



Antitrust fight

Examining SEP charges against Qualcomm, **Michael E Salzman** provides some interim lessons in the licensing ring

One year after hostilities broke out, we are still in the early rounds of the two-front attack in Californian federal courts by Apple and the Federal Trade Commission (FTC) on Qualcomm's licensing programme for its smartphone patents – including especially the standard essential patents in its portfolio.¹

So it is too early to mark in stone any lessons we might draw from the charges being levelled in those cases.

Yet, Qualcomm has taken a couple of hits in the early stages in the US courts, after a \$975m settlement with the Chinese antitrust authorities, a harsh loss in the Korean Federal Trade Commission, and ongoing, additional scrutiny in Taiwan, the UK, the EU, and Japan.²

So, for those more inclined to find an alternate route around – rather than proceeding through – a war zone, it is not too early to look at the charges being levelled and consider how they might be avoided.

After a brief summary of the background for those who haven't been following these cases blow by blow, this article will chart where the mines have been spotted and suggest some avoidance strategies.

Background

Qualcomm is the dominant manufacturer of cellular baseband processors for smartphones and, of equal importance, a licensor of additional, patented technology for those same smartphones. Its fiscal 2017 revenue from microchip sales was approximately \$16.5bn, and its patent licensing revenue was approximately \$6.4bn.³

It can credibly claim to be one of the founding fathers of the smartphone (it claims to be the inventor of the smartphone; Apple begs

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to differ), and its patents read on numerous aspects of interoperability standards (UMTS, CDMA, and LTE for 2G, 3G, and 4G smartphones) that are essential so that all mobile phones can communicate with phones manufactured by others or operating over different mobile networks.

As part of the process by which its technology was incorporated into the smartphone standards agreed on by the ETSI, TTA, and ATIS standard setting organisations, (“SSOs”), Qualcomm promised to license these “standard essential patents” (“SEPs”) on terms that were to be “fair, reasonable, and non-discriminatory” (“FRAND”).

There have been earlier court decisions in the US and elsewhere enforcing FRAND commitments and otherwise touching on the do's

and don'ts of SEP licensing.⁴ Yet, Qualcomm's licensing practices touch on numerous areas where the law is not so clear, including some where there is disagreement among economists and policy makers.

In fact, if there is a single most visible area of disagreement between the new, Republican head of the Justice Department's antitrust division and the Democrats who preceded him, it is precisely over the undecided questions revolving around SEPs.⁵

While the pressure on Qualcomm has been building since at least the time of the regulatory action in China in 2015, two suits brought within days of each other in January 2017 in the very last days of the Obama Administration have brought the issues to a full boil.

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First, the Federal Trade Commission, by a 2-1, party-line vote, decided to bring an antitrust enforcement action against Qualcomm in federal district court in San Jose.⁶

And then Apple brought a private case against Qualcomm in San Diego and, shortly thereafter, arranged for the contract manufacturer companies that had been paying Qualcomm royalties reaching into the billions for Apple's iPhones to stop making payments to Qualcomm.

The two cases are now in the pre-trial discovery phase, with a tentative trial date of 4 January 2019 for the FTC case. Qualcomm's effort to get the FTC case dismissed as a matter of law was unsuccessful. So too was its effort to have the court in San Diego order Apple and/or the manufacturers to resume paying royalties while that case proceeds.⁷

Ancillary litigation has also broken out, with Apple challenging the validity of certain Qualcomm patents, and Qualcomm seeking to have iPhones assembled abroad barred from importation for alleged patent infringement.

The SEP practices in dispute and how to avoid them

It may well be that, at the end of the day, Qualcomm will prevail in the US courts, on appeal in Korea, and elsewhere, and/or the regulators will have second thoughts and not pursue Qualcomm further.

It is also very possible that Qualcomm will settle its disputes and/or voluntarily modify its licensing practices – either under current management or as a result of the hostile takeover campaign recently launched against it by Broadcom.⁸

For the time being, though, companies holding SEPs should be aware of the licensing techniques that are being questioned.

No squeezing, please

The FTC faults Qualcomm for refusing to sell its microchips to any



handset manufacturer that doesn't also purchase a patent licence from Qualcomm, for inventions it claims are essential to using the chips.

According to the FTC, this “no licence-no chips” policy allows Qualcomm to squeeze the margins of competing chip makers because Qualcomm can undercut their pricing for chips and make it back on patent royalty rates that are higher than they would otherwise be.

Qualcomm argues that margin squeezing is not a valid antitrust theory unless the low-priced product is sold for less than marginal cost (there is a Supreme Court of the US case that, on the face of it, seems to support Qualcomm on this, but the district court found that case didn't apply).⁹

It can also defend on the ground that chip purchasers really do need a licence to the Qualcomm patents to make use of the chips, so it would be self-defeating to sell the chips to buyers who intend to infringe.

Plainly, the safer course is to offer to sell your product without tying it to the licence, and sue for infringement those unwilling to take and pay for the licence.

If you are a SEP licensor that also sells a product, you should be able to back up your pricing for the licence as not more than is fair and reasonable on a standalone basis, and your royalty demand should not vary based on whether the licensee also purchases your product if necessary.

And, as a practice point, it makes sense to make sure that your company is not creating documents (or emails) suggesting that the price of a product being sold is inversely related to the price of a licence for the SEPs you are licensing.



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Sleeping with the enemy

Despite its FRAND commitments, Qualcomm’s policy apparently was to license its patents to customers of competing chip manufacturers, while refusing to issue licences to the manufacturers themselves. This was allegedly part of its no licence-no chips tactic, forcing handset manufacturers to do business with Qualcomm even if they preferred to buy competitors’ chips.

It is not settled whether Qualcomm’s approach is consistent with a FRAND promise of licensing on a non-discriminatory basis. And under antitrust law in general, a company is not required to cooperate with its competitors.

Yet, in denying Qualcomm’s motion to dismiss the FTC’s complaint, Judge Koh relied on a decades-old Supreme Court decision holding that a firm with monopoly power may be required to do business with its smaller competitors if the effect is to extend its monopoly.¹⁰

Going forward, you are inviting at least a complaint from the SSO and/or its members, if not a lawsuit, if you make a FRAND pledge for your SEPs but then won’t license them to your competitors. It would not be surprising if SSOs write that into their FRAND commitment rules if it’s not already included.

More than you bargained for

In a field like telecommunications, it is routine to license large blocks of patents in a single transaction. This promotes efficiency, reduces transaction costs, and, perhaps above all else, eliminates the need to pick through the patent thicket and determine whether a particular implementation reads on any, some, or all of the patents in the package. Modern antitrust law recognises this as pro-competitive and benign.

Yet, Apple complains in its lawsuit that Qualcomm insists on licensing packages of patents that Qualcomm selects for a single, all-in, percentage-of-revenue royalty rate, and does not allow a prospective licensee to exclude patents from the package (and its royalty payment obligations) that it doesn’t regard as “essential,” useful, or even valid.

Antitrust law has long scrutinised compelled “bundling” or “tying” of intellectual property when the licensee prefers to obtain a licence for one patent at a time, or less than all the patents the licensor offers.

Whether Qualcomm will be able to justify on efficiency or other grounds its alleged insistence on licensing the package of patents it offers remains to be seen.

In the meantime, a licensor with a portfolio of patents can avoid repeating Qualcomm’s battle by following the orthodox wisdom that each patent should be at least nominally available for license on its own – although the pricing for particular patents does not necessarily need to be proportionate to the place of that patent in the portfolio.

In other words, and speaking generally and for the main run of cases, the package licence can be priced in a way that incentivises implementers to accept a licence for the whole package rather than proceeding one by one or for a slimmer package.

Stay in your lane

Perhaps the most vivid charge in the Apple case is that Qualcomm has been charging the same percentage of revenue for its licences even while smartphones have been adding more and more features that have less and less to do with the Qualcomm patents, and even while, at the top end, smartphones have risen in price as they have gotten smarter.

The rate has stayed the same, but the rate base, even on a per unit basis, has risen several fold. (The FTC’s complaint alleges that Qualcomm’s proportion of SEPs in smartphones has declined to 13% as the phones evolved from 2G to 4G.)

Said simply, this is an allegation that, even if the Qualcomm licence was FRAND-priced at one time, it isn’t fair and reasonable anymore. There is currently a pitched debate about whether pricing for SEPs is a fit topic for antitrust enforcement or whether, instead, the FRAND promise should be enforced by SSOs or their members under contract law.¹¹

Yet, there is at least one prominent instance where a federal judge did set a FRAND price under an antitrust theory of liability.¹²

How to determine a FRAND rate when licensor and licensee can’t agree is an unsettled topic. Most agree that the licensor should be fairly rewarded for the value of its invention, but not for the additional value derived from the fact that it has been incorporated into the standard.¹³ Teasing this out is more easily said than done.

But the simple lesson of Apple’s gripe is that both the rate and the

rate base are part of the “fair and reasonable” equation. Far be it from me to fault Qualcomm for seeking to maximise its royalty stream.

But it is fair ground for criticism from licensees that an SEP licensor is violating its FRAND commitment if its share of revenue is constant and its contribution to the revenue stream is declining.

So you should be aware, whether as licensor or licensee, that a percentage-of-revenue licence fee that was deemed reasonable when the revenue stream was a one-lane road may look different as additional lanes are added to the revenue stream.

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Footnotes

1. *Fed Trade Comm’n v Qualcomm Inc*, Case No 5:17-cv-00220-LHK (ND Cal filed 17 Jan 2017); *Apple Inc v Qualcomm Inc*, Case No 3:17-cv-00108-GPC-MDD (SD Cal filed 20 Jan 2017).
2. Don Clark, ‘Qualcomm to pay \$975m antitrust fine to China,’ *Wall St J*, 10 Feb 2015, <https://www.wsj.com/articles/qualcomm-settles-china-probe-1423518143>; Hyunjoo Jin, ‘South Korean court rejects Qualcomm’s request to suspend antitrust body’s order,’ Reuters, 4 Sept 2017, <https://www.reuters.com/article/us-qualcomm-antitrust/south-korean-court-rejects-qualcomms-request-to-suspend-antitrust-bodys-order-idUSKCN1BF10D>; order den prelim inj, *Qualcomm Inc v Compal Elecs Inc*, No 35-1 (ND Cal 7 Sept 2017), ECF No 138; order den mot to dismiss, *Fed Trade Comm’n*, No 69 (ND Cal 26 June 2017), ECF No 133; Jess Macy Yu, ‘Taiwan ministry expresses ‘deep concern’ about Qualcomm’s antitrust fine,’ Reuters.com, 18 Oct 2017, <https://www.reuters.com/article/us-qualcomm-taiwan/taiwan-ministry-expresses-deep-concern-about-qualcomms-antitrust-fine-idUSKBN1CN12Y>; Aaron Tilley, Aoife White, ‘Apple’s UK Suit against Qualcomm adds to global patent war,’ *Bloomberg*, 2 Mar 2017, <https://www.bloomberg.com/news/articles/2017-03-02/apple-s-u-k-patent-suit-against-qualcomm-adds-to-global-battle>; press release, European Comm’n, sntitrust: ‘Commission sends two statements of objections on exclusivity payments and predatory pricing to Qualcomm,’ No IP/15/6271 (8 Dec 2015), http://europa.eu/rapid/press-release_IP-15-6271_en.htm.
3. Qualcomm Inc, Form 10-K, supra note 3, at 41. In this article, Qualcomm’s “microchip sales” encompasses revenues of Qualcomm CDMA Technologies (QCT), and “patent licensing revenue” encompasses revenues of Qualcomm Technology Licensing (QTL).
4. Eg, *SK Hynix Inc v Rambus Inc*, No C-00-20905 RMW, 2013 WL 1915865 (ND Cal 8 May 2013); *Broadcom Corp v Qualcomm Inc*, 501 F.3d 297 (3d Cir 2007); *Microsoft Corp v Motorola, Inc*, No C10-1823JLR, 2013 WL 2111217 (WD Wash. 25 Apr 2013); *Apple, Inc v Motorola, Inc*, 869 F Supp 2d 901 (ND Ill. 2012); Case C-170/13, *Huawei Techs Co v ZTE Corp*, 2015 ECR, available

at <http://curia.europa.eu>. The most recent FRAND decision is *TCL Commc’n Tech Holdings, Ltd v Telefonaktiebolaget LM Ericsson*, No SACV 14–341 JVS(DFMx), 2017 WL 6611635 (CD Cal 21 Dec 2017).

5. Compare Makan Delrahim, assistant attorney gen, US Dep’t of Justice, Remarks at the Univ of S Cal Gould Sch of Law’s Ctr for Transnat’l Law and Bus Conf (10 Nov 2017), <https://www.justice.gov/opa/speech/assistant-attorney-general-makan-delrahim-delivers-remarks-usc-gould-school-laws-center> (faulting the Obama administration’s competition policies for focusing excessively on the risks of “hold-up” overcharges by owners of SEPs, suggesting that FRAND commitments should be enforced through private, contract litigation rather than antitrust law enforcement, and warning of the dangers of collusive “hold-out” by implementers of technology reading on SEPs) with A Douglas Melamed & Carl Shapiro, ‘How antitrust law can make FRAND commitments more effective’ (Stanford Law Sch John M Olin Programme in Law and Econs, Working Paper No 510, 2017) (reasserting that antitrust has a crucial role to play in enforcing FRAND commitments and disputing that “hold-out” is a substantial problem in fact).
6. Shortly thereafter, chair Edith Ramirez left her position at the FTC. Since then the FTC has been operating with one Democratic and one Republican Commissioner, and three vacancies. Even though Republican commissioner Maureen Ohlhausen dissented from the decision to commence the lawsuit, she lacked the power to withdraw it even after becoming acting chair because of a 1-1 deadlock. A new, Republican chair has now been nominated, along with another Democratic member, but neither of them has yet been confirmed by the Senate.
7. See note 3.
8. Mike Freeman, ‘Broadcom goes hostile, seeks to replace Qualcomm’s board in takeover bid,’ *LA Times*, 4 Dec 2017, <http://www.latimes.com/business/technology/la-fi-tn-qualcomm-broadcom-20171204-story.html>.
9. Order den mot to dismiss at 35-38, *Fed Trade Comm’n v Qualcomm Inc*, No 69 (ND Cal 26 June 2017), ECF No 133 (distinguishing *Pac Bell Tel Co v linkLine Commc’ns, Inc*, 555 US 438 (2009)).
10. Order den mot to dismiss, supra note 10, at 39-41, 44-46 (citing *Aspen Skiing Co v Aspen Highlands Skiing Corp*, 472 US 585 (1985)).
11. Eg, Makan Delrahim, supra note 6 (contract law); A Douglas Melamed & Carl Shapiro, supra note 6 (antitrust law).
12. *Microsoft Corp v Motorola, Inc*, No 10-1823, 2013 WL 2111217 (WD Wash 25 Apr 2013) (Judge Robart adopts modified factors established by *Georgia-Pacific Corp v United States Plywood Corp*, 318 F Supp 1116 (SDNY 1970)); see also, *In re Innovatio IP Ventures, LLC Patent Litig*, No 11 C 9308, 2013 WL 5593609 (ND Ill 3 Oct 2013); *Realtek Semiconductor Corp v LSI Corp*, 946 F Supp 2d 998 (ND Cal 20 May 2013).
13. Eg, European Comm’n, ‘Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee’, COM (2017) 712 final (29 Nov 2017).

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