SECTION 2 MANGLED: FTC V. QUALCOMM ON THE DUTY TO DEAL, PRICE SQUEEZES, AND EXCLUSIVE DEALING

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George Mason University
Law & Economics Research Paper Series

19-21

This paper is available on the Social Science Research Network
at ssrn.com/abstract=3433564

Section 2 Mangled: FTC v. Qualcomm on the Duty to Deal, Price Squeezes, and Exclusive Dealing

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Abstract

Judge Koh handed down a sweeping opinion in May 2019 condemning as antitrust violations many of Qualcomm's business practices related to the royalty rates it charged to license its SEPs. The district court opinion significantly expands the scope of liability for refusals to deal and for non-predatory pricing behavior, further eroding the longstanding symmetrical approach to antitrust enforcement regardless of the kind of property involved.

We find three glaring errors in the district court opinion. First, the court expands the exception to the general rule permitting refusals to deal, as laid out in *Aspen Skiing*, well beyond the outer boundary of Section 2 by applying it to contracts negotiated by Qualcomm over 20 years ago and by inferring the company was willing to sacrifice profits even in the face of evidence that the change in dealing was implemented to *increase* short-term profits. Second, the district court accepted a price squeeze theory—characterized by the FTC as a "tax" on OEMs transacting with Qualcomm's rivals—directly contrary to the Supreme Court's holding in *linkLine*. Third, the court erroneously concluded that Qualcomm's exclusive dealing arrangements with Apple violate the Sherman Act, despite a glaring failure by the FTC to prove substantial

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foreclosure, contrary to modern antitrust precedent and economic theory, both of which make crystal clear that proof of substantial foreclosure is necessary to showing an anticompetitive effect from exclusive dealing.

The district court's inappropriate extension of antitrust liability in three separate areas of well-settled antitrust doctrine is remarkable and threatens to upend important precedent that has successfully guided business conduct for years. Further, the remedy—aside from putting the nation's security at risk and potentially undermining U.S. leadership in 5G technology and standard-setting—transforms the role of antitrust courts from adjudicators to central planners, a role for which the *Trinko* Court expressly stated they are ill suited. The decision invites plaintiffs to use the Sherman Act to reach conduct that has been generally shielded from antitrust liability. That invitation is ill advised and should be rejected by the Ninth Circuit, and if necessary, the Supreme Court.

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Introduction

Continuing the misguided trend of using antitrust law to intervene in contract disputes between sophisticated parties negotiating over intellectual property rights, Judge Koh handed down a sweeping opinion in May 2019 condemning as antitrust violations many of Qualcomm's business practices related to the royalty rates it charged to license its SEPs.[1] Though the case was brought by the Federal Trade Commission ("FTC") under Section 5 of the FTC Act, the district court concluded that Qualcomm's practices violate both Section 1 and Section 2 of the Sherman Act. The district court opinion significantly expands the scope of liability for refusals to deal and for non-predatory pricing behavior, further eroding the longstanding symmetrical approach to antitrust enforcement regardless of the kind of property involved.[2]

We find three glaring errors in the district court opinion. First, the court expands the exception to the general rule permitting refusals to deal, as laid out in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,[3] well beyond the outer boundary of Section 2 by applying it to contracts negotiated by Qualcomm over 20 years ago and by inferring the company was willing to sacrifice profits even in the face of evidence that the change in dealing was implemented to *increase* short-term profits. This expansion is squarely in conflict with the Supreme Court's decision in *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, which clarified and narrowed *Aspen Skiing* and reinforced the importance of a company's right freely to decide with whom to transact.[4] Companies that transact with rivals will face new and perilous uncertainty as to whether seemingly legitimate and profit-maximizing business decisions will be challenged and condemned. If the district court's holding is not repudiated on appeal, then the obvious consequence will be for companies to be deterred from much innocent and potentially procompetitive business conduct, and mutually beneficial partnerships with competitors will more often be foregone.

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[1] FTC v. Qualcomm Inc., No. 17-cv-00220-LHK, 2019 U.S. Dist. LEXIS 86219, at *254 (N.D. Cal. May 21, 2019).

[2] *See* Joshua D. Wright & Douglas H. Ginsburg, *Whither Symmetry? Antitrust Analysis of Intellectual Property Rights at the FTC and DOJ*, 9 COMPETITION POL'Y INT'L 41, 44–45 (2013).

[3] 472 U.S. 585 (1985).

[4] 540 U.S. 398 (2004).

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A second and particularly troublesome error in the district court's opinion is the acceptance of a price squeeze theory directly contrary to the Supreme Court's holding in *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*[5] By characterizing an alleged price squeeze as a "tax" on original equipment makers ("OEMs") transacting with Qualcomm's rivals, the FTC persuaded the district court that this theory or harm was not precluded by *linkLine*, which rejected price squeeze claims as non-cognizable under Section 2 absent showing both a duty to deal and predatory pricing. By accepting the FTC's rebranding of a price squeeze as a "tax," the district court allowed the FTC to circumvent the Supreme Court's prohibition on price squeeze claims and inappropriately created a liability standard that improperly punishes Qualcomm for monetizing its intellectual property. If affirmed, the district court's opinion threatens to untether antitrust from economic analysis and to undercut the predictability previously provided by *linkLine*.

Third, the district court's opinion erroneously concludes that Qualcomm's exclusive dealing arrangements with Apple violate the Sherman Act, despite a glaring failure by the FTC to prove substantial foreclosure. This holding is in tension with modern antitrust precedent and economic theory, both of which make crystal clear that proof of substantial foreclosure is necessary to showing an anticompetitive effect from exclusive dealing. Rather than attempt to measure foreclosure, the district court rested its analysis of Qualcomm's exclusive dealing arrangements solely upon the fact that Apple was a significant and strategically important customer for chip suppliers. But modern antitrust analysis requires plaintiffs to substantiate their claims with more than just theory or scant evidence that rivals have been harmed. The district court's findings fall far short of that standard and cannot withstand scrutiny on appeal to the Ninth Circuit, which has repeatedly required plaintiffs challenging exclusive dealing arrangements to show substantial foreclosure of the market.

The district court's inappropriate extension of antitrust liability in three separate areas of settled antitrust doctrine is remarkable and has drawn significant attention and criticism from antitrust enforcers from both U.S. agencies. One sitting Commissioner of the FTC has characterized the decision as a "dangerous antitrust overreach."[6] The Antitrust Division of the Department of Justice has filed an amicus brief with the Ninth Circuit in support of Qualcomm's

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[5] 555 U.S. 438 (2009).

[6] Christine Wilson, *A Court's Dangerous Antitrust Overreach*, WALL ST. J. (May 28, 2019), https://www.wsj.com/articles/a-courts-dangerous-antitrust-overreach-11559085055.

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motion for a partial stay of the district court ruling, stating that the court's opinion "threatens competition, innovation, and national security[,] . . . misapplie[s] Supreme Court precedent, and its remedy is unprecedented."[7] These criticisms are well founded, as the district court opinion portends to upend important and well-settled doctrine that has successfully guided business conduct for years. Further, the remedy—aside from putting the nation's security at risk and potentially undermining U.S. leadership in 5G technology and standard-setting—transforms the role of antitrust courts from adjudicators to central planners, a role for which the *Trinko* Court expressly stated they are ill suited.[8]

I. The District Court Incorrectly Interprets the Narrow *Aspen Skiing* Exception to Impose a General Duty to Deal upon Competitors, Contrary to *Trinko* and Longstanding Section 2 Law

A foundational tenet of U.S. antitrust law is that a firm does not have a duty to deal with its rivals.[9] The Supreme Court reiterated this principle as recently as 2004 in the case of *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*.[10] In that case, a unanimous Court refused to add "to the few existing exceptions from the proposition that there is no duty to aid competitors."[11] Accepting that, absent a duty to deal with rivals, a firm may be able to earn monopoly profits "at least for a time," the *Trinko* decision makes quite clear that imposing a general duty to deal would outweigh the benefits:

> Firms may acquire monopoly power by establishing an infrastructure that renders them uniquely suited to serve their customers. Compelling such firms to share the source of their advantage is in some tension with the underlying purpose of antitrust law, since it may lessen the incentive for the monopolist, the rival, or both to invest in those economically beneficial facilities.

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[7] United States' Statement of Interest Concerning Qualcomm's Motion for Partial Stay of Injunction Pending Appeal at 11, FTC v. Qualcomm Inc. (9th Cir. 2019) (No. 19-16122).
[8] *Trinko*, 540 U.S. at 408.
[9] United States v. Colgate & Co., 250 U.S. 300, 307 (1919) (noting that the Sherman Act "does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.").
[10] 540 U.S. 398 (2004).
[11] *Id.* at 411.

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> Enforced sharing also requires antitrust courts to act as central planners, identifying the proper price, quantity, and other terms of dealing—a role for which they are illsuited [sic]. Moreover, compelling negotiation between competitors may facilitate the supreme evil of antitrust: collusion. Thus, as a general matter, the Sherman Act "does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal."[12]

The *Trinko* Court acknowledged that "[t]he high value that we have placed on the right to refuse to deal with other firms does not mean that the right is unqualified."[13] The Court left intact the limited exception to the freedom afforded to firms to deal with whom they please carved out in *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*,[14] but located it, "at or near the outer boundary of Section 2."[15] The district court's analysis in *FTC v. Qualcomm Inc.* relies primarily upon the *Aspen Skiing* exception to find Qualcomm in violation of Section 2. To understand her error in doing so, we must begin by exploring the particular facts that supported an antitrust duty to deal in *Aspen Skiing*, and the nature of the exception.

In 1962, the three companies that operated the three major downhill skiing areas in Aspen, Colorado began offering an all-Aspen pass that allowed the purchaser to ski all three of their mountains.[16] The original all-Aspen pass included six coupons, each of which was redeemable for a daily lift ticket at any of the three mountains, and was often offered for a discount from the price of six daily tickets.[17] In 1964, defendant Aspen Ski Co. ("Ski Co.") purchased one of the other two resorts and began offering multi-area passes to skiers for its two mountains in competition with the all-Aspen pass that allowed skiers also to ski the plaintiff Aspen Highlands' mountain.[18] Ski Co.'s pass was more popular

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[12] *Id.* at 407-08 (quoting United States v. Colgate & Co., 250 U.S. 300, 307 (1919).

[13] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 601 (1985).

[14] *See generally id.*

[15] *Trinko*, 540 U.S. at 409.

[16] *Aspen Skiing*, 472 U.S. at 589.

[17] *Id.* at 589.

[18] *Id.* at 590.

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than the all-Aspen pass until Ski Co. opened a fourth mountain in 1967; all-Aspen passes then began to outsell Ski Co.'s multi-area passes.[19]

Ski Co. and Aspen Highlands split revenues from the sale of the all-Aspen passes in accordance with the number of coupons collected at each mountain.[20] This tracking method was complicated during the 1971-1972 season, when the companies replaced the coupon booklets with a pass that skiers could wear around their necks because the companies could no longer just count the number of coupons redeemed at each mountain.[21] From 1973 to 1977, the companies used various methods to track how many skiers using the pass visited each mountain and continued to split revenues proportionately.[22] In 1977, Ski Co. informed Aspen Highlands it would continue offering the all-Aspen pass only if Aspen Highlands agreed to accept a fixed share of revenues from ticket sales.[23] Aspen Highlands was unhappy with this new method of allocating revenue but ultimately agreed to accept a fixed percentage out of fear that not doing so would cause Ski Co. to eliminate altogether the all-Aspen pass.[24] The next year, as feared, Ski Co. did discontinue the all-Aspen pass by offering Aspen Highlands a fixed percentage of the revenues so low it knew Aspen Highlands would not accept.[25]

Ski Co. then launched a national advertising campaign marketing a pass covering only its own three mountains, strongly implying its mountains were the only ones in the Aspen area.[26] Ski Co. refused to sell Aspen Highlands any lift tickets for its three mountains, even at the full retail price, so that Aspen Highlands could not use them to offer a four-mountain pass that would include its mountain.[27] Aspen Highlands nonetheless attempted to offer skiers a pass that included three days of access to its mountain and three vouchers that were each valued at the price of a daily lift ticket at Ski Co.'s mountains. Ski Co. refused to accept the vouchers so Aspen Highlands decided to replace the vouchers with traveler's checks or money orders, which Ski Co. ultimately

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[19] *Id.* at 589-90.
[20] *Id.* at 589.
[21] *Id.* at 590.
[22] *Id.* at 590-91.
[23] *Id.* at 591.
[24] *Id.* at 592.
[25] *Id.* at 592-92.
[26] *Id.* at 593.
[27] *Id.*

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accepted in exchange for daily lift tickets. But Aspen Highlands' pass "met considerable resistance from tour operators and consumers who had grown accustomed to the convenience and flexibility provided by the all-Aspen ticket."[28] Aspen Highlands' market share for downhill skiing and ancillary ski services declined sharply from 1977 to 1981, following elimination of the all-Aspen pass.[29]

Taking all these facts together, the Supreme Court concluded that Ski Co.'s conduct ran afoul of Section 2. Most persuasive to the Court was the fact that Ski Co.'s decision to eliminate the all-Aspen pass made "an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years" and that Ski Co. "was willing to sacrifice short-run benefits and consumer goodwill in exchange for a perceived long-run impact on its smaller rival."[30] As to the first, the Court emphasized that the all-Aspen pass continued to be offered for a while after the market consolidated to two resort operators and after the fourth mountain was opened. As those market changes occurred, demand for the all-Aspen pass increased relative to demand for Ski Co.'s multi-area pass for its three mountains, indicating that skiers preferred to have access to the Aspen Highlands mountain along with Ski Co.'s mountains.[31] The Court therefore concluded that elimination of the all-Aspen pass adversely affected consumers as well as Aspen Highlands.[32]

Most significant to the Court, however, was Ski Co's profit sacrifice. In particular, the Court relied upon evidence that Ski Co. was willing to sacrifice daily ticket sales both to skiers who wanted to redeem lift tickets using the vouchers issued by Aspen Highlands and to skiers who would have purchased Ski Co. lift tickets if Ski Co. would have sold them to Aspen Highlands.[33] The Court determined the jury "may well have concluded that Ski Co. elected to forgo these short-run benefits because it was more interested in reducing competition in the Aspen market over the long run by harming its smaller competitor."[34] The Court concluded the evidence was sufficient to demonstrate that Ski Co.'s conduct was [1] "motivated entirely by a decision to avoid

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[28] *Id.* at 594.

[29] *Id.* at 594-95.

[30] *Id.* at 603, 610-11.

[31] *Id.*at 606. Expert testimony and anecdotal evidence also supported this inference.

[32] *Id.* at 606-07.

[33] *Id.* at 608.

[34] *Id.*

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providing any benefit to Highlands even though accepting [Aspen Highlands' vouchers] would have entailed no cost to Ski Co. itself, [2] would have provided it with immediate benefits, and [3] would have satisfied its potential customers," and was therefore an attempt to monopolize the market in violation of Section 2 of the Sherman Act.[35]

Since the Supreme Court's decision in *Aspen Skiing*, antitrust scholars have grappled with exactly what are the necessary conditions to proving a Section 2 claim based upon a refusal to deal; in particular, must the plaintiff show the defendant terminated a prior course of dealing, evidence of profit sacrifice, both of those factors, or something additional?[36] Lower courts have continued to develop and refine the doctrine, clarifying *Aspen Skiing* in the light shed by *Trinko*. Several circuits have held that termination of a profitable prior course of dealing is a necessary element of a Section 2 refusal to deal claim.[37] Other circuits have gone a step farther, requiring plaintiffs also to prove profit sacrifice in order to state a claim.

Most relevant to Qualcomm's appeal, the Ninth Circuit has held "there is only a duty not to refrain from dealing *where the only conceivable rationale or purpose* is 'to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition.'"[38] In an opinion authored by now Justice Gorsuch, the Tenth Circuit held in *Novell, Inc. v. Microsoft Corp.* that plaintiffs alleging an anticompetitive refusal to deal must show termination of a voluntary and profitable relationship, short-term profit sacrifice, *and* evidence that the monopolist's refusal to deal "was part of a larger anticompetitive

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[35] *Id.* at 610-11.

[36] *See* Susan A. Creighton & Jonathan M. Jacobson, *Twenty-Five Years of Access Denials*, 27 ANTITRUST 50, 51-52 (2012); Gregory J. Werden, *Identifying Exclusionary Conduct Under Section 2: The "No Economic Sense" Test*, 73 ANTITRUST L.J. 413 (2006); A. Douglas Melamed, *Exclusionary Conduct Under the Antitrust Laws: Balancing, Sacrifice, and Refusals To Deal*, 20 BERKELEY TECH. L.J. 1247 (2005); Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253 (2003); Dennis W. Carlton, *A General Analysis of Exclusionary Conduct and Refusals To Deal — Why* Aspen *and* Kodak *Are Misguided*, 68 ANTITRUST L.J. 659 (2001).

[37] *See In re* Elevator Antitrust Litig., 502 F.3d 47, 54 (2d Cir. 2007); Covad Commc'ns Co. v. Bell Atl. Corp., 398 F.3d 666, 673 (D.C. Cir. 2005); Covad Commc'ns Co. v. BellSouth Corp., 374 F.3d 1044, 1049 (11th Cir. 2004).

[38] Aerotec International, Inc. v. Honeywell International, Inc., 836 F.3d 1171, 1183-84 (9th Cir. 2016) (quoting MetroNet Services Corp. v. Qwest Corp., 383 F.3d 1124, 1184 (9th Cir. 2004) (emphasis added).

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enterprise, such as (again) seeking to drive a rival from the market or discipline it for daring to compete on price."[39] Citing *Trinko*, the court explained that the "point of the profit sacrifice test is to isolate conduct that has *no* possible efficiency justification."[40]

The Ninth Circuit first confronted the precise bounds of *Aspen Skiing* shortly after the Supreme Court had decided *Trinko.* In *MetroNet Services Corp. v. Qwest Corp.*,[41] the court considered conduct "similar in certain respects" to the behavior condemned in *Aspen Skiing* and concluded that the case at hand did not "fit comfortably in the *Aspen Skiing* mold" because the "circumstances that [the *Trinko* Court] found significant for creating antitrust liability [were] not present."[42] The court identified those significant factors as: (1) the unilateral termination of a voluntary and profitable course of dealing; (2) Ski Co.'s refusal to sell tickets to Aspen Highlands *even if compensated at the retail price*, suggesting a calculation that its future monopoly retail price would be higher; and (3) Ski Co.'s refusal to provide to its competitor a product that it sold at retail to other customers.[43] The district court contends the analysis in *Qualcomm* is consistent with *MetroNet*, and that Qualcomm's refusal to license its SEPs to rival modem chipmakers satisfies all three factors relevant to the antitrust duty to deal.[44]

a. Termination of a Voluntary and Profitable Course of Dealing

The district court opinion plainly states that "because Qualcomm previously licensed its rivals, but voluntarily stopped licensing rivals even though doing so was profitable," Qualcomm's behavior satisfies the first element required to find liability: termination of a previously profitable course of dealing.[45] To support this finding, the opinion cites agreements between Qualcomm and rival chipmakers from the 1990s, which were negotiated under a different technology standard.[46] The district court's analysis expands significantly the set of previously negotiated contracts that might be subjected ex

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[39] 731 F.3d 1064, 1074-75 (10th Cir. 2013).
[40] *Id.* at 1077.
[41] 383 F.3d 1124 (9th Cir. 2004).
[42] *Id.* at 1132.
[43] *Id.* at 1132-33.
[44] FTC v. Qualcomm Inc., No. 17-cv-00220-LHK, 2019 U.S. Dist. LEXIS 86219, at *254 (N.D. Cal. May 21, 2019).
[45] *Id.* at *254-55.
[46] *Id.* at *255.

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post to a duty to deal by relaxing the showing required to support an inference of "profit sacrifice."

Recall that the *Aspen Skiing* Court found it significant that the terminated course of dealing constituted "an important change in a pattern of distribution that had originated in a competitive market and had persisted for several years" as the character of the market changed.[47] The fact that a course of dealing emerges in a competitive market and persists for years strengthens the inference that the course of dealing itself is profitable. Without more, of course, one cannot establish that terminating that course of dealing is profitable because market conditions might have changed. Thus, the strength of the profit sacrifice inference arises from confidence that (1) the initial course of dealing was actually profitable, and (2) its termination arises exclusively from seeking to acquire monopoly power and not from the firm's adaptation to a change in market conditions. The district court opinion, however, fails to identify a terminated course of dealing during the time Qualcomm was providing chips and licenses that implemented either of the two technology standards under which the FTC alleges Qualcomm "strangled competition"—the CDMA and premium LTE modem chip markets.[48]

Indeed, the prior dealings relied upon by the district court occurred more than ten years before any of the alleged anticompetitive refusals to deal identified by the district court, except in two instances (in which both refusals occurred at least five years after the prior dealings identified by the court).[49] Qualcomm's decision to change its business model and the subsequent refusal to license rival chipmakers is not even remotely analogous the conduct found to be anticompetitive in *Aspen Skiing*, where the terminated course of dealing resulted in immediate harm both to Aspen Highlands and to consumers. The immediacy of the effect of the terminated course of dealing in *Aspen Skiing* supports the inference that the refusal to deal, as opposed to other intervening events, was the cause of any harm to competition. In contrast, the allegedly unlawful prior course of dealing in *Qualcomm* ended long before anyone claimed it had any such

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[47] Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 603 (1985).

[48] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *397.

[49] *Id.* at *255 (citing a 1999 email between Qualcomm employees showing the company then licensed rival chipmakers); *see also id*. at *212-230 (summarizing Qualcomm's later refusal to license chipmakers MediaTek in 2008, Project Dragonfly in 2011, Samsung in 2011, Intel in 2004 and 2009, HiSilicon in 2009, LGE in 2015, and Samsung in 2009 and 2018).

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impact. The significant latency between the allegedly anticompetitive refusal to deal and any anticompetitive effect undermines the inference underlying the economic logic in *Aspen Skiing* because it is much more likely that events other than the terminated course of dealing impacted Qualcomm's rivals.

Putting aside the obvious fact that the prior course of dealing contrived by the district court hardly resembles anything close to the joint venture that lasted more than a decade in *Aspen Skiing*, the Ninth Circuit in *MetroNet* concluded that a firm's refusal to continue dealing with its rival does not meet *Trinko*'s standard if the defendant was merely "attempting to increase its short-term profits."[50] As the district court opinion acknowledges several times, Qualcomm's explicit reason for ceasing to license its SEPs to chipmakers in favor of licensing them only to OEMs was that doing so was "humongously more lucrative."[51] Qualcomm decided to stop separately licensing OEMs and their component suppliers (e.g., modem chipmakers) because it concluded licensing only at the device-level was more efficient and more profitable. Smartphones assembled by OEMs practice both patents that are infringed by modem chips and patents that are infringed only by the complete device, and Qualcomm realized it would be very costly and complicated to identify and come to an agreement with each OEM on which patents would be practiced by which components or combinations of components or by the OEM's entire phone.

Because of the efficiencies generated from a device-level licensing model, it has become the longstanding industry practice of all major licensors of patents used in smartphones—including Nokia and Ericcson—to issue comprehensive licenses to OEMs and not to chipmakers. Qualcomm implemented the change to allow the company to better protect and recover the value of its patent portfolio—not as a mechanism to exclude its rivals, as in *Aspen Skiing*. The court's conclusion that Qualcomm's conduct satisfies the first factor necessary for a refusal to deal to occasion antitrust liability, namely "profit sacrifice," cannot be reconciled with the Ninth Circuit's holding that shifting away from an established course of dealing in an attempt to increase short-term profits "sheds no light upon whether [a defendant] was prompted not by competitive zeal but by anticompetitive malice."[52]

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[50] MetroNet Services Corp. v. Qwest Corp., 383 F.3d 1124, 1132 (9th Cir. 2004).
[51] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *231.
[52] *MetroNet*, 383 F.3d at 1132 (quoting Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 409 (2004)) (internal quotations omitted).

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b. Refusing to Provide Products at Retail Price, Suggesting a Motivation of Anticompetitive Malice

The district court similarly concluded Qualcomm's refusal to license its SEPs to rival chipmakers reveals an anticompetitive malice, as in *Aspen Skiing*.[53] But *Aspen Skiing*, *Trinko*, and *MetroNet* make clear that the question of anticompetitive malice turns upon the willingness to sacrifice short-term profits in hopes of later obtaining higher profits when the competitor has been run out of the market.[54] Qualcomm's pursuit of sales that combined chip sales and patent license royalties was profitable in the short run; there was no sacrifice of profits. As the district court itself noted, licensing to OEMs rather than chipmakers allowed Qualcomm to avoid patent exhaustion and ensure that those who practiced its patented inventions actually paid for them.[55] Therefore, *Trinko* does not permit an inference that "anticompetitive malice" rather than "competitive zeal" was the driving force behind Qualcomm's decision to stop licensing rival chipmakers.

MetroNet correctly focused upon this simple inquiry: Did the firm forsake short-term profits to achieve an anticompetitive end? The long and short of the analysis thus comes down to whether Qualcomm's changing its business model by switching to device-level licensing sacrificed profits that could be recouped only in the long term after rival chipmakers were driven out of the market. The district court unequivocally found that Qualcomm decided to stop licensing its SEPs to chipmakers because it was more lucrative to license only to OEMs.[56] The conclusion that Qualcomm's conduct meets the legal standard required under *Aspen Skiing*—a standard that has been carefully limited by the Supreme Court

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[53] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *256-57.

[54] *See Trinko*, 540 U.S. at 409 (The unilateral termination of a voluntary (*and thus presumably profitable*) course of dealing suggested a willingness to forsake short-term profits to achieve an anticompetitive end. Similarly, the defendant's unwillingness to renew the ticket *even if compensated at retail price* revealed a distinctly anticompetitive bent.") (internal citations omitted); *MetroNet*, 383 F.3d at 1132 (citing Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585, 608 (1985)) ("Similar to the unilateral termination of a prior profitable course of dealing, the defendant's refusal to sell to the plaintiff at the prevailing retail price, in the Court's view, indicated a willingness to sacrifice short-term benefits in order to obtain higher profits in the long run from the exclusion of competition.").

[55] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *257-59.

[56] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *237-38.

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and subsequently applied with equal care by the Ninth Circuit—simply cannot be reconciled with the district court's findings.

The *Trinko* Court clearly stated that *Aspen Skiing* "is at or near the outer boundary of § 2 liability."[57] Companies therefore may still be held liable for refusing to deal if a plaintiff is able to prove facts similar to the facts of that case, but the Supreme Court has "been very cautious in recognizing such exceptions, because of the uncertain virtue of forced sharing and the difficulty of identifying and remedying anticompetitive conduct by a single firm."[58] The district court, however, appears to have thrown the Supreme Court's caution to the wind. *FTC v. Qualcomm* does precisely what a unanimous Court refused to do in *Trinko*—create a new, broader exception to the proposition that there is no duty to deal with competitors.[59] The district court expands *Aspen Skiing* well beyond the "outer boundary" of Section 2 by applying it to all contracts previously negotiated by the defendant firm and by inferring the firm was willing to sacrifice profits even in the face of evidence the firm had changed its business model to *increase* current profits.

If affirmed, the district court decision will have substantial adverse consequences. First and foremost, the longstanding and well-settled refusal-to-deal doctrine will be significantly compromised. Though courts have found liability for refusals to deal only in rare circumstances, the *Trinko* Court reinforced the importance of a company's right freely to decide with whom to transact—a right recognized in enforcement of the Sherman Act for over a century.[60] Expanding the narrow exception recognized in *Aspen Skiing*, after the Supreme Court had instead narrowed it so dramatically in *Trinko*, will create a perilous uncertainty for companies seeking only to make legitimate profit-increasing—not profit sacrificing—business decisions.

That uncertainty, combined with the risk of treble damages, will undoubtedly deter much innocent and procompetitive business conduct. Particularly troublesome in this regard is the district court's conclusion that

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[57] *Trinko*, 540 U.S. at 409.

[58] *Id.* at 408.

[59] *Id.* at 411.

[60] United States v. Colgate & Co., 250 U.S. 300, 307 (1919) (noting that the Sherman Act "does not restrict the long recognized right of [a] trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal.")

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Qualcomm's dealings with rival chipmakers that ended long ago provide the requisite prior course of dealing required by *Trinko*. This invites a new wave of private antitrust litigation initiated by virtually any company that has ever transacted with a rival that subsequently decides, for whatever legitimate reason, to discontinue the relationship.

II. FTC's "Tax" Theory is a Poorly Disguised Price Squeeze Theory and is Prohibited by *linkLine*

The district court's adoption of the FTC's "tax" theory of harm as a cognizable antitrust claim is equally untenable. What the FTC strains to characterize as a "tax" is analytically identical to a price squeeze. A price squeeze occurs where a vertically integrated firm sells inputs to its upstream competitors at high prices, and to downstream consumers at low prices, resulting in upstream competitors that are "squeezed" out of the downstream market because the high prices charged for the input make it impossible to operate profitably in the downstream market.[61]

The FTC's price squeeze theory of harm is that Qualcomm's shift from licensing rival chipmakers to requiring OEMs to obtain comprehensive licenses, covering both patents that are infringed by modem chips and system-level patents that are infringed only by the complete device, changed its pricing incentives. According to the FTC, Qualcomm's device-level licensing model (which requires OEMs seeking to purchase Qualcomm chips also to obtain a license covering the patented technology embedded in those chips) has allowed Qualcomm to charge OEMs a higher royalty rate that "operates as a 'tax' that raises OEMs' costs of using [chips] supplied by Qualcomm's competitors [which also practice Qualcomm's patented technology], reduces demand for competitors' [chips], and reduces the ability and incentive of competitors to invest and innovate."[62] Specifically, the FTC complaint alleges:

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[61] *See* PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 767c (2007 Supp.); *see also* Jonathan M. Jacobson & Valentina Rucker, *Whither Price Squeeze Antitrust?*, GLOBAL COMPETITION POL'Y (Jan. 2008), https://www.competitionpolicyinternational.com/assets/0d358061e11f2708ad9d62634c6c40ad/Jacobson%20&%20Rucker,%20GCP%20Jan-08(1).pdf.

[62] Complaint at 19, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal. May 21, 2019) (No. 17-cv-00220-LHK).

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> When evaluating handset designs, OEMs consider the all-in cost of a [chip], consisting of both (i) the nominal price of the [chip]; and (ii) any patent royalties that the OEM must pay to use that [chip] in a handset. Qualcomm's tax, by raising the latter cost component, increases the all-in cost to an OEM of using a competitor's [chip], and thus weakens the competitive constraint on Qualcomm's own all-in [chip] price. By raising OEMs' all-in costs of using competitors' [chips], the tax diminishes OEMs' demand for those [chips] and reduces competitors' sales and margins.[63]

The district court held the royalties Qualcomm charges OEMs are "unreasonably high" and impose an "artificial and anticompetitive surcharge" on the price of rivals' chips that prevented rival chipmakers from charging as much as they otherwise could.[64] The Supreme Court rejected price squeeze claims as non-cognizable under Section 2 of the Sherman Act in *Pacific Bell Telephone Co. v. linkLine Communications, Inc.*[65] The FTC's attempt to rebrand a margin squeeze as a "tax" does not alter the fundamental nature of the claim, nor should it be sufficient to evade *linkLine*'s holding that, absent a duty to deal and predatory pricing, "a firm is certainly not required to price . . . in a manner that preserves its rivals' profit margins."[66]

The FTC's economic expert illustrated the tax theory using the following hypothetical:[67] An OEM, which must purchase both a chip and a license in order to manufacture and sell mobile devices (such as smartphones), is willing to pay $40 for both the chip and the license. Suppose a rival chipmaker's cost of manufacturing a chip is $5 and the FRAND royalty rate for the patent license is $10. Taking into account those $15 of costs, the gains from trade for a transaction with the rival chipmaker is $40 – $15 = $25. If the gains from trade are split equally between the OEM and the rival chipmaker, the OEM will pay Qualcomm the $10 royalty, purchase a chip from the rival for $17.50, and realize $12.50 in surplus; the rival chipmaker's gain from trade is the margin of $12.50 it receives in excess of its cost of $5. Suppose Qualcomm then increases the royalty rate to

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[63] *Id.* at 20.

[64] FTC v. Qualcomm Inc., No. 17-cv-00220-LHK, 2019 U.S. Dist. LEXIS 86219, at *84 (N.D. Cal. May 21, 2019).

[65] 555 U.S. 438 (2009).

[66] *Id.* at 452.

[67] *See* Transcript of Record at 1130-32, 1135-37, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal., Jan. 15, 2019) (No. 17-cv-00220-LHK).

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the OEM from $10 to $20. The gains from trade for a transaction with the rival chipmaker are reduced from $25 to $15. This time, splitting the gains from trade equally between the OEM and the rival chipmaker yields a $20 royalty rate paid to Qualcomm, $12.50 paid to the rival chipmaker (which now receives a reduced margin of $7.50), and buyer surplus of $7.50 for the OEM.

The consequences of the above hypothetical, according to the FTC, are that the "all-in" cost to OEMs of using a rival chipmakers' chip is increased and OEM demand for rival chipmakers' chips is therefore diminished.[68] By increasing OEMs' costs, Qualcomm is effectively reducing rival chipmakers' sales and margins, and weakening their competitive constraint on Qualcomm's own "all-in" chip price. Additionally, this "tax" allegedly diminishes rival chipmakers' ability and incentive to invest and innovate because they "must ship substantial volumes of [chips] and earn significant margins on those shipments to sustain the research and development required to maintain a viable business."[69]

Taking the FTC's theory on its face as a cognizable antitrust claim yields testable implications: we should see (1) higher royalty rates for Qualcomm, (2) reduced innovation by all chipmakers (including Qualcomm), and for chipmakers other than Qualcomm, (3) lower margins, and (4) lower output and/or higher prices. The record, however, is completely devoid of any evidence supporting any of the outcomes expected to result from Qualcomm's conduct under the FTC's theory of harm. Evidence (both in the record and at large) overwhelmingly supports the contrary—namely, the industry has been characterized by declining prices, increased output, increased innovation, and quality improvements.[70] Although the FTC's expert did not quantify the "royalty surcharge" allegedly imposed by Qualcomm, the company's expert presented evidence that royalty rates remained constant over time.[71] The district court's

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[68] Complaint at 20, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal. May 21, 2019) (No. 17-cv-00220-LHK).

[69] *Id.*

[70] *See* Transcript of Record at 1902, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal., Jan. 15, 2019) (No. 17-cv-00220-LHK).

[71] *Id.* at 1882-1886; *see also* Joshua D. Wright et al., Comment of the Global Antitrust Institute, George Mason University School of Law, on the Korea Fair Trade Commission's Amendment to Its Review Guidelines on Unfair Exercise of Intellectual Property Rights at 13 (Jan. 3, 2016), https://www.law.gmu.edu/assets/files/publications/working_papers/1601.pdf.

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conclusion that the FTC's theory of harm is supported as a matter of fact by record evidence is therefore unsustainable.

Regardless of whether the FTC's theory fails as a matter of fact—which we believe it clearly does—it certainly fails as a matter of law under *linkLine*. An examination of the facts in that case is instructive. By way of background, AT&T sold Digital Subscriber Line ("DSL") service at both the wholesale and retail levels; it provided other Internet Service Providers ("ISPs") with wholesale DSL transport service and sold DSL service directly to consumers at retail.[72] Four ISPs brought suit against AT&T, alleging that AT&T squeezed their profit margins by setting a high wholesale price for DSL transport and a low retail price for DSL Internet service.[73] In assessing the plaintiffs' claims about the competitive consequences of AT&T's high wholesale prices, the Supreme Court left no doubt because AT&T had no duty to deal with it plaintiffs at all it had "no obligation to deal under terms and conditions favorable to its competitors."[74] Indeed, the Court said, "[i]f AT&T had simply stopped providing DSL transport service to the plaintiffs, it would not have run afoul of the Sherman Act."[75] Regarding AT&T's low retail prices, the Supreme Court held that in order to prevail, the plaintiffs needed to satisfy the *Brooke Group* test for price predation, *viz*.,—prove the defendant's prices were below its cost and it had a dangerous probability of later being able to recoup the resulting losses.[76] Thus, the FTC's "tax" theory cannot stand on the basis of a price squeeze. It can only be salvaged if it independently satisfies the conditions for violating an antitrust duty to deal or predatory pricing under *Brooke Group*.

As previously discussed, however, Qualcomm did not have a duty to deal with rival chipmakers. Therefore, the FTC's tax theory is applicable only if Qualcomm could simultaneously raise its license price above competitive levels, lower the price of its chips to levels below "the relevant measure of cost" under *Brooke Group (*thus reducing demand for rivals' chips and driving rivals below the scale at which an equally efficient competitor could constrain its "monopoly power"), and recoup any profits lost from that price reduction. The district court, however, does not make any of the requisite findings to support such a

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[72] Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc., 555 U.S. 438, 443 (2009).

[73] *Id.* at 443.

[74] *Id.* at 450-51.

[75] *Id.* at 451.

[76] *Id.* at 451.

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claim,[77] despite the FTC's claims that "Qualcomm's tax, by raising the [patent royalty] cost component, increases the all-in cost to an OEM of using a competitor's [chip], and thus weakens the competitive constraint on Qualcomm's own all-in [chip] price."[78] And the FTC did not even allege predatory pricing; in fact, the hypothetical transaction above which the FTC's expert walked through at trial to illustrate this theory of harm assumed above-cost prices.[79]

The FTC has argued that *linkLine* is inapposite here because "this case concerns Qualcomm's threatened withholding of monopolized modem chips to raise the costs of rival chip suppliers" and the "findings of coercion and conditioning that are central to the district court's decision here were absent in *linkLine*, in which the defendant[] set prices for [its] wholesale and retail offerings independently of one another."[80] But the Court in *linkLine* made no reference to pricing wholesale and retail services "independently." Indeed, limiting the Court's holding to vertically integrated firms that price at each level independently as if they were not integrated would make no economic sense because no integrated firm would do that. But whether Qualcomm set prices for its licenses independent of chip prices is immaterial—*linkLine* clearly states, "[i]f both the wholesale price and the retail price are independently lawful, there is no basis for imposing antitrust liability simply because a vertically integrated firm's wholesale price happens to be greater than or equal to its retail price."[81] Whether Qualcomm's license and chip prices were lawful turns on whether they were below cost. Again, the district court made no finding that they were.

Antitrust analysis favors economic substance over form.[82] It does not allow plaintiffs to circumvent the Supreme Court's prohibition on price squeeze

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[77] With respect to Qualcomm's chip prices, the district court merely cited a then ongoing European Commission investigation into whether Qualcomm engaged in predatory pricing by selling certain chipsets to two customers below cost between 2009 and 2011; the court made no findings on the issue. *See* FTC v. Qualcomm Inc., No. 17-cv-00220-LHK, 2019 U.S. Dist. LEXIS 86219, at *26 (N.D. Cal. May 21, 2019).

[78] Complaint at 20, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal. May 21, 2019) (No. 17-cv-00220-LHK).

[79] *See* Transcript of Record at 1130-32, 1135-37, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal., Jan. 15, 2019) (No. 17-cv-00220-LHK).

[80] Brief for the Plaintiff-Appellee at 11, FTC v. Qualcomm Inc. (9th Cir. 2019) (No. 19-16122).

[81] Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc., 555 U.S. 438, 455 (2009).

[82] *See Am. Needle, Inc. v. NFL*, 560 U.S. 183 (2010) (quoting Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 773 (1984)) ("As *Copperweld* exemplifies,

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claims by rebranding the claim as a "tax" on rivals that are not vertically integrated. This type of formalism would untether antitrust from economic analysis and strip monopolization law of any predictability. The *linkLine* Court itself reiterated the importance of providing certainty to companies on what constitutes an antitrust violation:

> Institutional concerns also counsel against recognition of such claims. We have repeatedly emphasized the importance of clear rules in antitrust law . . . . Recognizing price-squeeze claims would require courts simultaneously to police both the wholesale and retail prices to ensure that rival firms are not being squeezed. And courts would be aiming at a moving target, since it is the *interaction* between these two prices that may result in a squeeze. Perhaps most troubling, firms that seek to avoid price-squeeze liability will have no safe harbor for their pricing practices.[83]

The district court's holding is manifestly inconsistent with the teaching of the Supreme Court in *linkLine*. The court here creates a liability standard that improperly punishes Qualcomm for monetizing its intellectual property, and it does so on a record with no evidence of predatory behavior and, indeed, without making the relevant findings.

III. The District Court's Exclusive Dealing Analysis Does Not Show Substantial Foreclosure as Required under the Sherman Act

Finally, the district court erred in concluding that Qualcomm's exclusive deals with Apple violate the Sherman Act. In 2011 and 2013, Qualcomm and Apple entered into agreements whereby Apple agreed to use exclusively Qualcomm chips in new iPhone and iPad models and, in turn, Qualcomm agreed to make large lump sum payments to Apple, which the FTC alleged "constituted partial relief from Qualcomm royalties."[84] The 2011 agreement required

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substance, not form should determine whether a[n] . . . entity is capable of conspiring under § 1."); United States v. Yellow Cab Co., 332 U.S. 218, 227 (1947) ("The corporate interrelationships of the conspirators, in other words, are not determinative of the applicability of the Sherman Act . . . [which] is aimed at substance rather than form"), *rev'd on other grounds*, 467 U.S. 752 (1984).

[83] *linkLine*, 555 U.S. at 452-53.

[84] Complaint at 25, FTC v. Qualcomm Inc., 2019 U.S. Dist. LEXIS 86219 (N.D. Cal. May 21, 2019) (No. 17-cv-00220-LHK).

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Qualcomm to make incentive payments from 2011 until 2016 and required Apple to forfeit all future payments (and depending on when a new handset was launched, refund past payments) if it launched a new handset using a rival chipmakers' chip.[85] The 2013 agreements included the same arrangement and extended it to cover the contract manufacturers that were engaged by Apple and licensed by Qualcomm; in addition, Qualcomm agreed to rebate royalties in excess of per-handset caps collected from the contract manufacturers to Apple, subject to (among other terms) Apple's agreement to neither initiate nor induce others to initiate litigation claiming Qualcomm had failed to offer a license on FRAND terms.[86]

Antitrust law requires plaintiffs alleging monopolization or attempted monopolization to provide evidence of actual or likely anticompetitive effects. The Supreme Court held in *Tampa Electric Co. v. Nashville Co.* that proof of substantial foreclosure is an essential element for a plaintiff to prevail on an exclusive dealing claim.[87] Citing *Standard Oil*, Justice O'Connor's concurrence in *Jefferson Parish Hospital District No. 2 v. Hyde* emphasized that "[e]xclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive deal."[88] In that case, the Supreme Court held that an exclusive dealing agreement between a hospital and a firm of anesthesiologists that foreclosed 30 percent of the relevant market did not meet Section 2's requirement of substantial foreclosure.[89] Areeda and Hovenkamp explain that foreclosure consists of "impediments that prevent new firms from coming into a market, that deny access to inputs or outlets with the result that firms may be driven from the market, or that serve to transfer significant market share away from smaller firms and toward the dominant firm imposing the restraint."[90] The district court's failure to establish foreclosure of any actual or potential competition from the exclusive agreements between Qualcomm and Apple conflicts with the "substantial foreclosure" standard that has long governed exclusive dealing cases.[91]

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[85] *Id.*

[86] *Id.*

[87] 365 U.S. 320, 326-28 (1961) ("[T]he competition foreclosed by the contract must be found to constitute a substantial share of the relevant market").

[88] 466 U.S. 2, 45 (1984) (O'Connor, J., concurring).

[89] *Id.* at 32 (majority opinion) ("There is simply no showing here of the kind of restraint on competition that is prohibited by the Sherman Act.").

[90] 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1804a.

[91] *See* Joshua D. Wright, *Moving Beyond Naïve Foreclosure Analysis*, 19 GEO. MASON L. REV. 1163, 1165 (2012) ("Indeed, substantial foreclosure has proven to be a cornerstone of

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The Ninth Circuit has repeatedly required plaintiffs challenging exclusive dealing arrangements to show proof of substantial foreclosure.[92] Though the Supreme Court has not defined what constitutes "substantial" foreclosure, many courts have interpreted the Court's rulings in *Tampa Electric* and *Jefferson Parish* as creating a presumption of legality for exclusive dealing arrangements in cases where the arrangement forecloses less than 30 or 40 percent of the market.[93] Areeda and Hovenkamp similarly conclude that "single-firm foreclosure percentages of less than 30 or 40 percent in a properly defined market would seem to be harmless to competition."[94] Following that logic, the Ninth Circuit in *Omega Environmental v. Gilbarco, Inc.* upheld an exclusive dealing arrangement which foreclosed 38 percent of the relevant market.[95]

The district court simply made no findings of foreclosure here, much less the substantial foreclosure required by the law. Rather, the court appears to have relied solely upon the fact that Apple was a significant and strategically important account. The court made no findings that any competitor was ready, willing, and able to supply Apple with the specialty chips it needed for iPhones

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exclusive dealing analysis left untouched for the fifty years since *Tampa Electric*. Modern exclusion cases focus intensely upon measuring foreclosure").

[92] *See* Allied Orthopedic Alliances, Inc. v. Tyco Health Care Group LP, 529 F.3d 991, 996 (9th Cir. 2010); Omega Envtl. v. Gilbarco, Inc., 127 F.3d 1157, 1162 (9th Cir. 1997); Twin City Sportservice, Inc. v. Charles O. Finley & Co., 676 F.2d 1291, 1300 (9th Cir. 1982).

[93] *See* Sterling Merch., Inc. v. Nestlé, S.A., 656 F.3d 112, 124 (1st Cir. 2011) ("[F]oreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent, and while high numbers do not guarantee success for an antitrust claim, low numbers make dismissal easy.") (internal quotations omitted); B & H Med., L.L.C. v. ABP Admin., Inc., 526 F.3d 257, 266 (6th Cir. 2008) (holding that foreclosure levels under 40 percent were unlikely to raise competitive concerns); Stop & Shop Supermarket Co. v. Blue Cross & Blue Shield of R.I., 373 F.3d 57, 68 (1st Cir. 2004) ("For exclusive dealing, foreclosure levels are unlikely to be of concern where they are less than 30 or 40 percent.") (citing Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 45–46 (1984) (O'Connor, J., concurring)); CDC Techs., Inc. v. IDEXX Labs., Inc., 186 F.3d 74, 77 (2d Cir. 1999); Omega Envtl., Inc. v. Gilbarco, Inc., 127 F.3d 1157, 1162 (9th Cir. 1997) (holding that an exclusive dealing arrangement which foreclosed 38 percent of the relevant market did not violate the Sherman Act); Minn. Mining & Mfg. Co. v. Appleton Papers Inc., 35 F. Supp. 2d 1138, 1143 (D. Minn. 1999) ("Generally speaking, a foreclosure rate of at least 30 percent to 40 percent must be found to support a violation of the antitrust laws."); *see also* Jonathan M. Jacobson, *Exclusive Dealing, "Foreclosure," and Consumer Harm*, 70 Antitrust L.J. 311, 324 n.85 (2002).

[94] 11 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1821c.

[95] 127 F.3d at 1162.

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and iPads—and that Qualcomm invested in developing—during the exclusivity period. In fact, the evidence showed that it wasn't until Intel chose to invest substantial resources in chips for Apple that any competitor was able to meet Apple's needs. The fact that Intel was able to quickly take Apple's business from Qualcomm following that investment severely undermines the district court's conclusion that the exclusive arrangements between Qualcomm and Apple foreclosed competition from other chipmakers.

The district court justifies this obvious deficiency in its analysis by citing a Fourth Circuit case against du Pont that reversed dismissal of a complaint alleging the defendant's exclusive dealing agreements, among several things, "severely limited [the plaintiff] from competition for the most important customers in categories needed to gain a foothold for effective competition."[96] Other cases analyzing competitors' ability to "gain a foothold" have been heavily criticized by leading antitrust scholar Herbert Hovenkamp for failing to make "any serious attempt to distinguish harm caused to rivals by anticompetitive practices from those caused by healthy competition."[97] In any event, the *du Pont* case concerned the burden of proof required *at the pleading stage*, which is obviously less than the burden of proof a plaintiff is required to meet at trial.[98]

The district court also cites the D.C. Circuit's *Microsoft* case as finding "dispositive that the monopolist's exclusive deals kept the rival's share 'below the critical level necessary for Navigator or any other rival to pose a real threat to Microsoft's [browser] monopoly.'"[99] The court failed to note, however, the *du Pont* court's observation that "Microsoft had exclusive agreements with fourteen of the top fifteen access providers in North America, ensuring that its browser was offered as the default browser or as the only browser to the majority of internet users in that area."[100] As the *Microsoft* court itself explained, "it is clear

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[96] FTC v. Qualcomm Inc., No. 17-cv-00220-LHK, 2019 U.S. Dist. LEXIS 86219, at *273-74 (N.D. Cal. May 21, 2019) (quoting E.I. du Pont de Nemours & Co. v. Kolon Indus., Inc., 637 F.3d 435, 452 (4th Cir. 2011)).

[97] HERBERT HOVENKAMP, THE ANTITRUST ENTERPRISE: PRINCIPLE AND EXECUTION 70-71, 180 (Cambridge Press 2005) (describing *Conwood Co., L.P. v. U.S. Tobacco Co.* as "deeply troublesome and offensive to antitrust policy"); *see also* Joshua D. Wright, *Antitrust Analysis of Category Management:* Conwood v. United States Tobacco Co., 17 SUP. CT. ECON. REV. 311 (2009).

[98] *Kolon*, 637 F.3d at 452-53.

[99] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *274 (quoting United States v. Microsoft Corp., 253 F.3d 24, 59 (D.C. Cir. 2001)).

[100] *Kolon*, 637 F.3d at 451.

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that in all cases the plaintiff must both define the relevant market *and prove the degree of foreclosure*. This is a prudential requirement; exclusivity provisions in contracts may serve many useful purposes."[101] The FTC made no such showing here, and the district court made no findings as to the degree of foreclosure, as opposed to the naked assertion that foreclosure was substantial. The record evidence does not show that Qualcomm's agreements with Apple actually resulted in foreclosure of any competitor, and the findings the district court did make show that Intel was not foreclosed at all.[102]

Modern antitrust analysis requires plaintiffs to substantiate their claims with more than just theory or evidence that a rival has been harmed.[103] The district court's findings fall well short of that standard. This failure, if upheld, will put the Ninth Circuit in conflict with the well-settled notion that a critical element of an exclusive dealing claim is a showing of substantial foreclosure.

IV. Conclusion

The district court decision is fraught with legal and economic error. If affirmed, the Ninth Circuit will be in conflict with longstanding Supreme Court precedents. First, and most important, the district court's ruling is a significant expansion of antitrust's limited duty to deal, penalizing a refusal to deal by a firm that made a profitable change in its business model several years after prior dealings with rivals. This will undoubtedly generate uncertainty for companies engaging in legitimate conduct and deter firms from entering into procompetitive relationships with rivals in the first instance for fear that termination of those dealings will result in antitrust exposure and the threat of treble damages.

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[101] *Microsoft*, 253 F.3d at 69 (D.C. Cir. 2001) (emphasis added).

[102] *Qualcomm*, 2019 U.S. Dist. LEXIS 86219, at *190-91 ("Finally, in late 2016, Apple launched a handset with an Intel modem chip. Qualcomm's rival Intel reaped significant benefits after Apple selected Intel to supply modem chips for a 2016 iPhone. Because an OEM must purchase modem chips well in advance of launching a handset, Apple made the decision to work with Intel in 2014, two years before the 2016 handset's commercial launch, as Matthias Sauer (Apple Engineer) testified at trial[.]").

[103] *See* Timothy J. Muris, *The FTC and the Law of Monopolization*, 67 ANTITRUST L. J. 693, 723 (2000) (Although the case law is hardly a model of clarity, one point that is settled is that injury to competitors by itself is not a sufficient basis to assume injury to competition.).

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Second, the district court's decision revives the margin squeeze theory of harm the Supreme Court expressly rejected in *linkLine*.[104] Third, the district court lowered significantly the evidentiary burden facing a plaintiff claiming harm from the defendant's exclusive dealing contracts by failing to require the FTC to prove a significant share of the relevant market was foreclosed to Qualcomm's rivals.

The district court decision is part of a trend in recent antitrust cases blurring the fundamental distinction between the role of contract law and that of antitrust law in governing disputes between sophisticated parties. Absent a showing of harm to competition, antitrust is not an appropriate regime for resolving contractual disputes. While Section 5 of the FTC Act has historically been the vehicle of choice for plaintiffs seeking to challenge under the antitrust laws conduct that could be remedied with contract law, the district court decision invites plaintiffs to use the Sherman Act to reach conduct that has been generally shielded from antitrust liability. That invitation is ill advised, and should be rejected by the Ninth Circuit, and if necessary, the Supreme Court.

[104] Pacific Bell Tel. Co. v. linkLine Commc'ns, Inc., 555 U.S. 438, 452 (2009).

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