manufacturers, CDMA Application Specific Integrated Circuit agreements ("CDMA ASIC Agreements") between Qualcomm and chip manufacturers ensure that Qualcomm will not assert its patents against a manufacturer in exchange for its promise not to sell chips to unlicensed OEMs. These agreements paired with Qualcomm's licensing policy for OEMs essentially ensure that OEMs will pay Qualcomm a per-unit licensing royalty regardless of where they purchase their chips.

In 2019, the United States District Court for the Northern District of California held that Qualcomm possessed monopoly power in the relevant markets and that its licensing policies violated Sections 1 and 2 of the Sherman Act and Section 5(a) of the FTC Act. The district court determined that Qualcomm had a duty to issue licenses to rival chipmakers under *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp*, 472 U.S. 585 (1985), and that its licensing policy for OEMs was anticompetitive. The district court also held that Qualcomm's royalty rates were unreasonably high when paired with its licensing policy and that its exclusive deals with Apple foreclosed a substantial share of the modem chip market. The district court issued a permanent worldwide injunction prohibiting Qualcomm from engaging in certain licensing practices and compelling them to negotiate and license SEPs to modem-chip suppliers on FRAND terms. *Federal Trade Commission* v. *Qualcomm Inc.*, 411 F. Supp. 3d 658 (N.D. Ca. 2019).

III. The Ninth Circuit Decision

On appeal, a panel of the Ninth Circuit unanimously reversed the district court's injunction and concluded that Qualcomm's licensing practices did not violate antitrust law.

First, the panel rejected the district court's finding that Qualcomm had an antitrust duty to license its patents to its competitors. Generally, there is no duty to deal with competitors under antitrust law, with one narrow exception carved out by *Aspen Skiing*. The Ninth Circuit emphasized that *Aspen Skiing* remains narrowly applicable to circumstances where (1) a firm ends a voluntary and profitable course of dealing, (2) the rationale is to sacrifice short-term gain for increased long-term profits from excluding competition, and (3) the product at issue is still being sold to similar competitors. The panel was not persuaded that Qualcomm's policy reflected a shift from a former profitable course of dealing and reasoned that the "chip-supplier neutral" policy did not single out a specific chip supplier. The panel also noted that Qualcomm's shift to this business model was motivated by a change in patent-exhaustion law and the desire to increase both short and long-term profits.

Second, the panel rejected the FTC's argument that, even though Qualcomm did not have an antitrust duty to deal with its competitors, its refusal to do so caused anticompetitive harm by collecting the equivalent of a surcharge from its rivals' customers. Finding the district court erroneously focused on harm to OEMs, the panel focused on potential harm in the CDMA and premium LTE modem chip markets. The appellate court reasoned that the policy applied equally to all chip suppliers, not just its competitors' OEM customers, and acted as a *de facto* license allowing competitors to use the patents royalty-free before selling their chips to OEMs.

Because it found the FTC did not meet its initial burden of proof under the rule of reason, the panel was less critical of Qualcomm's procompetitive arguments. However, it observed that Qualcomm's justification of avoiding inefficient multi-level licensing was "reasonable and consistent with current industry practice." The panel was also persuaded by the opinions of the Honorable Paul R. Michel, a retired Federal Circuit Court of Appeals Chief Judge, and former FTC Commissioner Joshua Wright, who both argued that antitrust law was less appropriate than contract and patent law for resolving the dispute at hand.

Next, the panel rejected the district court's determination that Qualcomm's licensing royalty rates charged to OEMs operated as an "anticompetitive surcharge" on its rival chip suppliers. The district court stated that these rates were "unreasonably high" and that the cost effect was passed onto consumers. The panel disagreed, explaining that the measure of "reasonableness" used by the district court was meant for calculating patent law liability, and any harm would have been suffered by the OEMs, not Qualcomm's competitors. Instead of being an arbitrary tax meant to create exclusivity, the rates reflected the added value of Qualcomm's patent licenses to each OEM's end products.

Last, the panel determined that Qualcomm's minimum chip quantity purchase agreements with Apple in 2011 and 2013 did not foreclose a substantial share of the modem chip market, even though they may have amounted to exclusive dealing contracts. Rather than finding this harmed competition, the panel observed that in 2014, Intel, Qualcomm's biggest competitor for Apple contracts, won Apple's business over Qualcomm. However, as the contracts had been terminated, the court concluded that there was no current conduct to enjoin.

IV. Conclusion

In addition to validating Qualcomm's licensing practices, this decision may provide comfort to companies' utilizing similar business models. Because the panel found antitrust law did not extend into the realm of the FRAND dispute at issue, future litigants may argue that similar disputes likewise fall outside the purview of the Sherman Act. The opinion also reaffirmed the narrow scope of *Aspen Skiing's* "duty to deal" exception. Firms that participate in an SSO may be bound by FRAND terms, but depending on how broadly future courts interpret this Ninth Circuit opinion, antitrust law may not necessarily force them to deal with competitors.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Elai Katz at 212.701.3039 or ekatz@cahill.com; or Lauren Rackow at 212.701.3725 or lrackow@cahill.com; or email publications@cahill.com.