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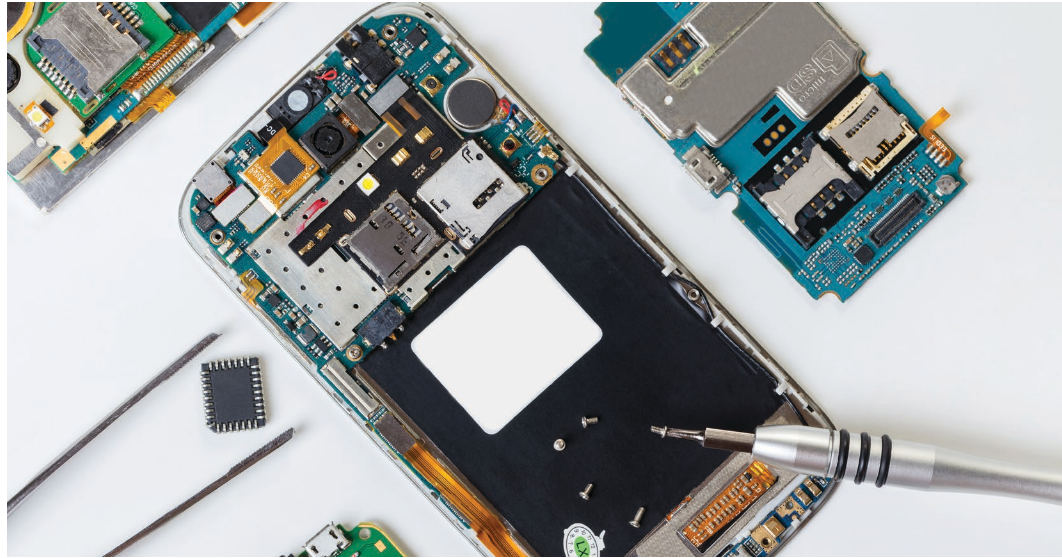
Qualcomm Loss Raises Risks for Substanyial Market Participants' IP Licensing Decisions and Ability to Provide Loyalty Discounts



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The U.S. Federal Trade Commission (FTC) convinced a California federal district court not only that Qualcomm's longstanding intellectual property licensing practices and volume-based discounts violated the antitrust laws, but also that its far-reaching requests for injunctive relief — including the renegotiation of existing patent licenses and a seven-year compliance monitoring period — were appropriate. The decision is relevant for all firms, not just high tech, and offers lessons in a number of areas, including whether and when the antitrust laws can impose a duty to deal with rivals, the risks of loyalty discounts, and the proper documentation of business decisions.

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After a 10-day bench trial, the *FTC v. Qualcomm* court handed the FTC a complete victory and consistently rejected Qualcomm's view of the facts, instead relying primarily on the FTC's interpretation of ordinary course documents and the testimony of frustrated licensees and competitors. The court appears to have been influenced by unsuccessful attempts by international antitrust agencies to reign in the identical practices challenged by the FTC, while, at the same time, summarily rejecting the U.S. Department of Justice Antitrust Division's eleventh-hour attempt to intervene in any decision regarding remedies. Although Qualcomm "strongly disagrees with" and has indicated its intent to appeal the decision, the court's credibility determinations might make reversal more difficult to achieve. Even with the court's myriad statements regarding credibility, much controversy exists regarding its application of the antitrust laws, and subsequent district and appellate courts will doubtless have much to say on its treatment of issues such as the duty to deal with rivals, de facto exclusive dealing, causation and injunctive relief standards.

Background

On the heels of investigations by government agencies in Japan, Korea, Taiwan, China and the European Union, the FTC sued Qualcomm in 2017 for its alleged use of anticompetitive tactics to maintain its monopoly power in the wireless cellphone chip market. Much of the FTC's complaint centered on Qualcomm's ownership of certain standard essential patents (SEPs) that are key to the development and production of compatible devices able to communicate with each other. Because an SEP is critical to other industry participants, SEP holders must commit to licensing their SEPs on fair, reasonable and nondiscriminatory (FRAND) terms.

The FTC claimed that Qualcomm's refusal to license its SEPs to other chip suppliers violated its FRAND commitment and the antitrust laws, that Qualcomm instead used its monopoly over chip supply and threats to withhold supply to coerce device manufacturers into unfair license arrangements, and that Qualcomm tied up such a large portion of the available business through exclusive dealing arrangements that its rival chip suppliers were unable to enter or thrive in the market.

Court's Opinion

As an initial matter, the court determined that Qualcomm had market power in two relevant global product markets — CDMA modem chips and premium LTE modem chips — based primarily on ordinary course documents reflecting high market shares and higher royalty rates. Further, the court held that the FTC did not need to prove that

the alleged anticompetitive acts caused competitive harm — here, the maintenance of Qualcomm's market power. Instead, the court stated that, in a government agency's case for injunctive relief, the court need only infer causation when a defendant has market power and the defendant's conduct "reasonably appears capable" of maintaining that power.

"Taxing" Competitors' Sales Through a "No License-No Chips" Policy. First, the court held that Qualcomm engaged in anticompetitive behavior by refusing to sell chips to cellphone manufacturers that would not sign a separate license agreement that covered not only the patents in Qualcomm chips, but also Qualcomm's SEPs in other manufacturers' chips. Because of its strong position in the chip market, Qualcomm increased its licensing leverage by threatening to withhold (or actually withholding) chips that cellphone manufacturers needed.

This coercive tactic, the court held, allowed Qualcomm to charge royalties that exceeded the value of its IP in several ways, including by allowing Qualcomm to charge a royalty on the price of the entire device, no matter the incremental value the chip added to the device, and by permitting Qualcomm to maintain a 5 percent royalty despite the fact that its role in standard setting declined over time. This no license-no chips policy gave Qualcomm an edge over competitors on whose chips Qualcomm was collecting an identical royalty, harmed consumers by driving up the price of competing chips, and, with further threats to cut off chip supply, prevented litigation that would have tested the royalty rates — all of which perpetuated Qualcomm's chip monopoly and allowed its anticompetitive licensing techniques to continue.

De Facto Exclusive Dealing Arrangements. Second, the court defined de facto exclusivity to include the offering of contractual incentives and penalties that, in effect, coerce purchasers into buying a substantial portion of their needs from the supplier. The court then found that incentives Qualcomm provided to cellphone manufacturers amounted to this de facto exclusive dealing. Because of Apple's substantial purchase volume and significance in the industry, the court focused on Qualcomm's agreements with Apple. The court found that Apple received hundreds of millions of dollars in rebates if it purchased exclusively from Qualcomm — rebates that Qualcomm could claw back if Apple purchased any chips from a Qualcomm rival during the deal periods.

The court's analysis of Apple-Qualcomm agreements concentrated on Apple's stature and sales volume, the duration of the deal, and the presence of additional competition reducing or enhancing provisions. For example, the court noted that Qualcomm's agreement with Apple blocked Qualcomm rivals from field testing and engineering collaboration opportunities with Apple and from the reputational boost that flows from an Apple partnership. In addition, the court took issue with the five-year duration of the rebate agreements, which, when paired with the rebate clawback provision, in effect, blocked Qualcomm's rivals from supplying chips to Apple for the full five-year terms of the agreements.

The court also found that several Qualcomm near-exclusive deals with other cellphone manufacturers allowed Qualcomm to coerce cellphone manufacturers into favorable licensing deals by threatening to withhold the chips on which its near-exclusive dealing partners depended.

Refusal to Deal With Rivals. In advance of trial, the court granted the FTC's partial summary judgment motion, holding that Qualcomm's commitments to two standard-setting organizations required it to license its SEPs to other chip suppliers on FRAND terms and leaving the court to determine only whether Qualcomm's failure to do so gave rise to antitrust liability. The evidence at trial showed that Qualcomm would only enter into licensing agreements with rivals if the rivals agreed to sell only to cellphone manufacturers that also had licensing deals with Qualcomm and agreed to disclose customer names and sales volumes to Qualcomm. The court concluded that Qualcomm's refusal to license fairly and directly to its rival chip makers qualified as anticompetitive conduct without any procompetitive justification.

Additionally, the court controversially held that Qualcomm has an antitrust duty to deal with its rivals, relying on the Supreme Court's decision in *Aspen Skiing Co. v. Aspen Highland Skiing Corp.*, 472 U.S. 585 (1985), and the Ninth Circuit's decision in *Metro-Net Services Corp. v. Qwest Corp.*, 383 F.3d 1124 (9th Cir. 2004). Specifically, the court concluded that such a duty exists when three conditions are met: (1) the defendant unilaterally terminated a voluntary and profitable course of dealing; (2) the defendant refused to deal even if compensated at market rates, which the court interpreted as proof of "anticompetitive malice"; and (3) the withheld product was already sold to other customers. Accordingly, the court found Qualcomm's previous voluntary and profitable licensing deals with competitors particularly problematic and concluded that Qualcomm's real justification for not licensing rivals was to prevent them from effectively competing.

Finally, although Qualcomm complained that it would be difficult to engage in the multilevel licensing scheme the FTC urged, these arrangements were routine in the industry before Qualcomm began licensing only to cellphone manufacturers, and a market for chip-based licenses (as opposed to device-based licenses) undoubtedly existed.

Remedy

The court's remedy is sweeping, and disrupts not only Qualcomm's future plans but requires Qualcomm to renegotiate existing licenses. In fashioning its remedy, the court was not deterred by Qualcomm's position in the nascent 5G chip market or the Department of Justice's vague, last-minute attempt to intervene in the remedies phase.

Implications

- Business people must be educated on drafting documents, particularly strategic planning, board-level materials, and other documents drafted or relied on by high-level personnel. At a minimum, business teams need to be reminded that the term "market" has a unique meaning in antitrust law; in most documents the terms "application," "industry," "business," or "customers" are more accurate and less risky than the term "market."

- In light of the court's controversial finding of the existence of an antitrust duty to deal with one's rivals, clients and practitioners need additional guidance regarding the existence and scope of that duty, especially in light of the Supreme Court's previous statement in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko*, *LLP*, 540 U.S. 398, 409 (2004), that *Aspen Skiing* is "at or near the outer boundary of § 2 liability." In light of the seemingly divergent views of the FTC and the DOJ regarding the duties of SEP holders, SEP holders should take care to document their basis for licensing decisions, including calculation of royalty rates.

- Although loyalty discounts are usually procompetitive and lawful, compliance training should address the risks of pushing customers to the point where those customers believe that they are being coerced into near-exclusive deals with suppliers.

- Along with the Third Circuit's decision in *FTC v. Shire ViroPharma, Inc.*[1] earlier this year, there will likely be additional guidance regarding the FTC's statutory authority and relevant standards to obtain injunctive relief.

Endnote

1 In *FTC v. Shire ViroPharma, Inc.*, 917 F.3d 147, 159 (3d Cir. 2019), the FTC contended that Shire's past conduct justified enjoining Shire from the same conduct in future markets – a similar argument the FTC made to the *Qualcomm* court regarding the nascent 5G segment. However, unlike the *Qualcomm* court, the Third Circuit rejected the FTC's argument in *Shire* and determined that an injunction cannot be granted based on "showing a violation in the distant past and a vague and generalized likelihood of recurrent conduct" in the future. The conduct must be occurring or about to occur for an injunction to be issued.