

FTC v. Qualcomm Decision—Qualcomm Enjoined From Anticompetitive Practices, Creating Standard-Essential-Patent Licensing Uncertainty

Judge Lucy Koh of the U.S. District Court for the Northern District of California ruled for the Federal Trade Commission (FTC) last week in its antitrust enforcement action against Qualcomm, and issued an injunction that, if upheld on appeal, could seriously impair Qualcomm's business model and enhance competition in the market for standards-compliant baseband modem computer chips used in cell phones and tablets. *FTC v. Qualcomm Inc.*, No. 17-cv-00220-LHK, Dkt. 1490 (N.D. Cal. May 21, 2019) ("D. Ct. Op.").

Background

Since the early 2000s, Qualcomm's business model has depended on revenues from licensing standard-essential-patents (SEPs) and sales of standards-compliant baseband modem chips. Indeed, over the last 10 years, the vast majority of Qualcomm's profits have come from licensing its SEPs, rather than selling chips.

In 2014, the FTC launched an investigation into allegedly anticompetitive practices that Qualcomm used to boost its SEP licensing revenues, including accusations that Qualcomm had used its dominance of the modem chip market to extract unreasonably high royalties on its SEPs. That investigation led the FTC to file suit against Qualcomm in January 2017, alleging that Qualcomm violated Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45(a). Section 5 of the FTC Act prohibits "[u]nfair methods of competition," including practices that violate both the letter and the spirit of Sections 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2.

Judge Koh held a bench trial in January 2019 and issued her opinion and judgment on May 21, 2019.

The End Result—Judge Koh's Injunction

As discussed below, Judge Koh found that Qualcomm's conduct violated Sections 1 and 2 of the Sherman Act and thereby violated Section 5 of the FTC Act. Based on those findings, she issued the following injunction:

- Qualcomm must not condition its supply of modem chips on a customer's patent license status. Qualcomm must also negotiate or renegotiate license terms with customers in good faith under conditions free from the threat of lack of access to or discriminatory provision of modem chips or associated technical support or access to software.
- Qualcomm must make exhaustive SEP licenses available to modem chip suppliers on fair, reasonable and non-discriminatory (FRAND) terms and submit, as necessary, to arbitration or judicial resolution to determine such terms.
- Qualcomm must not enter express or de facto exclusive dealing agreements for the supply of modem chips.
- Qualcomm must not interfere with any customer's ability to communicate with a government agency about a law enforcement or regulatory matter.

- Qualcomm must submit to compliance and monitoring procedures for seven years, and it must report to the FTC on an annual basis regarding its compliance with the remedies above.

As a practical matter, the injunction dismantles three key components of Qualcomm's business model:

1. It forces Qualcomm to license its SEPs to other manufacturers of baseband modem chips in a way that results in exhaustion of Qualcomm's patent rights downstream. Qualcomm had been unwilling to offer such licenses, and the FTC and others considered this practice a significant barrier to entry into the baseband modem chip market.
2. It prohibits Qualcomm from entering into exclusive dealing arrangements for supply of modem chips. This may end up unwinding some or all of the recent Apple–Qualcomm settlement agreement, even though that agreement was negotiated in the shadow of the *FTC v. Qualcomm*
3. It prevents Qualcomm from maintaining its "no license, no chips" policy, under which Qualcomm would refuse to supply modem chips to smart phone makers if they would not agree to Qualcomm's SEP license.

As a result, competing baseband modem chip manufacturers, such as MediaTek and others, should find that unfair barriers to competing with Qualcomm in the baseband modem chip market have been eliminated or reduced.

Why Judge Koh Found That Qualcomm Violated Section 5 of the FTC Act

Judge Koh found that Qualcomm violated the antitrust laws through its practices in two markets between approximately 2006 to 2016. D. Ct. Op. 215.

To begin with, Judge Koh found that Qualcomm had "market power" and "monopoly power" in the markets for CDMA modem chips and premium LTE modem chips. CDMA and LTE are technologies used in the air-interface portions of standardized cellular networks, which enable cellphones and tablets to send and receive information to and from network base stations. CDMA (code-division-multiple access) is one of standards used in "3G" communications. LTE relates to the "4G" standard. Premium LTE modem chips are modem chips that have the superior performance characteristics (e.g., faster uplink and downlink transmission speeds) required of high-performance smart phones.

Judge Koh found that Qualcomm had 60% to almost 100% share of these markets over long periods and could therefore impose and sustain prices above competitive levels despite the presence of large OEM purchasers. She summed up her conclusion on market and monopoly power as follows:

[B]ecause Qualcomm has owned a dominant share of the premium CDMA [and LTE] modem chip market, there are significant barriers to entry, and competitors have lacked the ability to discipline Qualcomm's prices, the Court concludes that Qualcomm has possessed monopoly power in the premium CDMA [and LTE] modem chip market.

Having determined Qualcomm had economic power in these two markets, Judge Koh proceeded to evaluate whether Qualcomm practices had harmed competition and whether Qualcomm had any procompetitive justifications for those practices. Judge Koh ultimately found that Qualcomm's practices had harmed competition and that Qualcomm had offered only pretextual justifications for those practices. In reaching these findings, Judge Koh found that Qualcomm engaged in anticompetitive practices that harmed both smartphone makers and competitors. These practices included Qualcomm's "no license, no chip" policy, its use of various types of leverage (e.g., the "sticks" of chip supply, engineering assistance, software support and the "carrots" of chip

rebates and other incentive funds) to force smartphone makers into impermissible express or de facto exclusive dealing arrangements, its refusal to license its SEPs to competing chip makers and its unreasonably high royalty rates.

Judge Koh found that Qualcomm's SEP licensing arrangements distorted competition, in part, by imposing a surcharge on rivals by forcing smartphone makers to pay for an additional license to Qualcomm's SEPs even when they bought chips from Qualcomm and to pay unreasonably high royalties. Judge Koh found that these practices allowed Qualcomm to increase its royalty earnings "humongously." She further found that these practices created unfair barriers to entry because they simultaneously saddled other chipmakers with the cost of licensing Qualcomm's SEPs while enabling Qualcomm to discount the price of its chips.

In reaching these findings, Judge Koh concluded that Qualcomm had a duty, both under its FRAND commitment and under U.S. antitrust law, to license its SEPs to potential competitors. As to the antitrust duty, although a company ordinarily has "no duty to aid competitors," Judge Koh found that Qualcomm's refusal to license its SEPs violated antitrust law under a line of U.S. Supreme Court and U.S. Court of Appeals for the Ninth Circuit cases. D. Ct. Op. 134-46 (citing *Verizon Commc'ns Inc. v. Law Offices of Curtis v. Trinko, LLP*, 540 U.S. 389 (2004); *Aspen Skiing, Co. v. Aspen Highland Skiing Corp.*, 472 U.S. 585 (1985); *MetroNet Servs. Corp. v. Qwest Corp.*, 383 F.3d 1124 (9th Cir. 2004)). Specifically, Judge Koh found that:

1. Qualcomm's refusal to license its modem-chip SEPs constituted a unilateral termination of a voluntary and profitable course of dealing;
2. Its refusal was motivated by anticompetitive malice and reflected a willingness to sacrifice short-term benefits for higher long-term profits through the exclusion of competition; and
3. "A market for modem chip SEPs" already exists under which other chip makers have already been provided with licenses. D. Ct. Op. 137-141.

Judge Koh also concluded that using the retail price of the smart phone as the royalty base for its SEP licenses was contrary to U.S. patent law and unreasonable because, as Qualcomm's internal documents recognized, modem chips provide only a small portion of the overall value of smartphones and tablets. If affirmed on appeal and followed by other courts, these two rulings may affect SEP licensing practices far beyond this case.

Judge Koh then issued an injunction against Qualcomm because she concluded that its unlawful practices were likely to continue, even in the next-generation "5G" space. The injunction sought to "unfetter a market from anticompetitive conduct, to terminate the illegal monopoly, deny to [Qualcomm] the fruits of its statutory violation, and ensure that there remain no practices likely to result in monopolization in the future." D. Ct. Op. 216 (quotation marks omitted). The FTC was not required to satisfy the traditional four-factor equitable test for granting injunctive relief because the FTC Act provides for injunctive relief "if 'there exists some cognizable danger of recurrent violation.'" D. Ct. Op. 216 (quoting *United States v. W.T. Grant Co.* (U.S. 1953)).

What's Next?

Qualcomm has vowed to appeal the ruling, a process that could take well over a year. Qualcomm has not identified what issues it will raise on appeal, but Judge Koh's credibility determinations—including her rulings that Qualcomm's contemporaneous documents were more credible than the testimony of its witnesses at trial—will receive deference on appeals, making it more difficult for Qualcomm to challenge her factual findings.

On May 29, Qualcomm filed a motion in front of Judge Koh to stay the injunction pending appeal. In support of that motion, Qualcomm argued that the stay was appropriate because the injunction requires Qualcomm to renegotiate its existing licenses and "the Order's implications extend far beyond Qualcomm: by condemning the

practice of licensing only complete cellular devices (which all major SEP-holders have employed for decades), the Order threatens to upend the entire wireless communications industry (including the licensing practices of other major SEP holders like Ericsson, Nokia, and InterDigital)" If Judge Koh denies relief, Qualcomm may seek a stay from a motions panel of the Ninth Circuit or, failing that, the Supreme Court. In the meantime, the injunction remains in place, and Qualcomm must comply with it or face further consequences.

Are FTC and DOJ on Opposite Sides of SEP Licensing Practices?

The FTC and the Antitrust Division of the U.S. Department of Justice (DOJ) are the two federal agencies primarily responsible for enforcing the U.S. antitrust laws. The injunction the FTC sought in this case and largely obtained appears to have more sharply defined the wedge between the two agencies regarding the appropriate role of antitrust law in SEP licensing cases. As this case confirms, the FTC has not shied away from using antitrust law to regulate what it considers anticompetitive conduct in this sphere.

By contrast, the Antitrust Division, though Assistant Attorney General Makan Delrahim, has reversed its previous policy in this area and has urged a much more lenient approach to licensing practices of patentees. In particular, Mr. Delrahim has publicly "criticized the argument that it ought to be a violation of antitrust law for a holder of a standard-essential patent, or SEP, to exclude competitors from using that technology" The FTC took a contrary position in pursuing this case, and Judge Koh has now endorsed the FTC's view.

Notably, Judge Koh also rejected the Antitrust Division's request, in an amicus brief, that she refrain from issuing broad injunctive relief against Qualcomm without further testimony about the ramifications for 5G markets. The FTC has its own litigating authority independent of DOJ, and we shall see whether the two enforcement agencies continue to disagree as the case heads to appeal.

Perkins Coie's Antitrust & Unfair Competition practice has significant experience in this area, and we will continue to monitor developments as they occur.

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