‘Connection restored’: *Broadcom v. Qualcomm* appellate reversal on FRAND licensing obligation for wireless technology standard brings case back into line with mainstream antitrust precedent[1]

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Private standard setting, it is often said, can maximize consumer welfare – the primary goal of antitrust law – on a number of levels.

Chief procompetitive benefits of standard setting include, among other factors:

▪ the enhancement of product interoperability, which facilitates information sharing among purchasers of products from competing manufacturers and thereby increases the utility of all products and enlarges the overall consumer market;
▪ the spreading of costs of research and development across the resulting wider market;
▪ a lowering of the cost to consumers of switching between competing products and services, thereby enhancing competition among suppliers; and
▪ informed, objective comparison by standards development organizations (SDOs) between competing technologies, patent positions and licensing terms – usually through policies requiring disclosure of relevant patents and licensing commitments – before an industry becomes locked into a standard.

The antitrust laws afford some latitude to competing firms that participate in SDOs in order to help them achieve the procompetitive benefits of standards development. Key principles of antitrust and intellectual property law come into play in standards development – often in apparent tension with one other – because as competitors collaborate to forge common technological platforms they also seek to maintain control over their own proprietary rights.

For such collaboration to achieve the desired goals, firms in SDOs must be able to rely on each other to deal fairly and in good faith, and to abide by the SDO’s rules. Opportunities for abuse, primarily in the form of deceptive conduct, arise more readily

[1] © 2007 Richard Wolfram. A previous article by Mr. Wolfram on the Broadcom/Qualcomm case appeared in the Dec. 2006-Jan. 2007 issue of *Global Competition Review* (available at www.rwolframlex.com/images/can-u-hear-us.pdf) following the district court decision. Mr. Wolfram’s practice focuses on antitrust litigation and counseling, including standard setting issues.

and can more easily be concealed in standard setting than in the “rough and tumble” of natural competition.

“The competitive risk [in SDOs],” explains one leading authority, “is that the misrepresentation will cause a standard-setting organization to adopt a standard it otherwise would have rejected, and that the adoption of that standard will in turn confer on the defendant market power it would not otherwise have obtained.” To safeguard against such abuse, SDO rules typically require participants to disclose any intellectual property rights that are essential to the standard, as it is being developed, and to agree to license any technology that becomes incorporated into and is essential to the standard on fair, reasonable and non-discriminatory (FRAND) terms.

If abuse of the standard setting process is tolerated, firms will decline to participate and the promised efficiencies will fail to materialize – to the ultimate detriment of consumers. So, antitrust law has an important role to play in ensuring that the standards development process itself is neither distorted nor hijacked through intentional abuse by any participant in the process. For this reason, monopolization law (based on deception as the predicate exclusionary conduct) is regularly applied in this context. The challenge for courts is to balance IP law and antitrust – on the one hand promoting proprietary technological innovation, on the other ensuring that the collaborative process of standard setting is conducted openly, transparently and without deliberate distortion.

Recently, two cases in particular – *FTC v. Rambus Inc.* and *Broadcom v. Qualcomm* – highlight the procompetitive benefits of standard setting and also the antitrust pitfalls for SDO participants who fail to disclose intellectual property rights essential to a developing standard or breach their commitment to license on FRAND terms any IP essential to the standard. Also – and this is of signal importance to global firms – competition agency concern over the antitrust implications of standard setting now appears officially to have hit European shores, and the focus is on the conduct of these same two companies: In August and October 2007, respectively, the European Commission opened investigations into the licensing practices of Rambus and Qualcomm, based on facts substantially similar to those at issue in the FTC and Broadcom cases.

In re Rambus

In August 2006, the Federal Trade Commission – which does not set precedent for the federal courts, but is viewed as authoritative in antitrust law and has significant enforcement and judicial expertise in standard setting – unanimously found Rambus, a developer of technology for dynamic access random memory (DRAM), liable for monopolization through abuse of standard setting. Reversing the administrative court below, the FTC held that Rambus, in contravention of the disclosure rules and the reasonable expectations of the other members of the SDO, had deliberately failed to disclose intellectual property rights it had in DRAM technology which was then chosen to comprise a standard by an SDO in which it participated.

The FTC reasoned that Rambus had engaged in "patent ambush" through a course of dealing over several years in which it disregarded the SDO's disclosure obligations; deceived the other members; took advantage of their expectations; misled them to believe that it was not seeking patents that would be covered by standards decided on by the SDO; and even collected information about the pending standards and amended its relevant patent applications to ensure that subsequently issued patents would cover the ultimate standards. Recognizing both the procompetitive benefits and the potential for anticompetitive abuse in standard setting, and emphasizing the need for "procedures that prevent the standard-setting process from being biased by members with economic interests in stifling product competition," the FTC rejected Rambus's argument that its IP rights, including trade secret protection for its patent applications, trumped the SDO's rules.

Rambus had urged the FTC not to apply the balancing test of procompetitive efficiencies and anticompetitive harms outlined in *U.S. v. Microsoft*, but to apply instead the "profit sacrifice" test most recently applied by the Supreme Court in *Verizon v. Trinko* (which dealt with a claim of monopolization based on a unilateral refusal to deal). Under the profit sacrifice test, a monopolist's conduct is deemed exclusionary only if it would have been unprofitable for it to engage in the conduct but for an expectation that its conduct would exclude rivals and enable it to recoup its losses through the acquisition of long-run monopoly power. Rambus contended that its conduct was not exclusionary because it had no such expectation in keeping information about its patent applications secret and refusing to share that information with competitors. Rather, it said, its conduct was beneficial to itself regardless of what happened at the SDO or to its competitors.

The FTC reasoned that the profit sacrifice test is inappropriate when the conduct reduces consumer welfare but is inexpensive to execute, and so does not involve a significant profit sacrifice. Instead, it concluded, where conduct may have imposed substantial costs on rivals and contributed significantly to the creation of monopoly power, without reducing prices or causing the defendant to forgo sales or even spend substantial funds beyond what it otherwise would have spent (as happened in *Rambus*), the correct approach is to evaluate whether the monopolist's conduct on balance harms competition. Rambus has now appealed the FTC's decision to the Court of Appeals for the District of Columbia – the same court which decided *U.S. v. Microsoft*.

Broadcom v. Qualcomm

Last month, in *Broadcom v. Qualcomm* (3^{rd} Cir., Sept. 4, 2007), a Third Circuit appellate panel reversed in relevant part the lower court's decision dismissing claims that Qualcomm, a cellular communications technology company, had violated the antitrust laws – in particular, Section 2 of the Sherman Act – when it reneged on its commitment to license on FRAND terms any technology essential to certain wireless standards developed by the SDOs in which it participated. In reinstating key claims of monopolization and attempted monopolization, the appellate decision restored order in a case that threatened to challenge the FTC's teachings in *Rambus* and earlier precedent by appearing to make Section 2 monopolization law inapplicable to standard setting conduct.

Qualcomm develops digital wireless communications products based on its code division multiple access (CDMA) digital technology. Broadcom, a semiconductor supplier for wired and wireless communications, alleged that Qualcomm engaged in anticompetitive conduct in the markets for the technology and chipsets that operate cell phones employing wideband CDMA (WCDMA), a third generation technology implemented through a mobile telephone standard known as the universal Mobile Telephone System (UMTS). According to Broadcom (which asserts it needs a license from Qualcomm to compete with its UMTS chipsets), Qualcomm abused the procedures of international (European Technological Standards Institute – ETSI) and U.S. standard setting bodies by failing to license patents deemed essential to WCDMA technology and the UMTS standard, in violation of the SDOs' rules. The standards development bodies adopted the UMTS standard in reliance on Qualcomm's written representation that it would license its patents on FRAND terms.

The precise question (which Qualcomm correctly noted had never been decided by an agency or court) for the court was whether a firm's deceptive inducement of an SDO into adopting a standard by committing to license IP essential to that standard and later, after lock-in has occurred, breaching that commitment by demanding non-FRAND royalties, is actionable anticompetitive conduct under the federal antitrust laws. Citing Supreme Court (*Allied Tube*) and FTC (*Dell*, *Unocal*, *Rambus*) precedent, the Court of Appeals held in the affirmative and applied the following test, listing four necessary elements, for finding such conduct actionable:

> (1) a consensus-oriented private standard-setting environment,
> (2) an intentionally false promise by a patent holder to license essential proprietary technology on FRAND terms,
> (3) reliance by an SDO on that promise when including the technology in a standard, and
> (4) the patent holder's subsequent breach of that promise.

As the court explained, citing *Rambus*, "[d]eception in a consensus-driven private standard-setting environment harms the competitive process by obscuring the costs of including proprietary technology in a standard and increasing the likelihood that patent rights will confer monopoly power on the patent holder."

The appellate court drew a sharp distinction between recent jurisprudence on refusals to deal, especially when supported by intellectual property rights, and mainstream common law and agency precedent in antirust standard setting matters. The district court, in dismissing the action, had characterized the challenged conduct as "a refusal to deal fairly in the wideband CDMA market." As the appellate panel explained, the district court then "rejected this 'basic allegation' as an impermissible attempt to extend the Supreme Court's jurisprudence" on refusals to deal. Based on this logic, the lower court, instead of balancing alleged procompetitive efficiencies with anticompetitive harms under the *Microsoft* test, as the FTC did in *Rambus*, explicitly drew inspiration from *Trinko* on unilateral refusals to deal. If the right to refuse to deal with other companies is not unqualified, the district court said, "the Supreme Court has nonetheless been very cautious in recognizing . . . exceptions because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm." On this authority, and in reliance on Qualcomm's broad IP rights as a patent owner, the court reasoned that "reviewing and supervising the terms upon which Qualcomm licenses its patents and offers to sell its UMTS chipset may be beyond the effective control of the court under the antitrust laws."

For purposes of the motion, the lower court accepted that the SDO had decided on the UMTS standard in reliance on Qualcomm's commitment to license its patents on FRAND terms and that Qualcomm had reneged on its licensing commitment.[2] It also recognized that Qualcomm's "alleged 'inducement' of the [SDO] may be considered anticompetitive conduct in the sense that a false promise biased the [SDO] in Qualcomm's favor, to the detriment of those patent-holders competing to have their patents incorporated into the standard."

Thus, in both *Rambus* and *Qualcomm*, the defendant was deemed to have engaged in deception – either by failing to make the necessary disclosure (*Rambus*) or by falsely inducing the other participants to rely on, and failing to fulfill, its licensing commitment (*Qualcomm*). The FTC found that Rambus's deceptive conduct distorted the standard setting process and enabled it to monopolize the relevant markets by locking in its competitors to a standard which it then controlled through its patents. In *Qualcomm*, even the lower court similarly found that Qualcomm had falsely induced other members of the SDO to choose its technology as the standard in reliance on its licensing commitment. When it became clear that Qualcomm would not honor its commitment, the industry could not turn back; it was locked in to technology which Qualcomm controlled and which made it a monopolist in the relevant market *precisely because* the industry had chosen UMTS as the standard in reliance on Qualcomm's false commitments.

But the district court in *Qualcomm* tacked away from *Rambus* in holding that the false promise was not actionable under antitrust law, even if it may be actionable under another theory, such as breach of contract. The lower court reasoned, in the words of the appellate panel, that Broadcom failed to state a claim for monopolization "because Qualcomm enjoyed a legally-sanctioned monopoly in its patented technology, and . . . this monopoly conferred the right to exclude competition and set the terms by which that technology was distributed."[3] The appellate panel rejected this approach, noting that the

[2] The court thus put aside for purposes of the motion the vexed question of what constitutes FRAND.
[3] This argument calls to mind Microsoft's losing argument (with respect to licensing *not* in a standard setting context) to the Court of First Instance in its appeal of the European Commission's judgment and fine that it had an absolute right to refuse to provide interoperability information to Sun Microsystems because the information was protected by intellectual property rights. Similarly, in the DOJ case against Microsoft, the Court of Appeals considered and (swiftly) rejected the company's contention that copyright

case did *not* involve a refusal to deal (and that Qualcomm itself had "conceded as much" at oral argument).[4]

Next, the lower court had also reasoned that the inclusion of Qualcomm's WCDMA technology in the UMTS standard, even though based on false promises by Qualcomm, did not constitute antitrust harm to competition because the loss or preclusion of competition in this market came about not because of Qualcomm's false inducement, but because the choice of *some* standard inevitably results in the loss of competition. That is, it was the choice of a standard, not Qualcomm's conduct, that resulted in the loss of competition, in the view of the court. But this reasoning collapses as a matter of antitrust analysis because it ignores the difference between competition for the standard on the merits and competition for the standard that has been distorted through deception in a collaborative setting. Thus, as the appellate panel noted, the lower court did not even discuss the possibility that the FRAND commitments that the relevant SDOs required "were intended as a bulwark against unlawful monopoly." As the FTC said in *Rambus*: "We cannot stress too strongly the importance we place on the fact that the challenged conduct occurred in the context of a standard-setting process in which members expected each other to act cooperatively."

To accept the reasoning of the district court in *Qualcomm* would mean accepting that the elimination of competition that inevitably results from the choice of a standard – whatever standard – somehow inoculates from antitrust scrutiny a member's willful distortion of standard setting that has induced other SDO members to select its particular technology as the standard. The fact that competition will inevitably be lost due to a fair selection of a standard does not excuse a loss of competition due to a distortion of the standard setting process, any more than a loss of competition through competition on the merits would excuse a loss of competition through illegal monopolization. It goes without saying that competition will be lost when a standard is chosen. But surely that doesn't preclude the application of antitrust law. The harm to competition that is the focus of antitrust law in these circumstances concerns the integrity of the selection process for the standard, not the loss of competition that naturally results from the choice of a standard. The district court looked through the wrong end of the glass, misconceived the "harm to competition" at issue in standard setting, and was rightly reversed.

As a corollary to this misconception, and to its reliance on *Trinko*, the lower court also read too much into IP rights in the context of SDOs that impose disclosure and licensing restrictions as a condition of participation. The court was clearly correct in saying that "Qualcomm's 'power' to control the licensing of its patents is derived from the rights it enjoys as a patent-holder." After all, a patentee is statutorily entitled to

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conferred an absolute right to place whatever conditions it wanted on its customers' use of the Windows operating system.

[4] It added, however, that even under a refusal to deal analysis, as construed by the latest Supreme Court authority in this area (*Trinko*), it would still find the claims actionable because Qualcomm is alleged to have actively marketed its WCDMA technology for inclusion in an industry-wide standard (analogous to engaging in a voluntary course of prior dealing with its rivals, as required by *Trinko*) and to have voluntarily agreed to license that technology on FRAND terms (as the price for participation in the relevant SDOs).

license on terms of its choosing, or to refuse to license altogether. But the district court painted with too broad a brush in saying that "[t]he adoption of an industry standard neither diminishes nor augments this exclusionary right." First, the exclusionary right is qualified when the patentee submits to a licensing commitment as a condition of its participation in an SDO. Second, as the appellate court put it, the lower court "failed to recognize that even if adoption of the UMTS standard did not expand Qualcomm's exclusionary rights as a patent holder, it nevertheless significantly expanded Qualcomm's *market power* by eliminating alternatives to its patented technology." (Emphasis added.)

A twist on causation

Finally, it should be noted that the appellate decision may suggest a slight change of view in the nature of a plaintiff's burden on causation with respect to antitrust allegations of abuse of standard setting. Litigants in the past, including both Qualcomm and Rambus, have sensibly argued that there can be no antitrust harm from their alleged abuse of the standard setting process (e.g., patent hold-up, as in *Rambus*, or a breach of FRAND commitments, as in *Qualcomm*) if there are no alternative technologies available as choices for the standard – because the choice of the defendant's technology would then be inevitable. In other words, with or without the alleged abuse, the other members of the SDO would have no choice but to select the defendant's technology as the standard – and the plaintiff therefore could not show that it necessarily was the defendant's anticompetitive conduct that caused the choice of its technology as the standard.

Although the burden rests initially with the plaintiff to show plausible alternatives, to counter the argument that the choice of the defendant's technology was inevitable, the appellate court in *Qualcomm* may have opened the door to a slight shading of the conventional causation argument. The logic is as follows: Almost all private SDOs, including those at issue in *Qualcomm*, prohibit their members from selecting as a standard the technology of a firm that does not give a FRAND commitment. Thus, the court states, "even if Qualcomm's WCDMA technology was the *only* candidate for inclusion in the standard, it still would not have been selected by the relevant SDOs absent a FRAND commitment," because their members were prohibited from making such a selection by the SDO rules. (Emphasis added.) That is, the SDO members need not in fact have selected any technology as a standard. In this respect, the choice of Qualcomm's technology was not inevitable because the other SDO members could not have chosen it absent Qualcomm's FRAND commitments.

Of course, however, Qualcomm did make FRAND commitments. Thus, in the absence of alternative technologies, does the logic of the court's point collapse just because a FRAND commitment *has* been given, albeit falsely? Clearly, if members knew in advance that a fellow participant, such as Qualcomm, was going to breach its commitment, they would never select its technology as a standard in the first place. Thus, when a defendant argues that its alleged breach of its FRAND commitment is of no antitrust consequence if there are no alternative technologies, it is effectively arguing that even if it had given no FRAND commitment (which is the logical equivalent of breaching its commitment, at least in the limited sense that a commitment that is breached has no more substance than a commitment not given), the SDO members would still have had no choice but to pick its technology as the standard. But as the appellate court emphasizes, the members are prohibited from selecting technology that is not accompanied by a FRAND commitment. In the court's view, this reasoning (with some extrapolation on the author's part) – along with allegations in the complaint that an SDO's adoption of a standard eliminates competing technologies – defeats the argument that in the absence of alternative technologies, the choice of WCDMA as the standard is inevitable.

Whether deliberately or not, the court may have made plaintiffs' task of establishing causation through the *non*-inevitability of the selection of defendants' technology as the standard somewhat easier, as it may now be enough to note that the SDO members could not have chosen a defendant's technology as the standard if it gave no FRAND commitment, and that the effect of breaching a commitment is the same as giving no commitment at all.

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As the appellate court in *Qualcomm* noted, a consensus has been steadily building on the application of antitrust principles to violations of SDO disclosure and FRAND licensing rules. The appellate court's return to these principles in *Qualcomm* surely strengthens the growing consensus and offers yet another caution to firms about the dangers of breaching SDO disclosure or FRAND obligations.