

Client Alert

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Qualcomm Agrees to \$975 Million Fine and Conduct Remedies to Resolve Chinese Standard Essential Patent Licensing Investigation

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The assertion of standard essential patents (SEPs) by patent-holders has raised patent, contract, and competition issues in jurisdictions around the world. One SEP holder, Qualcomm, has faced particular scrutiny with respect to its licensing practices, which are under investigation by enforcement agencies in the U.S., Europe, and Asia. On February 9, 2015, China's National Development and Reform Commission (NDRC) announced that it had concluded its investigation into Qualcomm's patent licensing practices, with Qualcomm agreeing to pay a \$975 million fine and to several remedial commitments affecting its patent licensing practices in China.

BACKGROUND OF THE NDRC'S INVESTIGATION

The NDRC commenced its investigation of Qualcomm in November 2013, focusing on whether Qualcomm's patent licensing practices constituted abuse of dominance prohibited under China's Anti-Monopoly Law (AML). According to its published statement, the NDRC received information from dozens of Chinese and international mobile phone and baseband chip manufacturers. The NDRC also discussed its investigation with Qualcomm.

THE NDRC'S FINDINGS OF ABUSE OF DOMINANCE

The NDRC concluded that Qualcomm's patent licensing practices violated the AML. It found Qualcomm to be dominant in the markets for CDMA/WCDMA/LTE wireless communication SEPs and for baseband chips. It then found that Qualcomm had abused its dominant position through several practices.

First, the NDRC concluded that Qualcomm charged unfairly high patent royalties by:

- refusing to provide to Chinese licensees a list of the patents for which they were charged royalties;
- charging royalties for certain expired patents;
- demanding Chinese licensees provide royalty-free grant-back licenses under their relevant patents, with no offsets to their royalty payments to Qualcomm; and
- requiring royalties to be based on the selling price of mobile phone handsets.

Second, the NDRC concluded that Qualcomm tied licenses to wireless communication SEPs without justification to licenses to non-SEPs by refusing to license separately SEPs and non-SEPs. The NDRC found that this practice forced some Chinese companies to license non-SEPs from Qualcomm.

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Third, the NDRC concluded that Qualcomm unfairly conditioned supplies of Qualcomm chipsets on agreements not to challenge Qualcomm's patents. Specifically, the NDRC found that Qualcomm required its baseband chip customers to enter into patent license agreements that included a no-challenge clause in order to receive Qualcomm baseband chipsets. Moreover, the NDRC found that Qualcomm refused to supply chipsets to companies that disputed the inclusion of a no-challenge clause in their license agreement or otherwise litigated over patent licensing.

QUALCOMM'S FINE AND PROPOSED "RECTIFICATION PLAN"

Qualcomm agreed to resolve the NDRC's investigation by paying a fine of \$975 million, which equaled 8% of Qualcomm's sales in China in 2013. Qualcomm also proposed a "rectification plan" in which it committed to terms including:

- for licenses of 3G and 4G Chinese SEPs for branded handsets sold for use in China, Qualcomm will charge royalties of 5% for 3G handsets and 3.5% for 4G handsets that do not implement CDMA or WCDMA, basing these royalties on 65% of the handset's wholesale net selling price;
- when licensing to Chinese companies, Qualcomm will license 3G and 4G Chinese SEPs separately from Qualcomm's other patents; and
- Qualcomm will provide Chinese companies a patent list during license negotiations.

In addition, under its proposed rectification plan, Qualcomm committed to cease requiring that Chinese licensees:

- provide royalty-free grant-back licenses under their patents;
- pay royalties on expired patents; and
- agree not to challenge Qualcomm's patents as a condition to Qualcomm's supply of baseband chips.

The NDRC approved Qualcomm's rectification plan, stating that Qualcomm's proposed remedies satisfied its requirements.

KEY TAKEAWAYS

There are several important takeaways from the resolution of the NDRC's Qualcomm investigation.

First, the NDRC did not specify particular conduct remedies. Instead, the NDRC approved the commitments proposed by Qualcomm in its rectification plan as sufficient to satisfy the NDRC's requirements. Thus, the extent to which private litigants may be able to use these commitments in a damages action or otherwise remains unclear.

Second, Qualcomm's commitments in its rectification plan are limited to its activities in China. The commitments apply only to Qualcomm's licensing of Chinese companies and of Chinese SEPs, and the royalty commitments apply only to sales of handsets for use in China. To the extent Chinese companies sell handsets for use outside of China, the commitments do not prevent Qualcomm from charging royalties in excess of the agreed rates and to assess those royalties based on the full wholesale net selling price of such handsets.

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Third, although Qualcomm agreed to cease basing royalties on the full wholesale net selling price of handsets, it committed only to reduce the royalty base to 65% of the wholesale net selling price. Qualcomm did not agree to base royalties on the smallest saleable patent-practicing unit, which is the trend in recent U.S. case law.¹

Finally, Qualcomm also committed to growing its investments in China. It is unclear what this commitment entails, although Qualcomm noted recent examples of its investments in China, including providing engineering support to China's mobile operators in rolling out 4G LTE networks in China, working closely with Chinese handset manufacturers to build their businesses inside and outside of China, expanding its relationship with a Chinese semiconductor foundry, and creating a China-specific investment fund to support the development in China of mobile and semiconductor technologies.²

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¹ See, e.g., *VirmetX, Inc. v. Cisco Sys., Inc.* 767 F.3d 1308, 1326-1328 (Fed. Cir. 2014).

² Press Release, Qualcomm Inc., Qualcomm and China's National Development and Reform Commission Reach Resolution – NDRC Accepts Qualcomm's Rectification Plan – Qualcomm Raises Midpoints of Fiscal 2015 Revenue and Non-GAAP EPS Guidance (Feb. 9, 2015), available at http://files.shareholder.com/downloads/QCOM/3864235320x0x808060/382E59E5-B9AA-4D59-ABFF-BDFB9AB8F1E9/Qualcomm_and_China_NDRC_Resolution_final.pdf.