# ROPES & GRAY

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# Qualcomm's "No License, No Chips" Program Violates Antitrust Laws

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On May 21, 2019, following a full trial on the merits, Judge Koh of the Northern District of California issued a 233-page opinion in a closely watched case between the Federal Trade Commission ("FTC") and Qualcomm, one of the largest chip suppliers in the world. *See FTC v. Qualcomm Inc.*, No. 17-CV-00220-LHK, slip op. (N.D. Cal. May 21, 2019). In a decision Qualcomm has vowed swiftly to appeal, Judge Koh found violations of Sections 1 and 2 of the Sherman Act (and, therefore, a violation of Section 5 of the FTC Act) and invalidated Qualcomm's "No License, No Chip" business model, condemned discounts characterized as *de facto* exclusive dealing, and entered an injunction upending Qualcomm's business model. Depending on how the appeal fares, the decision may have significant implications for licensing practices of holders of Standard Essential Patents ("SEPs"), including for 5G and the Internet of Things ("IoT").

## Qualcomm's "No License, No Chip" Business Model

Judge Koh focused on three interrelated aspects of Qualcomm's conduct that the FTC asserted harmed competition in the markets for key modem chips used in cellular telephones. First, Qualcomm refused to make available to rivals exhaustive licenses to SEPs required to implement key standards on such chips. As a consequence, chip customers (cell phone makers, or original equpiment manufacturers ("OEMs")) could only use the chips of Qualcomm's competitors without infringing Qualcomm's SEPs if the chip customers themselves licensed the SEPs from Qualcomm. Second, Qualcomm leveraged its monopoly position in chips to secure unreasonably high rates for its SEPs. Qualcomm, for example, refused to provide must-have chips unless customers took the unreasonable IP licenses—the "no license, no chip" model. Combined, these two practices had the effects, the Court reasoned, of raising rivals' costs: chip rivals, unable to attain licenses from Qualcomm directly, were burdened with the high-cost licenses Qualcomm generated from OEMs. Saddling rivals with higher costs helped Qualcomm maintain its chip monopoly. Third, Qualcomm extended market share discounts to key customers that, the Court found, amounted to *de facto* exclusive dealing agreements, arrangements that also hindered Qualcomm's chip rivals.

## Judge Koh's Analysis of Qualcomm's "No License, No Chips" Licensing Policy

In analyzing the first two aspects of Qualcomm's conduct, Judge Koh relied on detailed testimony from 16 OEMs (or groups of OEMs), including LG Electronics, Sony, Samsung, Huawei, Motorola, Lenovo, Blackberry, Apple, ZTE, Nokia, smaller Chinese OEMs, and others. The Court found that several common anticompetitive actions emerged:

- First, Qualcomm refuses to sell an OEM modem chips exhaustively by requiring a separate patent license before selling modem chips, including cutting off OEMs' chip supply to coerce OEMs to sign patent licenses on favorable terms to Qualcomm. Thus, the Court concluded that "Qualcomm wields its chip monopoly power to coerce OEMs to sign patent license agreements." *Id*. at 44.

- Second, Qualcomm's patent licenses include unusual provisions that require OEMs to cross-license their patents—often royalty-free—to Qualcomm's modem chip division in exchange for rights to Qualcomm's licensing division's patents. *Id*. at 45.

- Third, Qualcomm has refused to provide samples of Qualcomm modem chips, withheld technical support, and delayed delivery of software or threatened to require the return of software until OEMs sign Qualcomm's patent license agreements. *Id*.

- Fourth, Qualcomm refuses to provide OEMs lists of Qualcomm's patents or patent claim charts during license negotiations. *Id.*

- Fifth, Qualcomm paid Samsung in 2018 in order "to silence Samsung." *Id.*

- Sixth, through Qualcomm's practice of threats, Qualcomm has been able to generate and sustain unreasonably high royalty rates, including on handset sales that contain a rival's modem chip. Qualcomm even imposed artificial and anticompetitive surcharges on the price of rivals' modem chips. *Id.*

Judge Koh's legal analysis of the "no license, no chip" policy rested on three pillars. First, Judge Koh held that the antitrust laws imposed a duty on Qualcomm to license its SEPs to rivals, stressing that Qualcomm previously had a practice of extending such licenses but drew them back when Qualcomm determined it could make greater profits through coercing licenses from OEMs and at the same time hinder chip rivals. *Id.* at 128-30. Here, the Court also invoked its prior ruling finding that Qualcomm's refusal to license violated commitments made to two cellular-standard-setting organizations (Telecommunications Industry Association ("TIA") and Alliance for Telecommunications Industry Solutions ("ATIS")). *Id.* at 125-26.

Second, Judge Koh reasoned that, set against the backdrop of this illegal refusal to deal, the cost-raising "no license, no chip" policy hindered rivals, leading to anticompetitive harm in modem chips. Here, Judge Koh, quoting the D.C. Circuit's decision in *United States v. Microsoft Corp.*, held it sufficient that Qualcomm engaged in "anticompetitive conduct that reasonably appear[s] capable of making significant contribution to . . . maintaining monopoly power." *Qualcomm*, No. 17-CV-00220-LHK, slip op. at 42-43 (citations and internal quotation marks omitted). Nonetheless, and third, Judge Koh stated that she found actual anticompetitive effects:

Qualcomm's practice of refusing to license its cellular SEPs to rival modem suppliers . . . has promoted rivals' exit from the market, prevented rivals' entry, and delayed or hampered the entry and success of other rivals. Without a license to Qualcomm's SEPs, a rival could not sell modem chips with any assurance that Qualcomm will not sue the rival and its customers for patent infringement. Qualcomm's refusal to license its SEPs to rivals also enables Qualcomm to demand unreasonably high royalty rates.

*Id.* at 114. Qualcomm further delayed licensing negotiations so that rivals' chips were outdated by the time they entered the market. *See, e.g.*, *id.* at 115.

## Anticompetitive Exclusive Dealing

Judge Koh further condemned Qualcomm's market share discounts as *de facto* exclusive dealing that caused further unlawful hindering of chip rivals. For example, the Court concluded that Qualcomm's deals with Apple, including the 2011 Transition Agreement ("TA") and the 2013 First Amendment to Transition Agreement ("FATA"), violated the Sherman Act since "Qualcomm shrunk rivals' sales and foreclosed its rivals from the positive network effects of working with Apple." *Id.* at 141. The Court "easily conclude[d]" that the TA and FATA were *de facto* exclusive deals because Qualcomm incentivized Apple to purchase substantial volumes of Qualcomm modem chips, and if Apple purchased *any* modem chips from a Qualcomm rival, the TA would automatically terminate and Apple would have to pay back hundreds of millions of dollars in incentives. *Id.* at 142-43.

## Qualcomm's Lack of Credibility

Significantly, Judge Koh criticized Qualcomm for relying on incredible trial testimony at odds with its own contemporaneous documents. Qualcomm introduced only 16 of its own documents at trial, which was a fraction of the 125 Qualcomm documents that the FTC introduced. Upon consideration of the evidence and testimony, the Court found "Qualcomm's internal, contemporaneous documents more persuasive than Qualcomm's trial testimony prepared specifically for this antitrust litigation." *Id.* at 12. The Court then reviewed various contradictions in the witnesses' trial

testimony, including statements made by Qualcomm's President and its CEO during the trial in comparison to contemporaneous emails, handwritten notes, and recorded statements to the IRS.

## Remedy

Judge Koh, citing evidence that Qualcomm intended to extend its practices to emerging 5G standards, granted injunctive relief to prevent, in her view, a substantial risk of ongoing anticompetitive behavior, including:

- Qualcomm cannot use the "no license, no chips" policy, and Qualcomm must negotiate or renegotiate license terms with customers in good faith and without threats or discriminatory provisions. *Id*. at 227-29.

- Qualcomm must make exhaustive SEP licenses available to modem-chip suppliers on FRAND terms. *Id*. at 229.

- Qualcomm may not enter express or *de facto* exclusive dealing arrangements for the supply of modem chips. *Id*. at 229-31.

- Qualcomm may not interfere with the ability of any customer to communicate with a government agency about a potential law enforcement or regulatory matter. *Id*. at 231-32. (Qualcomm at times had entered settlements precluding counterparties from assisting competition-law investigations or suits.)

- Qualcomm must submit to compliance and monitoring procedures for seven years to the FTC. *Id*. at 232-33.

## Implications

Qualcomm has vowed to seek an expedited appeal of Judge Koh's decision and to attempt to stay the injunction pending appeal. Judge Koh's conclusion that Qualcomm violated an antitrust duty to deal (separate and apart from its FRAND commitments to standard-setting bodies) will surely be tested on appeal, as will her application of the *Microsoft* "nascent competitor" causation standard, among other rulings. The Department of Justice, which previously filed a Statement of Interest suggesting caution in formulating remedies, may also make its views known. In the meantime, *FTC v. Qualcomm* stands as an important landmark in the intellectual property/antitrust interface. It serves as a reminder to technology firms that licensing practices and asserted violations of FRAND commitments can, in certain circumstances, lead to allegations of anticompetitive harm in adjacent product markets—allegations that have the potential to entirely upend longstanding business models.