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District Court Denies Motion to Dismiss FTC Section 5 Complaint Against Qualcomm

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Early this year, the US Federal Trade Commission ("FTC") filed a complaint in the Northern District of California charging Qualcomm with violating Section 5 of the FTC Act, which prohibits "unfair methods of competition." The FTC's complaint alleges that Qualcomm used anticompetitive tactics to maintain a monopoly in the supply of baseband processors for use in cell phones and other consumer products. It further contends that Qualcomm has market and monopoly power in the markets for CDMA baseband processors and Premium LTE baseband processors.

FTC's Allegations Against Qualcomm

The complaint makes three major allegations concerning Qualcomm's anticompetitive behavior. First, the FTC claims that Qualcomm maintains a "no license, no chips" policy under which it will supply its baseband processors only on the condition that original equipment manufacturers ("OEMs") agree to Qualcomm's preferred patent license terms. Because of Qualcomm's alleged dominance in the supply of important baseband processes, and because handset manufacturers cannot risk losing supply, they are not able to negotiate fair, reasonable and non-discriminatory ("FRAND") rates for Qualcomm's standard essential cellular patents ("SEPs"). Second, the FTC alleges that Qualcomm has consistently refused to license its SEPs on FRAND terms to competing suppliers of baseband processors. Instead, Qualcomm insists on licensing only at the handset level. This tactic allegedly forces OEMs to pay elevated royalties to Qualcomm on products whether they use Qualcomm's or a Qualcomm competitor's baseband processors. Thus, the FTC alleges that Qualcomm imposes an anticompetitive "tax" on OEMs if they choose to use rivals' processors. And third, the complaint alleges that Qualcomm extracted exclusive chipset supply contracts from Apple in exchange for reduced patent royalties from 2011 to 2016.

The FTC seeks to: (a) enjoin Qualcomm from requiring that handset OEMs take a license to its SEPs, and instead incorporate those costs into the price of Qualcomm chipsets; (b) uphold its commitment to license its SEPs on FRAND terms to all comers, including its competitors; and (c) stop paying handset OEMs for exclusivity.

The complaint is – by any measure – unusual in its approach, especially considering its reliance on Section 5 of the FTC Act, as opposed to more traditional Sherman Act theories. The complaint does not allege, for example, that Qualcomm's "no license no chips" policy is anticompetitive "tying" or that Qualcomm ties its SEPs and non-SEPs. Rather, the thrust of the complaint is that Qualcomm was never forced into negotiating a true FRAND rate for its SEPs – by a counterparty or by a court – because it leveraged OEMs' need for its baseband chipsets and refused to deal with baseband chipset competitors, who likely would have been best positioned to negotiate (and if necessary litigate) a true FRAND rate. Thus, Qualcomm obtained "elevated" royalties from the OEMs who do pay.

Opposition to Filing Complaint

The FTC Commissioners voted 2-1 to file the complaint, with then-Commissioner (and current acting Chairman) Maureen Ohlhausen dissenting for two key reasons. First, she believed that the complaint was precipitously filed on the eve of a new presidential administration without adequate evidentiary support. (Per the Commissioner, this was borne out by the fact that the agency could not even make a traditional claim under the Sherman Act, and instead relied on the more nebulous FTC Act). In short, she predicted that the issuance of such a deficient complaint will undermine US intellectual property

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Second, Commissioner Ohlhausen objected as a matter of law to the FTC theory that the patent royalties that Qualcomm charges handset manufacturers that use non-Qualcomm chipsets are an anticompetitive "tax." This tax – it is alleged – discourages handset manufacturers from buying chipsets from Qualcomm's competitors (since the manufacturers must pay the Qualcomm "tax" in any event), raises customers' costs, and is tantamount to a margin squeeze. Commissioner Ohlhausen viewed the complaint as deficient because it *does not allege* that the elevated royalty rates, *e.g.*, the "taxes", *violate* FRAND. She further observed that "[t]he fundamental element of this theory is a royalty overcharge. If Qualcomm charges reasonable royalties for its patents, then there is no anticompetitive "tax"—the complaint's nomenclature for a price squeeze—but only the procompetitive monetization of legitimate patent rights. Importantly, there is no suggestion that Qualcomm charges higher royalties to OEMs that buy non-Qualcomm chipsets. Hence, the complaint's taxation theory requires that Qualcomm charge OEMs unreasonably high royalties."[2]

District Court Denies Qualcomm's Motion to Dismiss

Given the unusual approach taken by the FTC, and Commissioner Ohlhausen's strong dissent, no one was surprised when Qualcomm filed a motion to dismiss the FTC complaint for failure to state a claim under Rule 12(b)(6) in April of this year. In the motion, Qualcomm did not contest that it has monopoly power in the markets for CDMA and premium-LTE modem chips, where it has 80% share. Rather, it contested that it has engaged in anticompetitive practices in violation of Section 1 or 2 of the Sherman Act, and thus in violation of Section 5 of the FTC Act. In June, District Court Judge Lucy Koh denied the motion in a lengthy opinion. Even by 12(b)(6) standards, which require the court to accept all allegations of fact in the complaint as true, this was a particularly strong ruling in favor of the FTC.

First, regarding Qualcomm's "no license-no chips" approach, Judge Koh ruled that the FTC had adequately pled that Qualcomm charged above-FRAND rates on its chipset patent licenses for several reasons. As alleged in the complaint, Qualcomm is able to charge a "surcharge" or "tax" on top of FRAND rates because of OEMs' fear of losing supply. Moreover, chipset manufacturers are similarly denied the opportunity to negotiate FRAND rates because Qualcomm refuses to grant them SEP licenses at all. The complaint alleges that Qualcomm patent royalties are some of the highest in the cellular SEP space. And finally, Qualcomm allegedly charged a flat percentage of handset sales prices as royalty rates even as handsets become much more expensive due to the addition of non-cellular technologies (*e.g.*, cameras, additional memory, etc.), which suggests that they were seeking compensation in excess of the value of their SEPs.

The court also held that the FTC adequately pled that the no license-no chips policy harms competition because, in allegedly breaching its FRAND obligations twice (by not licensing its competitors and by threatening to withhold its chips to induce OEMs to pay above-FRAND rates), Qualcomm raised the "all-in" price that OEMs pay on *all* modem chips, even non-Qualcomm chips. Qualcomm was then allegedly able to use the profits from the above-FRAND surcharge it received on sales of *all* cellular handsets to offer its customers discounts on chip purchases its competitors cannot match.

Judge Koh rejected Qualcomm's argument that at most the FTC has alleged a price squeeze of its competitors, which is generally not actionable under US antitrust law, holding instead that Qualcomm

[2] Dissenting Statement of Commissioner Maureen K. Ohlhausen In the Matter of Qualcomm, Inc. File No. 141-0199 January 17, 2017, at 1.

had an independent duty to deal with its competitors based upon its FRAND commitments to ETSI, TIA, and ATIS and other standards setting organizations ("SSOs"). Thus, she found that the FTC adequately alleged that Qualcomm's no license-no chips policy is anticompetitive conduct in violation of either Section 1 or 2 of the Sherman Act, and thus in violation of Section 5 of the FTC Act.

Second, Judge Koh held that the FTC adequately alleged that Qualcomm's refusal to license SEPs to its modem chips competitors is independent anticompetitive conduct that violates Section 2 of the Sherman Act, and thus Section 5 of the FTC Act. Specifically, such a refusal, in conjunction with its larger course of conduct, constituted a violation of an antitrust duty to deal under the *Aspen Skiing*,[3] *Trinko*,[4] and *MetroNet*[5] factors because: (a) Qualcomm engaged in a voluntary course of dealing with its competitors that it altered when it participated in SSOs but failed to honor its FRAND commitments undertaken in the standards setting process, and (b) that Qualcomm acted with anticompetitive malice by refusing to license SEPs to competitors because doing so eliminated the possibility that any firm would have been able to negotiate a FRAND rate with Qualcomm (*i.e.,* competitors are best placed to do so because a threatened chipset supply disruption would not harm them).

And finally, Judge Koh held that the FTC adequately alleged that Qualcomm's exclusive deal with Apple foreclosed a substantial portion of the relevant market from its competitors, even though the FTC did not allege what percentage of the market was foreclosed. The FTC's allegations that Apple sells large volumes of handsets, is a particularly important OEM, and provides its vendors with a "halo effect" were sufficient. Further, the fact that Apple was unable to work with other vendors prior to Intel with the iPhone 7, despite its own statements that it wanted to, were sufficient to plead actual foreclosure.

Some Key Takeaways

Assessing the impact of Judge Koh's opinion should be considered in light of the procedural posture of the case—the court has not ruled on the merits but merely allowed the FTC's case to survive beyond a motion to dismiss. Nevertheless, three aspects of the ruling are noteworthy.

First, the FTC adequately plead that a SEP-holder's FRAND commitment constitutes an exception to the general antitrust rule that there is no duty to deal with competitors. Imposing an antitrust duty to deal based on FRAND is consistent with the Third Circuit's ruling in *Broadcom v. Qualcomm*.[6] It is also consistent with the consensus view that FRAND commitments require SEP holders to conclude licenses with willing licensees. Some SEP-holders have attempted to argue that the language of various SSOs, which, for example, obligates them to be "prepared to grant irrevocable licenses on . . . [FRAND] terms and conditions,"[7] only requires that they make an offer to license and reserves the right to deny licenses. By imposing an antitrust duty to deal, Judge Koh's ruling confirms that a FRAND commitment means more than just making an offer—and arguments to the contrary are more unlikely to succeed.

Second, it is potentially significant that Judge Koh ruled that the FTC stated a claim under Sections 1 and 2 of the Sherman Act, even though the FTC never expressly alleged such violations (or amended the complaint to do so). As described earlier, the FTC's complaint was brought under its standalone Section 5 authority, but in its motion to dismiss, Qualcomm alleged that the FTC failed to adequately allege claims for monopolization and restraint of trade under the Sherman Act, likely to

[3] 472 U.S. 585 (1985).
[4] 540 U.S. 398 (2004).
[5] 383 F.3d 1124 (9th Cir. 2004).
[6] 501 F.3d 297 (3d. Cir. 2007).
[7] European Telecommunications Standards Institute ("ETSI") Intellectual Property Rights Policy § 6.1.

bolster Qualcomm's position that the Section 5 claims were otherwise insubstantial. Judge Koh declined to rule on whether the FTC "has stated a claim for a violation of § 5 that is independent of a Sherman Act violation," thus not addressing whether Qualcomm's conduct violated the statute upon which the complaint was premised. This ruling likely will be cited by Apple in support of the Sherman Act case it brought against Qualcomm that currently is pending in the Southern District of California.

Third, the opinion illustrates that adjudicating a breach of FRAND may not involve a complicated rate-setting exercise. Judge Koh found that the FTC adequately alleged a FRAND violation by alleging that Qualcomm's royalty rate stayed constant over time despite (a) an increasing royalty base due to the introduction of additional technology in high-end smartphones apart from Qualcomm's SEPs, and (b) the decreasing number of Qualcomm SEPs relative to the total SEPs necessary to make a wireless device. In doing so, Judge Koh suggests that the FTC may be able to prove a violation of FRAND without the need of complicated technical valuation evidence of Qualcomm's SEPs.