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What 9th Circ. Qualcomm Licensing Ruling Means For SEPs

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On Tuesday, in Federal Trade Commission v. Qualcomm Inc., the U.S. Court of Appeals for the Ninth Circuit unanimously vacated a May 2019 decision of the U.S. District Court for the Northern District of California, reversing the district court's finding that Qualcomm violated antitrust law through its licensing practices for standard-essential patents covering cellular technology and reversing a permanent, worldwide injunction against several of Qualcomm's core business practices.

These practices included Qualcomm's policy of licensing only to original equipment manufacturers, or OEMs, and not to direct competitors and its "no license, no chips" licensing policy of only selling chips to customers if they also take a patent license.

In reversing the district court decision, the panel found no antitrust violations and concluded that to the extent Qualcomm's conduct was problematic in the sense that it may have breached any of its fair, reasonable and nondiscriminatory commitments, the remedy for such a breach was in contract or tort law.

Indeed, the panel went so far as applauding Qualcomm's efforts of making "significant contributions to the technological innovations underlying modern cellular systems," while distinguishing Qualcomm's licensing behavior as "hypercompetitive," which is not illegal, as opposed to being anti-competitive, which is.

Accordingly, we will likely see even more aggressive development of patent portfolios within emerging technologies, such as 5G wireless technology, with an even greater focus on SEP patenting. Additionally, we will also see continued use and reliance on licensing programs similar to those employed by Qualcomm.

Lastly, both SEP holders and those defending against SEP enforcement should prepare themselves for a potential increase in contract law-based disputes and patent law remedies that have traditionally been applied to resolve SEP/FRAND disputes.

Background

In May 2019, U.S. District Judge Lucy Koh of the Northern District of California issued a 233-page order finding that Qualcomm's licensing practices in the markets for CDMA and premium LTE modem chips violated Sections 1 and 2 of the Sherman Act and Section 5 of the Federal Trade Commission Act.

The district court applied a two-step analysis finding that (1) Qualcomm possessed monopoly power in the two chip markets from evidence that Qualcomm owned a dominant share of each market, that there were significant barriers to entry, and that competitors lacked the ability to discipline Qualcomm's prices; and (2) Qualcomm's licensing practices were anti-competitive and harmed consumers.

Qualcomm appealed the decision to the Ninth Circuit, which issued a partial stay of Judge Koh's ruling in August 2019. Subsequently, dozens of amicus briefs were filed attacking the district court's decision.

Notably, the U.S. Department of Justice supported Qualcomm, filing a statement of interest that departed from the FTC's views. The DOJ's divergence from the FTC's positions is nothing new, as the growing rift between the two government agencies has been heavily publicized over the past several months.[1]

The Ninth Circuit's Unanimous Decision

U.S. Circuit Judge Consuelo Callahan, writing for the unanimous Ninth Circuit panel, found that Qualcomm did not violate antitrust law through its licensing practices for SEPs covering cellular technology, reversing a permanent, worldwide injunction against several of Qualcomm's core business practices.

The panel addressed three main issues in determining whether Qualcomm's licensing practices were an anti-competitive violation of the Sherman Act.

First, the Ninth Circuit examined the district court's finding that Qualcomm had an antitrust duty to license its SEPs to its direct competitors in the modern chip markets pursuant to the exception outlined in Aspen Skiing Co. v. Aspen Highlands Skiing Corp.,[2] In Aspen Skiing, the U.S. Supreme Court held that a company engages in prohibited, anti-competitive conduct when:

- It unilaterally terminates a voluntary and profitable course of dealing;
- 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
- The refusal to deal involves products that the defendant already sells in the existing market to other similarly situated customers.

The Supreme Court later characterized the Aspen Skiing exception as "at or near the outer boundary of § 2 liability."[3]

The panel found that "none of the required elements for the Aspen Skiing exception were present, and the district court erred in holding that Qualcomm was under an antitrust duty to license rival chip manufacturers." The panel reasoned that Qualcomm never licensed other chip makers while it had a

monopoly position in the market for chips, only before.

Qualcomm's decision to start licensing only to OEMs was not to obtain higher profits in the long run by excluding competition, which is the second element of the Aspen Skiing exception, but was due to the change in patent-exhaustion law; and there was no evidence that Qualcomm singles out any specific chip supplier for anti-competitive treatment in its SEP licensing practices.

The panel concluded that Qualcomm's OEM-level licensing policy, however novel, was not an anti-competitive violation of the Sherman Act.

Second, the panel held that the FTC did not satisfactorily explain how Qualcomm's alleged breach of its FRAND contractual commitment itself impaired the opportunities of rivals.

Because the FTC did not meet its initial burden under the rule of reason framework, the panel was less critical of Qualcomm's pro-competitive justifications for its OEM-level licensing policy — which, in any case, appeared to be reasonable and consistent with current industry practice.

The panel concluded that to the extent Qualcomm breached any of its FRAND commitments, the remedy for such a breach was in contract or tort law.

In reaching this determination, the panel gave significant weight to

the persuasive policy arguments of several academics and practitioners with significant experience in [standard-setting organizations, or SSOs], FRAND, and antitrust enforcement, who have expressed caution about using the antitrust laws to remedy what are essentially contractual disputes between private parties engaged in the pursuit of technological innovation.

These included particularly Chief U.S. Circuit Judge Paul Michel and former FTC Commissioner Joshua Wright.

For example, Judge Michel noted that:

[w]hile antitrust policy has its place as a policy lever to enhance market competition, the rules of contract and patent law are better equipped to handle commercial disputes between the world's most sophisticated companies about FRAND agreements.

Judge Michel further pointed out that both the Ninth Circuit and the U.S. Court of Appeals for the Federal Circuit have successfully already resolved disputes over FRAND agreements and obligations, confirming that "the hammer of antitrust law is not needed to resolve FRAND disputes when more precise scalpels of contract and patent law are effective."[4]

Third, the panel addressed the district court's primary theory of anti-competitive harm: Qualcomm's imposition of an anti-competitive surcharge on rival chip suppliers via its licensing royalty rates. The panel found that the only identified harm was to Qualcomm's customers — generally cellphone, but also smart car, manufacturers — who were outside of the relevant market of CDMA and premium LTE modem chips.

The panel also analyzed the district court's theory that Qualcomm's royalty acts as a surcharge for manufacturers that purchase chips from its rivals. The panel found this determination to be contrary to

Federal Circuit precedent, as the district court improperly found that the smallest patent-practicing unit concept is required when calculating patent damages, while refusing to consider that the patent royalties may be based on total handset price.

Accordingly, the panel concluded that Qualcomm's patent-licensing royalties and "no license, no chips" policy did not impose an anti-competitive surcharge on rivals' modem chip sales.

Instead, these aspects of Qualcomm's business model were chip-supplier neutral and did not undermine competition in the relevant market. Specifically, under Qualcomm's licensing practices, OEMs are required to pay a per-unit royalty to Qualcomm, regardless from which chip supplier they choose to source their chips.

Implications

When the Ninth Circuit issued a partial stay of Judge Koh's ruling in favor of Qualcomm, the court "characterized the district court's order and injunction as either 'a trailblazing application of the antitrust laws' or 'an improper excursion beyond the outer limits of the Sherman Act.'" In this week's decision, the panel unanimously found the latter, that the application of antitrust law to FRAND disputes is beyond the limits of the Sherman Act.

The Ninth Circuit's ruling encourages SEP holders and SEP implementers to resolve FRAND disputes without turning to the "hammer of antitrust law." As a result of the court's finding Qualcomm's OEM-level licensing policy novel and not an antitrust violation, SEP holders developing a licensing strategy should ensure that it is supplier-neutral, such that no one supplier is benefited or harmed more than another.

SEP holders should also ensure that their licensing strategies do not undermine competition in the relevant market, although harm in the form of increased costs to customers may be acceptable.

In addition, SEP holders should avoid implementing a policy requiring customers first to agree to purchase their product before the customer is offered an SEP license. Such a policy will likely raise antitrust concerns. This can be avoided by requiring the customer to obtain a license before purchasing the SEP holder's product.

SEP implementers, on the other hand, should become intimately familiar with the policies of the SSOs relevant to their business and the contract laws of the jurisdictions that govern these SSO contracts. SEP implementers should also take active measures to ensure SSO policy compliance by themselves and the SEP holders and document these efforts.

If an SEP licensing dispute does arise, it is also important to identify the harm in the relevant market, which will usually exist at the supplier level of the manufacturing chain. Harm can be shown in the form of lost business, such as the OEM's switching suppliers, or required reimbursements from a supplier to an OEM. Additionally, if an SEP implementer desires to pursue an antitrust claim in the future, it will be crucial to identify an effective restraint on trade or exclusionary conduct.

The Ninth Circuit's decision did not clear up all issues on appeal, as the court notably declined to decide whether Qualcomm's royalty rates were reasonable and whether Qualcomm's licensing practices violated any contract or patent law principles. Accordingly, the question of how to value SEPs and the mechanisms to resolve SEP disputes continue to rapidly evolve, and both SEP holders and implementers

should continue to monitor SEP case law and trends in light of this decision.

Lastly and fundamentally, the decision essentially endorses Qualcomm's patent development and licensing policies. As such, innovators should and will likely even more aggressively seek to patent inventions related to emerging technologies, particularly those governed by industry standards. For example, we have already seen tremendous growth in 5G wireless-related SEP patents globally. That growth will likely continue and be further spurred by this decision.

Furthermore, as the court acknowledged "other SEP licensors like Nokia and Ericsson have concluded that licensing only OEMs is more lucrative, and structured their practices accordingly." These types of licensing approaches will certainly further expand in light of the court's decision, highlighting the need for all parties to stay in front of emerging SEP and FRAND global legal developments.

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[1] See, e.g., "FTC Goes Toe-To-Toe-To-Toe With Qualcomm, DOJ," Law360, Feb. 11, 2020, available at https://www.law360.com/articles/1243004/ftc-goes-toe-to-toe-to-toe-with-qualcomm-doj; "Free Competition or National Security? Chip Giant Qualcomm's Business Practices Pit the FTC Against the DOJ," The National Law Review, July 25, 2019, available at https://www.natlawreview.com/article/free-competition-or-national-security-chip-giant-qualcomm-s-business-practices-pit.

[2] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

[3] Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004).

[4] See Microsoft Corp. v. Motorola, Inc., 795 F.3d 1024 (9th Cir. 2015); Microsoft Corp. v. Motorola, Inc., 696 F.3d 872 (9th Cir. 2012); Ericsson, Inc. v. D-Link Sys., Inc., 773 F.3d 1201,1225–36 (Fed. Cir. 2014).