CLIENT ALERT

Ninth Circuit Reverses Lower Court in *FTC v. Qualcomm*, Distinguishing "Hypercompetitive Behavior" From Antitrust Violations

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On August 11, 2020, the Court of Appeals for the Ninth Circuit issued its decision in *FTC v. Qualcomm*, reversing Judge Lucy Koh's controversial May 2019 decision and holding that Qualcomm's practices of licensing its patents on cellular communication do not violate the Sherman Antitrust Act.[1]

The Ninth Circuit thus offers patent holders considerable latitude in the licensing of their intellectual property, as it held that the exercise of monopoly power does not constitute an antitrust violation unless it impairs competition to maintain that monopoly. Pursuant to the panel decision, such deference may be particularly pronounced for patentees engaging in "novel business practices" in the "dynamic and rapidly changing technology markets." The Ninth Circuit decision requires challengers of such behaviors to provide "clearer proof of anticompetitive effect" than that identified by the FTC.

Last year, in staying an injunction against Qualcomm, the Ninth Circuit characterized the district court's decision "as either 'a trailblazing application of the antitrust laws' or 'an improper excursion beyond the outer limits of the Sherman Act.'"[2] In reversing, the Ninth Circuit concluded it was the latter.

1 *Federal Trade Comm'n v. Qualcomm Inc.*, No. 19-16122, D.I. No. 225-1 (9th Cir. Aug. 11, 2020), here (hereinafter, "*Qualcomm*").

2 *Id.* at 9.

Whether the FTC will seek rehearing of the panel decision, rehearing *en banc*, or *certiorari* in the Supreme Court remains to be seen. Interestingly, however, the FTC announced on August 13th that Chairman Simons is no longer recused from the FTC's consideration of further action in the case.[3] The participation of Chairman Simons will no longer leave the Commission deadlocked at a two-two vote as to the conduct of the case.[4]

Qualcomm's Patent Licenses and Modem Chip Sales

The FTC's challenge focused on two different, but interrelated, aspects of Qualcomm's business: the first, its licensing of its patent portfolio covering cellular devices and other related products with cellular applications; the second, its sale of modem chips – hardware that enables those devices to communicate across cellular networks.[5]

Qualcomm's patent portfolio includes several standard essential patents ("SEPs"), which are necessary to practice technology defined by international standards-setting organizations ("SSOs"), and which must be licensed on fair, reasonable, and nondiscriminatory ("FRAND") terms. To avoid exhaustion of these patents based on upstream sales, Qualcomm licenses its portfolio exclusively to original equipment manufacturers ("OEMs") of cellular and related devices (*e.g.*, Apple and Samsung), rather than to other manufacturers of modem chips (*e.g.*, Intel and MediaTek) who compete against Qualcomm for sales. However, Qualcomm offers its competitors "de facto licenses" to practice its patent portfolio by pledging not to assert its patents in exchange for the manufacturers' promising not to sell to unlicensed OEMs and for certain information about the manufacturers' agreements with OEMs.[6] Additionally, Qualcomm refuses to sell its own modem chips to OEMs that did not agree to license Qualcomm's patent portfolio, which included patents that are necessary for the OEMs to use and sell the chips purchased from other manufacturers.[7]

In its earlier decision, the district court found that several aspects of this general practice violate the Sherman Act, including (1) Qualcomm's refusal to license its patent portfolio to rival chip manufacturers; (2) Qualcomm's charging allegedly "unreasonable" royalty rates to OEMs to license its patents that raised the cost of OEM's using rivals' chips; and (3) agreements with OEMs to exclusively supply chips. Addressing each of these findings, the Ninth Circuit held that

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3 Victoria Graham, *FTC's Simons No Longer Recused in Qualcomm Antitrust Case*, BLOOMBERG LAW (Aug. 13, 2010), here.

4 The FTC action against Qualcomm began in the closing days of the Obama administration; despite a subsequent change in FTC leadership, Chairman Simons's recusal left the commission with two Republicans and two Democrats, and precluded any settlement with Qualcomm. *See* Brett Kendall and Asa Fitch, *U.S. Appeals Court Throws Out Antitrust Ruling Against Qualcomm*, THE WALL STREET JOURNAL (Aug. 11, 2020).

5 *See Qualcomm*, slip op. at 18-19.

6 The Ninth Circuit provided little information about the information demanded by Qualcomm from its competitors regarding their relationships with OEMs and did not comment on the competitive sensitivity of that information. *See id*. at 14.

7 *Id.* at 14-15.

none of those actions rose to the level of an antitrust violation. Rather than "anticompetitive behavior, [which] is illegal under federal law," the Court held that Qualcomm had engaged in "[h]ypercompetitive behavior," which "is not."[8]

For Antitrust Liability, Anticompetitive Conduct Must Be Directed Against a Competitor

As a threshold matter, in addressing the alleged anticompetitive impact of Qualcomm's licensing practices, the Ninth Circuit cast the relevant market as "the market for [ ] modem chips," and noted that an antitrust violation must be premised on an improper restraint on competition *in this market*.[9] The panel held that the district court erred in looking "beyond these markets, to the much larger market of cellular services generally," including in predicating antitrust liability on harm to OEMs and the resulting increase in prices of cellular devices.[10]

Even if it were true that Qualcomm's behaviors harmed OEMs, the Ninth Circuit reasoned, such impact could not establish an antitrust violation because OEMs "are Qualcomm's *customers*, not its competitors."[11] Noting that the "opportunity to charge monopoly prices" is not itself unlawful, the panel held that a violation of Section 2 of the Sherman Act requires conduct aimed at excluding *competitors*, not merely the exertion of monopoly power against consumers.[12] As a result, the panel limited the scope of its analysis to "Qualcomm's practices in the area of effective competition" – the market for the manufacture of modem chips and the effect of its practices on its competitors in that market.[13]

The Ninth Circuit Limits the Application of *Aspen Skiing*

Focusing on this narrower inquiry, the panel considered whether Qualcomm's refusal to license its patent portfolio to competing chip manufacturers constituted an antitrust violation under *Aspen Skiing*. The district court had held such conduct to implicate the limited "duty to deal" set forth by the Supreme Court in *Aspen Skiing*, which finds a violation where: (1) a company "unilaterally terminates a voluntary and profitable course of dealing; (2) the only conceivable rationale or purpose is to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition; and (3) the refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers."[14] Notably, the Ninth Circuit quoted subsequent Supreme Court decisions describing *Aspen*

8 *Id.* at 55.

9 *Id.* at 29-30.

10 *Id.* at 30.

11 *See id.* at 15, 25, 30.

12 *Id.* at 25, 31.

13 *Id.*

14 *Id.* at 32 (internal citations and quotations omitted).

Skiing as "at or near the outer boundary" of antitrust liability and as a ruling that should be applied "only in rare circumstances."[15]

The panel found none of the three prongs satisfied by Qualcomm's conduct.[16] Specifically:

- Qualcomm did not terminate a voluntary and profitable course of dealing, because it had not previously offered exhaustive licenses to chip manufacturers.[17]
- Qualcomm did not switch to OEM-level licensing to sacrifice short-term benefits for long-term profits but rather in response to a change in patent exhaustion law. Its shift in strategy was more profitable in both the long *and* the short terms and has been adopted by other patent licensors.[18]
- Qualcomm did not single out chip manufacturers for anticompetitive treatment. Rather, it declined to enforce its patents against all its competitors (in exchange for those competitors promising not to sell their chips to OEMs), even though they practiced them royalty-free – "the *Aspen Skiing* equivalent of refusing to sell a skier a lift ticket but letting them ride the chairlift anyway."[19]

The FRAND Disputes at Issue in the Qualcomm Case Merit Contract or Patent Law Resolution

The Ninth Circuit also rejected the FTC's argument that, in the absence of an *Aspen Skiing* duty-to-deal, the court could still find an antitrust violation in Qualcomm's policy of refusing to license its chip technology to rivals given its FRAND obligations pursuant to the SSO adoption of its technology as a standard.

- The panel held that Qualcomm's licensing practices were "chip-supplier neutral" because Qualcomm collected royalties from all OEMs, not just those that bought their chips from rival manufacturers.
- The panel noted that Qualcomm's policy could not have harmed competition in the manufacture of chips, because two new chip suppliers entered the market during the OEM-only licensure period.[20]

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15 *Id.* at 32-33 (quoting *Verizon Commc'ns Inc. v. Law offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 409 (2004)).

16 Notably, the FTC had conceded error in the district court's application of the *Aspen Skiing* exception. *Id.* at 33.

17 *Id.* at 33-34.

18 *Id.* at 34.

19 *Id.* at 35.

20 *Id.* at 36-37.

- The panel agreed that licensing to both OEMs and rival chip suppliers would require inefficient "multi-level licensing" and reduce profit.[21]

The panel also held that antitrust law is not an appropriate medium for the resolution of most FRAND disputes arising under SSO contracts. Although the Ninth Circuit acknowledged a Third Circuit case noting cognizable antitrust remedies where a party intentionally deceives SSOs to list patents as SEPs, or discriminates in royalty rates for SEPs, the Ninth Circuit found neither of those factors present in the instant case. As a result, Qualcomm's failure to license SEPs did not constitute an antitrust violation.[22] Citing the "persuasive policy arguments of several academics and practitioners," including former Chief Judge of the Court of Appeals for the Federal Circuit Paul R. Michel, the Ninth Circuit agreed that it would "be a mistake to use 'the hammer of antitrust law to resolve FRAND disputes when more precise scalpels of contract and patent law are effective.'"[23]

This analysis appears to align with the view of Trump appointee Makan Delrahim, the head of the Department of Justice's Antitrust Division, who has advocated for the rights of patent holders, and asserted that "the misuse of the antitrust laws in [licensing] situations tilts the negotiating field away from the free-market competitive outcome and threatens to undermine innovation."[24] Indeed, in 2018 remarks, Delrahim proposed a contractual remedy – rather than an antitrust one – for alleged violations of FRAND licensing obligations.[25] Similarly, FTC Commissioner Christine Wilson – appointed by President Trump in September 2018 – had criticized the *Qualcomm* decision in a 2019 *Wall Street Journal* column, arguing that antitrust liability for licensors would require companies to help competitors, and in so doing, stifle innovation.[26]

No Antitrust Liability in "Unreasonable" Royalty Rates

The Ninth Circuit also reversed the district court's finding that Qualcomm's licensing policy violated the Sherman Act by extracting unreasonably high royalty rates from OEMs. The court found no support for the argument that "royalties are 'anticompetitive' – in the antitrust sense – unless they precisely reflect a patent's current, intrinsic value and are in line with the rates other companies charge for their own patent portfolios."[27]

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21 *Id.* at 37.

22 *Id.* at 38-39.

23 *Id.* at 39 (citing Amicus Curiae Br. of The Honorable Paul R. Michel (Ret.) at 23).

24 *See* Makan Delrahim, Assistant Att'y Gen., U.S. Dept. of Justice, *Good Times, Bad Times, Trust Will Take Us Far: Competition Enforcement and the Relationship Between Washington and Brussels* (Feb. 21, 2018), *available* here and Makan Delrahim, Assistant Att'y Gen., U.S. Dept. of Justice, *"Don't Stop Thinking About Tomorrow": Promoting Innovation by Ensuring MarketBased Application of Antitrust to Intellectual Property* (June 6, 2019), *available* here.

25 *See id.*

26 Christine Wilson, *A Court's Dangerous Antitrust Overreach*, THE WALL STREET JOURNAL (May 28, 2019).

27 *Qualcomm* slip op. at 43-44.

The panel also rejected the FTC's argument that Qualcomm's high royalty rates negatively affect its rival chip manufacturers because they allow Qualcomm to extract a lower price for its chip sales, forcing competitors to accept lower profit margins to make sales. The court noted that the Supreme Court had previously rejected such a "margin squeeze" theory of antitrust liability.[28]

A Heightened Bar for "Exclusive Dealing" Liability

Lastly, the Ninth Circuit reversed the district court's determination that Qualcomm violated the Sherman Act by signing exclusive deals with Apple for the sale of modem chips from 2011 to 2015. While the panel recognized that exclusive dealing *can* form the basis of an antitrust violation, it held that such liability requires the exclusive dealing arrangement to foreclose competition in a substantial portion of the market.[29] The Ninth Circuit found no such foreclosure in Qualcomm's agreement with Apple in light of record evidence that Apple switched its chip supplier to Intel the following year, and that, at most, the agreements delayed Apple's transition to Intel by one year.[30] Moreover, even if liability were to attach, the panel held that such a "past wrong" would be an insufficient basis for the grant of an injunction.[31]

Conclusion

The Ninth Circuit's decision requires a rigorous application of antitrust criteria for liability resulting from patent licensing practices. That position grants patent holders considerably more latitude in licensing their technology and attributes to antitrust law a more limited role in policing those activities. Such latitude may be even more pronounced in analyzing novel business practices, especially in emerging fields such as the technology industry.

Indeed, the panel cautioned that such activities "should not be 'conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have caused or the business excuse for their use.'"[32] While such practices may "at first appear[ ] to be anticompetitive," they may in fact be "disruptive in a manner that [is] beneficial to consumers in the long run."[33]

Pursuant to the *Qualcomm* decision, where a patent holder has market power or monopoly power, a violation of the Sherman Act must involve conduct by the patent holder that directly excludes competitors in order to willfully maintain the monopoly in question. High royalty rates for customers, which may be the fruit of monopoly power, are insufficient on

[28] *Id.* at 46-47 (citing *Pac. Bell Tel. Co. v. linkLine Commc'ns, Inc.*, 555 U.S. 438, 451-452, 457 (2009)).

[29] *Id.* at 52-54.

[30] *Id.* at 54.

[31] *Id.* at 55.

[32] *Id.* at 26-27 (quoting *U.S. v. Microsoft Corp.*, 253 F.3d 34, 91 (D.C. Cir. 2001)).

[33] *Id.* at 51 (citing *Ohio v. Am. Express Co.*, 138 S. Ct. 2274, 2290 (2018)).

their own to constitute an antitrust violation. Exclusive dealing agreements must in fact foreclose substantial, viable competition to violate the Sherman Act.

Although this may remain a matter of continuing debate, the Ninth Circuit held that a patent holder's refusal to license an SEP to a rival may give rise only to a contract claim, not an antitrust claim, in the absence of deception of the SSO or discrimination in royalty rates that impairs competition on the merits by rivals.

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