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Proposed Statement of the Fair Standards Alliance on the Decision of the United States Court of Appeals for the Ninth Circuit in FTC v. Qualcomm

Introduction

The Fair Standards Alliance (FSA) is disappointed with the August 11, 2020 decision of the United States Court of Appeals for the Ninth Circuit in *FTC v. Qualcomm Inc.* The panel's decision reversed the trial court's judgment that Qualcomm's conduct—including the refusal to license its cellular standard essential patents (SEPs) to its competitors and its "no license, no chips" policy—violated U.S. antitrust laws.[1] The Federal Trade Commission (FTC) has not yet announced whether it would seek *en banc* review or certiorari of the Ninth Circuit's decision, although the decision may meet the criteria for doing so.

The FSA believes this decision threatens to harm competition and innovation, not only in the modem chip markets, but more broadly, in the development of IoT and 5G products and services. The loss in competition also creates security and supply chain vulnerabilities. It creates distrust in technologies that can otherwise bring tremendous benefits to populations around the globe. Indeed, the decision encourages business practices that are antithetical to competition and discourages innovation needed for 5G and other connected technologies that are important for competitiveness, and where national governments have expressed supply chain trustworthiness-related concerns.

Although the practical impact of the decision is likely to be significant, the decision stands on an unstable legal foundation and is limited in scope. The decision only binds courts in one of the 13 U.S. circuit courts and is not required to be followed by the U.S. courts outside that circuit which have already reached, or may reach, a different conclusion. Other tribunals – in the U.S. and internationally -- that have looked at the same or similar issues have concluded that the conduct addressed in the

[1] *FTC v. Qualcomm Inc.*, No. 19-16122, 2020 U.S. App. LEXIS 25347, at *62-63 (9th Cir. Aug. 11, 2020), slip opinion available at: https://cdn.ca9.uscourts.gov/datastore/opinions/2020/08/11/19-16122.pdf.

decision violates the antitrust laws of their respective jurisdictions. As discussed further below, the decision conflicts with well-established U.S. law and ignores the trial court's detailed factual findings.

The decision also does not address the substance of contractual FRAND commitments, which require a SEP holder to make licenses available to all willing licensees. The decision only analyses Qualcomm's behavior, and does not address collective action by multiple SEP holders to prevent upstream suppliers from obtaining licenses.

1. The Ninth Circuit's Decision Is Limited to Certain U.S. Antitrust Claims, Inconsistent with Other Tribunals, and Should Not Be Followed.

While we believe that the Ninth Circuit's decision is incorrect as a matter of competition law, the decision is silent on the contractual interpretation of FRAND commitments. Instead, the decision expressly recognized that a SEP holder's breach of its FRAND commitments may give rise to remedies in contract law and patent law.[2] Thus, the decision does not disturb the well-established principle that a SEP holder's refusal to license upstream suppliers and/or imposition of unreasonable royalties is not without judicial recourse.[3] To the contrary, such actions can constitute breach of contractual obligations, render the underlying patents unenforceable, or give rise to other defenses to patent infringement and related claims. *Id.*

The Ninth's Circuit's decision will only be binding law in one of thirteen U.S. circuit courts of appeals, the Ninth Circuit. As discussed below, its analysis and conclusions conflict with U.S. Supreme Court law, other Ninth Circuit cases, and the laws of other U.S. circuits.

The Ninth Circuit's conclusions are inconsistent with decisions and investigations in other jurisdictions, including the decision of the Seoul High Court of South Korea.[4] In affirming the decision of the Korea Fair Trade Commission, the Seoul High Court found that Qualcomm had an antitrust obligation to license other modem chip suppliers, as this is what the FRAND licensing policy of the SSO, ETSI, requires. Contrary to the Ninth Circuit, the Seoul High Court also found that it was not ordinary practice in the industry for patent holders to license their cellular SEPs exclusively at the handset level.

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[2] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *62-63. The district court had previously found that Qualcomm's commitments to two SSOs contractually require it to license its SEPs on FRAND terms to competing modem chip suppliers. *Id.* at *19 n.12. The Ninth Circuit vacated that factual finding because FTC's complaint did not assert a claim of breach of contract. *Id.* at *20 n.13.

[3] For further details and examples, please see the FSA position paper "SEP Licenses available to all", available at: https://fair-standards.org/wp-content/uploads/2020/07/160624_FSA_Position_Paper_-_SEP_licenses_available_to_all.pdf, as well as the FSA position paper "SEP licenses should be available to all companies in a supply chain that want a license for SEPs in their products – Supporting references", available at: https://fair-standards.org/wp-content/uploads/2020/06/200605-FSA-Position-Paper-Supporting-Legal-and-Policy-References-Licence-to-All.pdf.

[4] *Qualcomm v. Korean Fair Trade Commission*, 2017 *Nu* 48 (Dec. 4, 2019, Seoul High Court), available at: https://fair-standards.org/wp-content/uploads/2020/07/200722_Seoul-High-Court-2017Nu48-Final-Judgment_English-Translation.pdf.

The Ninth Circuit's decision is also inconsistent with antitrust investigations in other jurisdictions. In 2017, The Taiwan Fair Trade Commission concluded that Qualcomm's refusal to license chip competitors (*i.e.*, other modem chip suppliers) violated the Taiwan Fair Trade Act.[5] As mentioned just above, the Korean Fair-Trade Commission reached similar conclusions. In 2015, antitrust authorities in China concluded that the royalties Qualcomm charged for its SEPs, as well as other licensing practices, violated China's Antimonopoly Law.[6] Currently, the European Commission is also reviewing whether Nokia has violated competition laws by refusing to license suppliers in the automotive industry.[7]

Further, the Ninth Circuit's conclusions also do not address collective action. The Ninth Circuit found that Qualcomm had no antitrust duty to license its SEPs to its competitors, but it only analyzed Qualcomm's licensing policy as conduct by a single firm under Section 2 of the Sherman Act.[8] As a result, the decision does not address an agreement between two or more SEP licensors that harms competition by foreclosing licensing of SEPs to upstream suppliers. To the contrary, such agreements could constitute an anticompetitive conspiracy under Section 1 of the Sherman Act.

2. The Ninth Circuit's Decision Threatens to Harm Competition in the Modem Chip Markets and IoT Markets, and Has Dangerous Implications for National Security

We believe that despite its limitations, the Ninth Circuit's decision nevertheless threatens to harm competition in the markets for modem chips and a broad range of products and services that rely on connectivity standards. Refusals to license its competitors, combined with the other conduct at issue in the case, limits the ability of modem chip manufacturers to access cellular standards and sell standard-compliant chips to OEMs. Offering certain chip manufacturers a promise not to sue for infringement of its SEPs does little to promote competition because it requires the manufacturer to sell only to licensed OEMs.[9] This arrangement substantially reduces the chip manufacturer's incentive to seek out new customers and develop new product offerings. Moreover, the additional reporting costs and transaction costs can make it difficult for the manufacturer to compete and stay in business. Indeed, the Ninth Circuit admits that Qualcomm's conduct has already harmed competition by preventing rival manufacturers from making sales of standard-compliant chips.[10]

The decision also threatens to hinder innovation in the markets for IoT (Internet of Things) products and services that rely on connectivity standards. If SEP holders can refuse to license component suppliers and charge non-FRAND royalty rates based on the prices of finished products, this will limit the number of IoT firms throughout the value chain that can innovate on top of the cellular standards

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[5] *See* https://www.qualcomm.com/media/documents/files/tftc-press-release-translated.pdf.
[6] *See* https://www.ft.com/content/f976bb60-b0af-11e4-92b6-00144feab7de.
[7] *See* https://www.reuters.com/article/us-eu-antitrust-nokia-daimler/eu-antitrust-watchdogs-quiz-daimler-others-on-failed-nokia-fee-talks-idUSKBN21I21S.
[8] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *37-39. Although the district court found that Qualcomm's conduct also violated Section 1 of the Sherman Act, the underlying conduct was unilateral in nature.
[9] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *13-14.
[10] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *60-61; *see also id.* at *50-51.

to develop new IoT technologies. Small IoT device manufacturers could be forced to leave the business entirely if they are targeted by SEP holders demanding excessive royalties.

In addition to competitive harms, limiting the number of suppliers of modem chips can make customers' businesses less secure. If a firm sources most or all of its modem chips from a single source—either incorporating the chips into products to sell or using the chips in internal systems—any disruption in that source's supply chain could seriously disrupt the customer's business. For example, in the United States, the U.S. Department of Defense—which is required to use only domestic products for military operations—is now limited in its ability to maintain multiple modem chip suppliers because there is now only one remaining U.S. manufacturer that sells chips externally.[11]

3. The Ninth Circuit's Legal Analysis and Conclusions Are Wrong as a Matter of U.S. Law

4. The Ninth Circuit's Failure to Recognize the Anticompetitive Effects of a Breach of FRAND Commitment Conflicts with Its Own Precedent and the Decisions of Other Circuit Courts

The Ninth Circuit's failure to recognize that Qualcomm's breach of its FRAND commitment harms competition[12] is inconsistent with the court's own detailed findings just a few years earlier on how such conduct harms competition. In *Microsoft Corp. v. Motorola, Inc.*, the Ninth Circuit recognized that "[t]he development of standards … creates an opportunity for companies to engage in *anti-competitive behaviour*" and that "SEP owners obtain substantial leverage over new product developers."[13] The court further described how SEP holders licensing on non-FRAND terms can extract from manufacturers "an unduly high royalty rate for an SEP," an anticompetitive practice which can force manufacturers to pay excessive royalties that exceed the value of the standard and even the value of the product itself. *Id.*

The Ninth Circuit's decision is also at odds with the law of Third Circuit that a SEP holder's breach of its FRAND commitment can harm competition and violate antitrust laws.[14] The Ninth Circuit improperly attempted to narrow the Third Circuit's holding to cases where the SEP holder made an intentionally false FRAND promise to an SSO.[15] Nonetheless, the Third Circuit's discussions of how a breach of FRAND commitment can harm competition—for example, when an SEP holder demands "supracompetitive royalties" after firms are "locked in to a standard"—are not unique to cases of deception.[16]

[11] *See* https://www.wsj.com/articles/qualcomms-monopoly-imperils-national-security-11574634436.
[12] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *38-39.
[13] *Microsoft Corp. v. Motorola, Inc.,* 795 F.3d 1024, 1030-31 (Fed. Cir. 2015) (emphasis added).
[14] *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 314 (3d Cir. 2007).
[15] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *40-41 (citing *Broadcom Corp.*, 501 F.3d at 304, 314).
[16] *Broadcom Corp.*, 501 F.3d at 313-314.

5. The Ninth Circuit Failed to Ensure That Qualcomm's Royalty Rates Included Only the Value of a Cellular Handset Attributable to Patented Features

The Ninth Circuit rejected the district court's finding that Qualcomm's royalty rates—which were based on the sales price of an entire cellular handset—were "unreasonably high," but failed to evaluate whether Qualcomm apportioned the value of a product "between the patented feature and the unpatented features" based on "reliable and tangible" evidence as required by the U.S. Supreme Court.[17]

Proper apportionment is particularly important to mitigate harm to competition in the licensing of FRAND-encumbered SEPs. When apportionment is not required, SEP holders can more easily charge royalties in excess of FRAND that licensees would not be willing to pay if the patent were not standard-essential. This is because in order to make a product that complies with the standard, a manufacturer has no choice but practice the relevant SEPs.[18] Charging "unreasonably high" royalties for SEPs harms competition because the resulting royalties do not reflect the value of the patented technology, but rather the enhanced market power bestowed upon SEP holders by SSOs as a result of the FRAND promises they made before the standard was adopted.

6. The Ninth Circuit Failed to Consider Harm to SEP Consumers

The Ninth Circuit agreed with the district court that the relevant markets are the respective markets for CDMA modem chips and premium LTE modem chips.[19] In reversing the district court's antitrust findings, the Ninth Circuit repeatedly stated that antitrust law only recognizes harm to Qualcomm's competitors in these markets, *i.e.*, rival modem chip suppliers, and not harm to the OEM customers of the modem chip suppliers who also should reap the pro-competitive benefits of the FRAND commitment.[20] This definition of harm ignores the "consumer welfare standard" in U.S. antitrust law, which looks precisely to harms to *consumers* and is particularly salient in the SEP context.[21]

7. The Ninth Circuit Relied on Evidence that the District Court Did Not Find Credible

The Ninth Circuit gave credit to the procompetitive justifications offered by Qualcomm, finding that these justifications were "reasonable."[22] But the district court, in its findings of fact that followed a 10-day bench trial, found that all of Qualcomm's procompetitive justifications were "self-serving and pretextual" and rejected them accordingly.[23] Thus, the Ninth Circuit overstepped the bounds of appellate review by relying on evidence that the district court found not to be credible.

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[17] *Garretson v. Clark*, 111 U.S. 120, 121 (1884); *see LaserDynamics, Inc. v. Quanta Computer, Inc.*, 694 F.3d 51, 67 (Fed. Cir. 2012).
[18] *See Microsoft v. Motorola*, 795 F.3d 1024, 1031 (9th Cir. 2015).
[19] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *31.
[20] *See, e.g.*, *id.* at *30-31, 38-39, 48, 52.
[21] *Novell, Inc. v. Microsoft Corp*., 731 F.3d 1064, 1072 (10th Cir. 2013) (Gorsuch, J.).
[22] *FTC v. Qualcomm Inc.*, 2020 U.S. App. LEXIS 25347, at *39-40.
[23] *FTC v. Qualcomm*, 411 F. Supp. 3d 658, 756-58, 806 (N.D. Cal. 2019).

Conclusion

The impact of the Ninth Circuit's decision in *FTC v. Qualcomm* is limited because it does not disturb the available remedies in contract law and patent law for a SEP holder's breach of its FRAND commitments. Nor does it address collective action by SEP holders to preclude licensing to upstream suppliers. The decision is inconsistent with the antitrust investigations of other tribunals and need not be followed by other U.S. Circuit Courts. Nonetheless, we believe the decision threatens to harm competition and security by condoning anticompetitive licensing practices that limit the number of suppliers of modem chips and impede the development of IoT technologies. The decision conflicts with established U.S. law so as to warrant further review in the courts.

About the Fair Standards Alliance (FSA)

FSA is an alliance of 47 European and global companies, large and small, that advocates fairer licensing of standardised technology in the development and rollout of the IoT. FSA members significantly contribute to global innovation and the economy worldwide. Annually, the aggregate turnover of FSA members is more than EUR 2 trillion, and in aggregate our members spend more than EUR 140 billion on R&D and innovation. Alliance members have more than 500,000 patents, including SEPs, that are either granted or pending.

NOTE: The positions and statements presented in this paper do not necessarily reflect the detailed individual corporate positions of each member.