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No Chips? No Worries. Ninth Circuit Rejects FTC's Petition for *En Banc* Review of Decision Holding that Qualcomm Has No Antitrust Duty to Deal with Rivals

November 11, 2020

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On October 28, 2020, the full US Court of Appeals for the Ninth Circuit denied the US Federal Trade Commission's (FTC) petition for *en banc* review of the Court's earlier decision in *FTC v. Qualcomm*.[1] The prior decision, issued by a panel of the Court on August 11, 2020, was a significant setback for the FTC.[2] It reversed the US District Court for the Northern District of California's trial decision,[3] which held that Qualcomm's sales and licensing practices violated Sections 1 and 2 of the Sherman Act. At issue was a Qualcomm licensing practice in which it refused to license its cellular modem chip technology to rival chip manufacturers (such as Intel) and instead licensed exclusively to cell phone handset manufacturers (such as Samsung and Apple), who were customers for its chips. Pursuant to the policy, Qualcomm refused to sell chips to cell phone manufacturers unless they first obtained a license. Qualcomm permitted rival chip manufacturers to create and sell chips employing Qualcomm's Standard Essential Patents ("SEPs") without a license in exchange for a commitment that the rivals would license only to OEMs that had entered into a license agreement with Qualcomm. The policy was dubbed "no license, no chips." Qualcomm's "no license, no chips" policy was devised to avoid "patent exhaustion" and earn a higher premium on its licenses by licensing downstream to chip customers rather than directly to chip manufacturers.

Because Qualcomm's cellular modem chips are covered by SEPs that are subject to Fair Reasonable and Non-Discriminatory (FRAND) licensing obligations to members of a Standards Setting Organization (SSO), the Ninth Circuit panel's decision has important implications for SEP owners' obligations to potential licensees.

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[1] *Federal Trade Commission v. Qualcomm Inc.*, No. 19-16122, ECF 270 (9th Cir. Oct. 28, 2020).

[2] *Federal Trade Commission v. Qualcomm Inc.*, 969 F.3d 974 (9th Cir. 2020).

[3] *Federal Trade Commission v. Qualcomm Inc.*, 411 F. Supp. 3d. 658 (N.D. Cal. 2019).

KEY TAKEAWAYS:

- **Qualcomm had no antitrust duty to deal with rival chipmakers** because it had a valid business reason for its policy (other than to harm competitors) and thus did not fall within the narrow exception created by the Supreme Court in *Aspen Skiing*.[4] The decision reaffirms the bedrock principle that, except in exceedingly narrow circumstances, firms do not have an antitrust duty to deal with rivals. The Ninth Circuit explained that the principle applied even when the firm is subject to a FRAND commitment to offer FRAND licenses to any willing licensee.

- **FRAND disputes do not create an antitrust claim**: antitrust claims are not the proper vehicle to resolve disputes among the SEP holder and licensees or SSOs arising from a prior FRAND commitment and that either patent or contract law provide a more appropriate remedy in the absence of fraud.

- **Harm to competitors (not ultimate customers) is what matters in assessing antitrust injury**: Injury to customers does not. The Ninth Circuit limited the analysis of potential anticompetitive harm to Qualcomm's competitors in the defined relevant market—CDMA modem chips and premium LTE modem chips—and, unlike the District Court, excluded from its analysis any purported injury to chipset customers (i.e., cellular handset manufacturers) or handset consumers generally.

- **SEP holders are free to set royalty rates based on downstream products that incorporate the technology**: The Ninth Circuit held that Qualcomm's allegedly excessive SEP royalty rates negotiated with handset manufacturers were appropriately tied to handset price and did not violate the antitrust laws.

- **SEP holders may license their patents directly to customers, rather than their rivals, to avoid "patent exhaustion,"** and may refuse to sell their products to customers who fail to take a license.

Background

Qualcomm develops cellular communications technologies and was found to be a dominant cellular modem chip manufacturer during the time period at issue in the litigation. Qualcomm's technologies were included by SSOs in the 3G CDMA and 4G LTE cellular communications standards. As part of the selection process, Qualcomm made contractual commitments to the SSOs to license its SEPs on FRAND terms.

Qualcomm's business strategy was not to license its modem chip SEPs to rival chip manufacturers. Instead, Qualcomm licensed its patents at the downstream original equipment manufacturer (OEM) level to cell phone handset manufacturers like Apple and Samsung. Qualcomm permitted rival chip manufacturers to create and sell chips employing Qualcomm's SEPs without a license in exchange for a commitment that the rivals would license only to OEMs that had entered into a license agreement with Qualcomm. Similarly, Qualcomm refused to sell its chips to any OEMs unless the OEM first purchased a license. This has been described as the "no license, no chips" policy. Qualcomm stated that it employed the "no license, no chips" policy to maximize its profits and avoid patent exhaustion.[5]

Since 2016, the FTC and Department of Justice (DOJ) have disagreed on whether antitrust or patent and contract law is the appropriate cause of action when a SEP holder, like Qualcomm, fails to license its

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[4] *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 105 S. Ct. 2847 (1985) (holding that owner of three ski facilities had no valid business reason for discontinuing its participation in a joint "All-Aspen" lift ticket with the area's fourth ski facility and violated Sherman Act § 2).

[5] The doctrine of patent exhaustion prohibits patent holders from collecting additional license payments downstream from the licensee. "[A]uthorized sale of an article that substantially embodies a patent exhausts the patent holder's rights and prevents the patent holder from invoking patent law to control post-sale use of the article." *Quanta Computer, Inc. v. LG Electronics, Inc.*, 553 U.S. 617, 638 (2008).

patented technology to a rival despite the SEP holder's FRAND commitments. On January 17, 2017, the FTC filed an antitrust complaint in the Northern District of California asserting that Qualcomm violated Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), and Sherman Act §§ 1 and 2.[6] On May 21, 2019, following a 10-day bench trial, the Northern District of California held that Qualcomm's refusal to license its technologies to rival chipmakers, its "no license, no chips" policy, and its "unreasonable" royalty rates, among other practices, violated the federal antitrust laws. Qualcomm appealed.

The Ninth Circuit Panel's Decision

On August 11, 2020, a unanimous Ninth Circuit panel reversed the District Court's decision.

Antitrust Liability Requires Competitor Injury in the Relevant Market

The Ninth Circuit rejected the District Court's findings of competitive harm because they included injuries allegedly experienced in the "much larger market of cellular services generally."[7] The Ninth Circuit explained that the District Court conflated the alleged injuries resulting from Qualcomm's licensing practices (which affected its handset customers) and its practices related to modem chip sales (which was the relevant market for the analysis of harm to competition). Even if the two practices were interrelated, as the District Court claimed, "actual or alleged harms to customers and consumers outside the relevant markets are beyond the scope of antitrust law."[8] The Ninth Circuit, thus, limited its analysis of the purported competitive effects of Qualcomm's licensing and sales practices to the effective area of competition at issue—the relevant chip markets. As explained in further detail below, the Ninth Circuit found that competitors were not harmed because Qualcomm had no antitrust duty to deal with its competitors, the relative cost of competitors' chips was not increased by Qualcomm's licensing policy, and Qualcomm did not exclude competition through exclusive dealing contracts.

Qualcomm Had No Antitrust Duty to Deal

The Ninth Circuit rejected the District Court's finding that Qualcomm had an antitrust duty to deal under *Aspen Skiing*. Typically, "there is no duty to deal under the terms and conditions preferred by [a competitor's] rivals," and the Sherman Act "does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business" to choose the parties with whom they will deal.[9] In *Aspen Skiing*, the Supreme Court created an exception to this general rule when "(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."[10] The Ninth Circuit found that none of the *Aspen Skiing* factors had been satisfied. First, Qualcomm never granted exhaustive licenses to rival chip makers, and it ceased granting licenses entirely in response to developments in patent law's exhaustion doctrine which made it harder for Qualcomm to provide non-exhaustive licenses.[11] Second, rather than sacrificing short-term

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[6] *Federal* Trade Commission's Complaint for Equitable Relief at 31, *Federal Trade Commission v. Qualcomm Inc.*, 411 F. Supp. 3d. 658 (N.D. Cal. 2019); *Federal Trade Commission v. Qualcomm Inc.*, 411 F. Supp. 3d. at 669.

[7] *FTC v. Qualcomm*, 969 F.3d at 992.

[8] *FTC v. Qualcomm*, 969 F.3d at 993.

[9] *FTC v. Qualcomm*, 969 F.3d at 993 (citations omitted).

[10] *FTC v. Qualcomm*, 969 F.3d at 993-94 (citations and quotations omitted).

[11] Qualcomm historically entered into "non-exhaustive, royalty-bearing agreements" with rivals which expressly did not grant rights to the rivals' customers. Subsequent Supreme Court precedent found that "initial authorized sale of a

benefits for long-term profits, Qualcomm's decision to cease licensing its SEPs to rivals was more lucrative in both the short and long term, as even the District Court's opinion acknowledged. Finally, Qualcomm refused to license its chip technology to *all* rival chipmakers, rather than singling out any individual rival. For this reason, Qualcomm's refusal to license was distinguishable from the ski resort in *Aspen Skiing*, which refused to sell tickets only to one rival resort situated adjacent to it, but not any other ski resort.[12] Instead, the policy permitted rival chip makers to practice Qualcomm's patents without a license in return for a commitment to only sell chips to licensed OEMs to prevent patent exhaustion. The Ninth Circuit held that "Qualcomm's OEM-level licensing policy, however novel, is not an anticompetitive violation of the Sherman Act" and it did not constitute an unlawful refusal to deal.[13]

The Circuit Court also rejected the FTC's argument that Qualcomm's licensing practices violated its FRAND commitments and, in turn, Sherman Act § 2. The Court explained that Qualcomm's allegedly unreasonable licensing rates were a distinct business practice from its chip sales that, at worst, harmed OEM handset manufacturers, not chip manufacturers, and were chip-supplier neutral because royalties were collected from all OEMs, not just rivals' customers. In support of its finding that Qualcomm's rates did not cause competitive harm in the chip markets, the Court seized on Qualcomm's policy of permitting chip manufacturers to sell chips that practiced Qualcomm's patents to licensed OEMs and the fact that Intel and MediaTek entered the chip markets despite Qualcomm's licensing practices.[14]

Qualcomm's Royalty Rates Were Not Anticompetitive

The Ninth Circuit determined that, even if Qualcomm's royalty rates were "unreasonable," the District Court's surcharging theory "still fails as a matter of law and logic."[15] The District Court held that an unreasonably high royalty rate is charged regardless of whether an OEM uses Qualcomm's or a rival's chips because Qualcomm's licensing practices caused the total price of any modem chip sold by one of Qualcomm's rivals to include both the chip's actual price as well as Qualcomm's royalty "surcharge." According to the District Court, this resulted in an increase in the effective price of rivals' modem chips, a reduction in rivals' margins, and the fostering of exclusivity because Qualcomm was able to prevent rivals from underbidding it on chip prices. Rejecting the District Court's view, the Ninth Circuit first found that patent law precedent permitted the tying of patent royalties to the total handset price without exposing a firm to potential antitrust liability. Then, it dismissed the District Court's conclusion that royalties are

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patented item terminates all patent rights to an item," *Quanta Computer*, 553 US at 625, thereby making it difficult to maintain a non-exhaustive agreement. In response, Qualcomm stopped offering licenses to its rivals altogether.

[12] *Aspen Skiing*, 105 S. Ct. at 2852-53.

[13] *FTC v. Qualcomm*, 969 F.3d at 995.

[14] The Ninth Circuit rejected the District Court's reliance on *Broadcom Corp. v. Qualcomm, Inc.*, 501 F.3d 297 (3d Cir. 2007), explaining that, in *Broadcom*, the licensor intentionally deceived the SSO to induce the adoption of its patents into the standard, conduct that was not alleged here. The Circuit Court also favorably noted policy arguments submitted by amici curiae—such as retired Federal Circuit Chief Judge Paul R. Michel and former FTC commissioner Joshua Wright—which asserted that contract and patent law are better tools than antitrust law to handle FRAND disputes. *FTC v. Qualcomm*, 969 F.3d at 997.

[15] *FTC v. Qualcomm*, 969 F.3d at 998.

anticompetitive unless they precisely reflect the patent's current value,[16] a proposition found in *patent* not antitrust law.[17]

Qualcomm's "No License, No Chips" Policy Was Not Unlawful

The Ninth Circuit explained that the District Court's focus on the alleged anticompetitive harms stemming from Qualcomm's "no license, no chips" policy almost exclusively related to alleged injuries experienced by handset manufacturers while failing to identify how the policy directly impacted Qualcomm's competitors. Furthermore, Apple's decision to switch to Intel as its main chip supplier proved that OEMs could discipline Qualcomm's prices through negotiations, arbitration, or threating to change suppliers. The Court further found that the FTC's theory of harm—that OEMs paid a surcharge on phones that use rivals' chips—was self-defeating because the practice did not distort rivals' prices relative to Qualcomm's prices but, instead, raised the total price OEMs (i.e., the *customers* in the market for modem chips) must pay for chips regardless of their chip supplier. Finally, the Ninth Circuit explained that any harm resulting from Qualcomm's "unreasonable" royalty rates were experienced by Qualcomm's customers (i.e., handset manufacturers), not its competitors, and, therefore, they could not sustain an antitrust claim under basic principles of antitrust law.[18]

Qualcomm's Agreements with Apple Were Not Exclusive Dealing Contracts

Finally, the Ninth Circuit rejected the lower court's finding that Qualcomm's royalty agreements with Apple[19] for chip sales effectively constituted unlawful exclusive dealing contracts that foreclosed a "substantial share" of the market for CDMA modem chips. The Court explained that exclusive dealing contracts only run afoul of the Sherman Act where their "effect is to 'foreclose competition in a substantial share of the line of commerce affected.'"[20] The Ninth Circuit found that there is "some merit in the district court's conclusion that the Apple agreements were structured more like exclusive dealing contracts than volume discount contracts,"[21] but disagreed that the agreements had the actual or practical effect of substantially foreclosing the market.

The Ninth Circuit explained that Qualcomm's only major competitor during the relevant time period was Intel, and the District Court made no finding that it or any other competitor was harmed by Qualcomm's

[16] For example, the District Court found it unreasonable that Qualcomm's royalty rates remained constant as its SEP portfolio declined and that Qualcomm's prices were much higher than other SEP contributors like Nokia or Ericsson who had made comparable contributions to the standard. *See*, *e.g.*, *FTC v. Qualcomm*, 411 F. Supp. 3d at 779, 783-86.

[17] Regarding the District Court's finding that the royalty rate charged to handset manufacturers was an "artificial surcharge," the Circuit Court first found that, unlike in *Caldera, Inc. v. Microsoft Corp.*, 87 F. Supp. 2d 1244 (D. Utah 1999) (finding an anticompetitive surcharge when Plaintiff was forced to pay Microsoft for each computer sold, even if the computer ran on a competitor's operating system), the case upon which the District Court relied, Qualcomm's patents added value to each device that used a cellular modem chip, whether or not the chip was made by Qualcomm. Indeed, OEMs payed the same licensing fee whether they used chips from Qualcomm or one of its rivals.

[18] The Ninth Circuit also rejected the FTC's argument that rates must be tied to the single smallest saleable unit, the value of the patent portfolio, or the rates charged by similarly situated licensors. *FTC v. Qualcomm*, 969 F.3d 974, 998-1000 (9th Cir. Aug. 11, 2020).

[19] Qualcomm and Apple entered into "transaction agreements" in which Apple received substantial discounts if they purchased at least 80 million chips from Qualcomm each year. The agreement contained claw-back provisions tied to hundreds of millions of dollars in earned incentives, which would be triggered if Apple purchased modem chips from any Qualcomm rival. *FTC v. Qualcomm*, 411 F. Supp. 3d at 762-64.

[20] *FTC v. Qualcomm*, 969 F.3d at 1003 (quoting *Omega Envtl., Inc. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162 (9th Cir. 1997)).

[21] *FTC v. Qualcomm*, 969 F.3d at 1004.

agreements with Apple. Indeed, the record indicated that Apple chose to purchase chips from Intel in 2014, rather than Qualcomm, and that Intel had not been "a viable competitor to Qualcomm prior to 2014–2015, or that the 2013 agreement delayed Apple's transition to Intel by any more than one year."[22] These facts significantly undermined the District Court's finding that Qualcomm's royalty agreements with Apple restricted competition, given that Apple ultimately chose to contract with Intel.

Key Conclusions

- The panel's decision provides needed clarity regarding the proper framework under which FRAND disputes are to be litigated. In ruling against the FTC, the Ninth Circuit endorsed the DOJ's position that FRAND disputes are properly litigated under contract and patent law rather than antitrust law. Given the FTC's history of initiating investigations based on the premise that FRAND violations are subject to antitrust scrutiny, it remains an open question whether the FTC will continue to pursue the same or similar theories of competitive harm in an effort to develop a circuit split as it has done, with some success, in other unsettled areas of antitrust law. Of further interest will be whether the DOJ's position changes once the US administration changes after President-elect Biden takes office.

- SEP holders may experiment with novel business practices, "*especially* in technology markets," because courts must conduct an "elaborate inquiry" to determine the "precise harm [the practices] have caused or the business excuse for their use." [23] Indeed, the Ninth Circuit allowed Qualcomm to engage in *hyper*competitive conduct without being sued for *anti*competitive behavior.

- Although Qualcomm may have pioneered the practice by which SEP holders license their portfolio to OEMs rather than producers of component parts, it has been embraced by other SEP owners within the telecom industry, including Nokia and Ericsson, and the patent pooling firm Avanci. The Court's decision provides a framework for SEP holders to negotiate licenses with OEMs, who represent a smaller and more easily identifiable pool of licensees than the universe of individual parts manufacturers.[24]

- The fact that *Qualcomm* is a Ninth Circuit decision is particularly significant. The decision favors SEP holders and is in the jurisdiction in which many technology firms, key contributors to and members of SSOs, are located. Therefore, unless the decision is reversed by the Supreme Court, *Qualcomm* can be expected to have a lasting impact on SEP jurisprudence.

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[22] *FTC v. Qualcomm*, 969 F.3d at 1004.

[23] *FTC v. Qualcomm*, 969 F.3d at 990-91 (quoting *United States v. Microsoft*, 253 F.3d 34, 91 (D.C. Cir. 2001)).

[24] *See Response to the Avanci LLC's Request for a Business Review Letter*, US DEP'T OF JUST. (July 28, 2020) *available at* https://www.justice.gov/atr/page/file/1298626/download. (DOJ noted that it would have been more difficult to find and negotiate licenses with all of the component suppliers for connected vehicles than it would be to negotiate licenses with the easily identified and limited pool of OEM car manufacturers).

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