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IN THE SUPREME COURT OF THE STATE OF DELAWARE

MELBOURNE MUNICIPAL FIREFIGHTERS' PENSION TRUST FUND, derivatively on behalf of QUALCOMM, INCORPORATED, Appellant, Plaintiff-Below, v. PAUL E. JACOBS, STEVEN M. MOLLENKOPF, BARBARA T. ALEXANDER, DONALD G. CRUICKSHANK, RAYMOND V. DITTAMORE, SUSAN HOCKFIELD, THOMAS W. HORTON, SHERRY LANSING, HARISH MANWANI, DUANE A. NELLES, CLARK T. RANDT, JR., FRANCISCO ROS, JONATHAN J. RUBINSTEIN, GENERAL BRENT SCOWCROFT, and MARC I. STERN, Appellee, Defendants-Below, -and- QUALCOMM, INC., Appellee, Nominal Defendant-Below.	PUBLIC VERSION FILED ON: October 25, 2016 No. 444, 2016 CASE BELOW: COURT OF CHANCERY OF THE STATE OF DELAWARE, C.A. No. 10872-VCMR

APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDING

In 2009, nominal defendant-below appellee Qualcomm, Incorporated ("Qualcomm" or the "Company") suffered three adverse outcomes in antitrust proceedings:

(1) Qualcomm agreed to pay $891 million to settle a competitor's domestic antitrust action (the "Broadcom Settlement");

(2) South Korea's Fair Trade Commission ("KFTC") fined Qualcomm the Korean equivalent of $208 million and imposed corrective orders (the "KFTC Decision"); and

(3) Japan's Fair Trade Commission ("JFTC") imposed a Cease and Desist Order (the "JFTC Order").

(A354) Qualcomm paid the $891 million, paid the Korean equivalent of $208 million and appealed the KFTC Decision, and obtained a stay of the JFTC Order pending an administrative hearing.

On February 9, 2015, China's National Development and Reform Commission fined Qualcomm the Chinese equivalent of $975 million and ordered Qualcomm to desist from certain business practices that had been at issue in other antitrust proceedings. (A172-96) Qualcomm agreed to pay the $975 million fine and implement the rectification plan. (A17 ¶ 2) Qualcomm has been found to have violated the anti-trust laws in its largest markets, with the most recent fine coming years after Qualcomm's Board was made aware of the earlier violations of law.

Plaintiff-below appellant Melbourne Municipal Firefighters' Pension Trust Fund ("Melbourne" or "Plaintiff") obtained documents from Qualcomm pursuant to Section 220 of the Delaware General Corporation Law. On April 3, 2015, Plaintiff filed a stockholder derivative complaint (the "Complaint") alleging breach of fiduciary duty claims against certain directors and officers of Qualcomm.

Defendants moved to dismiss the Complaint pursuant to Court of Chancery Rules 12(b)(6) and 23.1. At oral argument, Plaintiff dropped Counts III and IV of the Complaint, for waste and unjust enrichment. (A409) On August 1, 2016, the Court of Chancery issued a Memorandum Opinion and Order (the "Opinion") (Ex. A hereto) granting defendants' motion to dismiss for failure to plead demand futility.

SUMMARY OF ARGUMENT

1. The Vice Chancellor erred in holding that the Complaint does not plead facts from which it reasonably may be inferred that Qualcomm's directors face a substantial likelihood of personal liability for allowing the Company to violate antitrust law. The red flags of the Broadcom Settlement, the KFTC Decision, and the JFTC Order required the Board to assess the legality of Qualcomm's business model and make necessary modifications to Qualcomm's patent licensing practices. The Complaint pleads that the Board did nothing other than oversee a public relations campaign, lobbying, and appeals. The Vice Chancellor misapplied Delaware law in holding that the red flags did not "rise to the severity" necessary to "implicate an immediate duty to alter a company's culture and business practices." (Op. at 34) The Vice Chancellor misinterpreted Qualcomm's public filings, gave Qualcomm's public protestations of innocence undue weight on a motion to dismiss, failed to make reasonable inferences in Plaintiff's favor, and misapplied substantive law under *Caremark* and its progeny in holding that the individual defendants are insulated from personal liability because the Board "concluded" and "consistently expressed" and "was under the impression" that Qualcomm's business practices were legal. (*Id*. at 34-35) The record does not permit the inference that the Board informed itself and acted in

good faith in responding to red flags that evidence a corporate policy of serially violating antitrust law.

STATEMENT OF FACTS

A. Qualcomm's Market Power and Business Model

Qualcomm designs, develops, manufactures, and markets digital communications products and services worldwide, with its largest markets in China, South Korea, Taiwan, and the United States. (A22 ¶ 12) Approximately 80% of Qualcomm's revenue comes from Southeast Asia. (A38 ¶¶ 51-52)

Qualcomm is the leader in the development and commercialization of the third-generation ("3G") digital wireless communication technology called CDMA, which represents the most lucrative portion of Qualcomm's patent portfolio. (A22-35 ¶¶ 12, 38, 40) The successor to 3G is called Fourth Generation, Long Term Evolution ("4G LTE"), and a Qualcomm-patented technology known as OFDMA is the leading technology driving this next-generation telecommunications standard. (A35 ¶ 42) Qualcomm obtains royalties from third-party chip manufacturers and mobile manufacturers for licensing CDMA and OFMDA. (A35-36 ¶¶ 43-45) Qualcomm receives about 3% to 5% on every 3G/4G LTE handset sold anywhere in the world. (A36-37 ¶ 46)

Qualcomm also generates revenue from manufacturing and selling chips and software used in many smartphones and wireless devices. (A35-36 ¶ 43) Qualcomm's chips are found in more handsets worldwide than those of any other

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company. Qualcomm controls 52% of the baseband chip market; its closest competitor, Intel, had only a 12% market share as of June 2013. (A37-38 ¶ 50)

Standard-setting organizations set common standards for a particular industry in order to ensure compatibility and interoperability of devices manufactured by different companies. Standard-setting organizations commonly have rules that govern the ownership of patent rights that apply to the standards they adopt, such as that a patent that applies to the standard must be adopted on "fair, reasonable, and non-discriminatory terms" ("FRAND"). (A41 ¶ 58) Qualcomm recognizes that it owes FRAND obligations by virtue of holding patents essential for all 3G standards that are based on CDMA and for holding patents essential to certain standards based on OFDMA. (A43 ¶ 61)

B. Red Flags in 2009 About Qualcomm's Abuse of Its Market Position

Qualcomm has repeatedly faced antitrust investigations and had to bear costly settlement payments, fines, and remedial orders in connection with business practices alleged to violate FRAND: (i) charging unreasonably high licensing fees (A49-53 ¶¶ 74-79); (ii) bundling non-essential and even expired patents as part of a single portfolio that includes licenses for industry-standard technology (A38-74 ¶¶ 80, 92, 125, 127-28); (iii) imposing licensing agreements that force licensees to provide reverse patent licensing free of charge (A53-74 ¶¶ 81, 102-04, 125, 127-28); and (iv) imposing unreasonable conditions on patent licenses and chip sales, such as packaging chip sales along with patent-based incentives and discriminatory pricing (A55-73 ¶¶ 86, 88-89, 92, 93, 98-99, 126). Three separate red flags were unfurled in 2009.

1. The Broadcom Settlement

The precursor to the first red flag was in 2007, when the United States Court of Appeals for the Third Circuit reversed in part a district court decision dismissing antitrust claims against Qualcomm, and held that "Broadcom has stated claims for monopolization and attempted monopolization under § 2 of the Sherman Act." *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 303 (3d Cir. 2007).

Qualcomm was alleged to have actively marketed its WCDMA technology for inclusion in an industry-wide standard, to have voluntarily agreed to license that technology on FRAND terms, and later to have insisted on non-FRAND licensing terms. *Id.* at 316. The Third Circuit announced a rule of antitrust liability directly applicable to Qualcomm's business model:

> We hold that (1) in a consensus-oriented private standard-setting environment, (2) a patent-holder's intentionally false promise to license essential proprietary technology on FRAND terms, (3) coupled with [a standard-determining organization's] reliance on that promise when including the technology in a standard, and (4) the

> patent holder's subsequent breach of that promise, is actionable anticompetitive conduct. This holding follows directly from established principles of antitrust law and represents the emerging view of enforcement authorities and commentators, alike…. ***We are unpersuaded by Qualcomm's argument that antitrust liability cannot turn on so vague a concept as whether licensing terms are reasonable***[.]

Id. at 314 & n.8 (emphasis added).

The Third Circuit further held that Broadcom had "adequately alleged that Qualcomm obtained and maintained its market power willfully, and not as a consequence of a superior product, business acumen, or historic accident." *Id.* at 315. Broadcom sufficiently alleged anticompetitive practices by Qualcomm "that resulted in Qualcomm's acquisition of monopoly power in the markets for CDMA chipsets and technologies and now threaten to create monopoly power in the emerging market for [3G] chipsets."[1] *Id.* at 391. Those anticompetitive practices were Qualcomm's alleged "insistence on non-FRAND licensing terms," including:

> Qualcomm was discriminating among licensees of the essential WCDMA technology by charging more and higher fees to those who do not use Qualcomm's [3G] chipsets. Qualcomm was demanding royalties on parts of [3G] chipsets for which it did not own patents, and demanding that [3G] licensees grant back to Qualcomm licenses for their own proprietary technologies on terms much more favorable to Qualcomm. Qualcomm was charging double royalties to [3G] cell

[1] The opinion refers to "UMTS chipsets" and explains that the 3G standard "is known as the Universal Mobile Telecommunications System ('UMTS') standard." 501 F.3d at 304.

> phone manufacturers who use non-Qualcomm [3G] chipsets …. Qualcomm was discouraging price competition by demanding sensitive sales and pricing information from its [3G] chipset licensees, even when those licensees were competing directly with Qualcomm. Qualcomm was also providing discounts, incentives, and payments to cell phone manufacturers who use only Qualcomm [3G] chipsets.

Id. at 315, 318 (citations omitted).

Broadcom had not only sued Qualcomm for antitrust violations in the United States, Broadcom had submitted a formal complaint to the Competition Directorate of the European Commission ("EC") alleging that Qualcomm's business practices with respect to licensing of patents and sales of chipsets violated Article 82 of the EC Treaty (governing antitrust law), and had submitted a formal complaint to the KFTC alleging that Qualcomm's business practices violated South Korean antitrust regulations. (A307-08)

On April 26, 2009, two months after the KFTC issued a Case Examiner's report setting forth allegations against Qualcomm (A307), Qualcomm entered into the Broadcom Settlement. Qualcomm agreed to pay Broadcom $891 million, not assert its patents against Broadcom's chip customers, and charge the same royalties to users of Broadcom chips and Qualcomm chips. (A62 ¶ 100)

2. The KFTC Decision

Three months after the Broadcom Settlement, on July 23, 2009, the KFTC rendered the KFTC Decision, imposing a corrective order and fining Qualcomm the equivalent of $208 million "for abusing its dominant position by charging discriminatory royalties and offering conditional rebates." (A331)

Qualcomm had controlled more than 98% of the Korean CDMA modem chip market since 2002. The KFTC found that Qualcomm had maintained its market dominance by excluding competitors through the business practices of: (i) charging discriminatory licensing royalties for its CDMA technology to mobile handset makers using non-Qualcomm modem chips; (ii) offering rebates for the sale of its CDMA modem chips on the condition that mobile handset makers meet the great portion of their demand with Qualcomm modem chips; and (iii) licensing its CDMA technology through contracts that ensured Qualcomm would continue to get 50% of the patent royalties it garnered for its technology even after the concerned patent expired or became invalid. (A331-33) The KFTC prohibited Qualcomm from continuing these practices. (A334)

The KFTC Decision is the product of three years of investigation and deliberation, including expert testimony and an invitation that Qualcomm provide comments on the Case Examiner's report. (A333-34) The KFTC's subsequent written opinion, issued in January 2010, was thorough:

> In its 188-page opinion, the [KFTC] analyzed Qualcomm's successful effort to use its position in licensing CDMA technology to exclude competitors (such as Samsung, EoNex, VIA Telecom, and Texas Instruments) in the downstream CDMA chip market. This market-impact analysis is probably the most thorough that any competition enforcement agency has provided in FRAND cases.

Harry First, *Exploitative Abuses of Intellectual Property Rights*, at 21 (NYU Center for L. Econ. and Org. Paper No. 16-26, Draft Mar. 6, 2016). The $208 million fine was by far the largest ever handed down by the KFTC. (A57 ¶ 90)

3. The JFTC Order

Two months after the KFTC Decision, on September 30, 2009, the JFTC issued the JFTC Order against Qualcomm. (A342-45) The JFTC found Qualcomm in violation of Article 19 of Japan's Antimonopoly Act for having coerced Japanese manufacturers into signing license agreements relating to CDMA technology that contain provisions granting Qualcomm a royalty-free license for the intellectual property rights of the Japanese manufacturers and barring the assertion of intellectual property rights against Qualcomm and its customers and licensees. (A342) The JFTC ordered Qualcomm to rescind these provisions and refrain from engaging in similar conduct. (A343)

C. Qualcomm Warns of Potential Adverse Outcomes in Antitrust Proceedings It Characterizes as "Without Merit"

On November 5, 2009, five weeks after the JFTC Order, Qualcomm filed its Form 10-K for the period ending September 27, 2009, which was signed by each of Qualcomm's directors. (A305-19) The 2009 10-K discussed the Broadcom Settlement, the KFTC Decision, and the JFTC Order, as well as the Company's exposure to antitrust legal risk.

Qualcomm warned investors of potential future adverse legal outcomes under antitrust law. In doing so, Qualcomm characterized the governmental proceedings as competitor-driven efforts to undermine Qualcomm's business model and property rights, and further characterized the governmental challenges as "without merit" and "distractions":

> *Efforts by some telecommunications equipment manufacturers to avoid paying fair and reasonable royalties for the use of our intellectual property may create uncertainty about our future business prospects, may require the investment of substantial management time and financial resources, and may result in legal decisions and/or political actions by foreign governments that harm our business.*
>
> A small number of companies have initiated various strategies in an attempt to renegotiate, mitigate and/or eliminate their need to pay royalties to us for the use of our intellectual property in order to negatively affect our business model and that of our other licensees…. A number of these strategies are purportedly based on interpretations of the policies of certain standards development organizations concerning the licensing of patents that are or may be

> essential to industry standards and our alleged failure to abide by these policies. There is a risk that relevant courts or governmental agencies will interpret those policies in a manner adverse to our interests.
>
> …
>
> Although **we believe that these challenges** [before the EC, KFTC, and JFTC] **are without merit**, and we will continue to vigorously defend our intellectual property and contract rights and our right to continue to receive a fair return for our innovations, **the distractions caused by challenges to our business model and licensing program are undesirable** and the legal and other costs associated with defending our position have been and will continue to be significant. We assume, as should investors, that such challenges will continue into the foreseeable future and may require the investment of substantial management time and financial resources to explain and defend our position.

(A307-08 (bold added)) The above-quoted text was largely unchanged from Qualcomm's Form 10-K for fiscal year 2008, before the adverse legal outcomes of 2009. (*See* A414)

Two paragraphs of Qualcomm's 2009 Form 10-K are devoted to describing the Broadcom Settlement. The Vice Chancellor misinterpreted that text as saying that Broadcom's antitrust claims were "without merit." (Op. at 7, 28) In fact, the pertinent paragraphs so characterize Broadcom's *patent infringement claims*, and do not specifically identify Broadcom's domestic antitrust action or its foreign antitrust complaints:

> ***Litigation Settlement, Patent License and Other Related Items***. Since 2005, the Company and [Broadcom] had been engaged in a series of complex legal disputes in various forums, including various claims by Broadcom that alleged infringement by the Company of certain Broadcom patents. The Company believed that these claims were without merit for a variety of reasons, including the Company's successful preparation and deployment of technical "design arounds" … as well as findings by USPTO examiners in the reexamination process …. [O]n April 26, 2009, the Company entered into a Settlement and Patent License and Non-Assert Agreement (the Agreement) with Broadcom. Under the Agreement, (i) the companies agreed to terminate all litigation between the parties; (ii) Broadcom agreed to assign certain patent rights to the Company; and (iii) the companies granted certain rights to each other under their respective patent portfolios, including agreements not to assert certain patents as well as an exhaustive license to certain patents that were the subject of litigation between the parties and to portions of related patents for integrated circuit and software products….

(A319) The 10-K elsewhere disclosed that Broadcom withdrew its antitrust complaints before the EC and the KFTC as part of the Broadcom Settlement. (A307-08)

Qualcomm did not assign any value to the patent rights it received from Broadcom, and determined that the "predominant component of the arrangement was the litigation settlement." (A319) Qualcomm recorded a $783 million charge, which represented the difference between the $891 million payment obligation and the sum of amounts accrued in prior fiscal periods plus imputed interest. (*Id.*)

Qualcomm disclosed limited points about the KFTC Decision. Qualcomm disclosed that it "intends to appeal the decision," that it recorded a $230 million charge, that it "does not anticipate that the cease and desist remedies will have a material effect on its operations," and that it "believes that its practices do not violate South Korean competition law." (A318)

The combined charges of $783 million for the Broadcom Settlement and $230 million for the KFTC Decision reduced Qualcomm's net income for fiscal 2009 ***by almost 40%***, to $1.6 billion. (A312)

As for the JFTC Order, Qualcomm's 2009 10-K disclosed that Qualcomm intended to invoke its right under Japanese law to an administrative hearing and to seek a stay of the JFTC Order pending that hearing. (A318) In February 2010, Qualcomm obtained a stay of the JFTC Order pending the outcome of the administrative hearing before the JFTC. (A65-66 ¶ 107)

D. Qualcomm Maintains Its Business Model While Relying on Public Relations and Appeals to Forestall a Reckoning

The Complaint does not allege that the Board undertook any independent investigation into the legality of Qualcomm's business practices or that the Board requested or received legal advice on that subject. To the contrary, the Complaint alleges the absence, even after the production of a significant volume of documents in response to a Section 220 demand, of "any evidence of any efforts or actions the Board undertook to address the continuing and repeated violations of fair competition laws in" foreign markets, such as the implementation of an effective anti-trust compliance program. (A48 ¶ 72; *see* A112-22 ¶¶ 219-20, 233, 237) In other words, if Qualcomm held exculpatory documents in its files, it could and would have produced them and shown the Board's proper and active engagement.

Rather than assess the legality of its business model and licensing practices and modify them, Qualcomm framed the issue as a public relations matter and gave no ground in litigation defense. According to a Strategic Plan Review in a June 28, 2010 board package, Qualcomm perceived a "Strategic Imperative" of initiating a public relations campaign to counter the global application of antitrust law to Qualcomm's licensing practices, which Qualcomm considered a violation of its intellectual property ("IP") rights:

Strategic Imperative:

- We continue to see aggressive efforts worldwide to increase regulation of IP or create new rules / laws that devalue IP
- We may continue to face regulatory complaints and investigations
- Recent activity in Europe, China, India, Japan, Korea and U.S.

- **Action Plan**
  - Proactively Lobby Government Agencies/Officials
  - Academic Advocacy Program to foster creation and publication of favorable papers on key issues
    - [redacted]
  - Speak / Present at key conferences on competition, standards and IPR around the world
  - Creation / participation in coalitions of like-minded companies
    - [redacted]
  - Improve Image / Brand Awareness
    - [redacted]

(A340; *see* A44 ¶ 64)

A February 1, 2012 Board package treated with contempt the notion that China's anti-monopoly law applied to Qualcomm's licensing of intellectual property:

> **Continue efforts to protect QC business model and preserve the value of QC IP**
>
> **China** – Continue to monitor and attempt to influence direction of SAC/CNIS regulations, indigenous innovation policies and regulation of license fees under guise of anti-monopoly law.

(A45 ¶ 66)

A June 17, 2013 Board package [redacted]

> Additionally, some companies in China have started to use their Anti-Monopoly Law (AML) against foreign companies as a competitive tool and as a way of reducing their cost, [redacted]

(A45-46 ¶ 67)

The Seoul High Court affirmed the KFTC Decision on June 19, 2013.

(A430) Commentators note that the Seoul High Court "affirmed the KFTC's finding of facts almost in their entirety" and explain:

> Similar to the KFTC, the court was more attentive to the fact that Qualcomm's royalty discrimination gave rise to anticompetitive effects in the "CDMA chip market" downstream from the CDMA technology licensing market. The court found that Qualcomm's competitors were excluded from the downstream chip market as a result of the royalty discrimination that occurred in concert with the conditional rebating.

Yoonhee Kim & Hui-Jin Yang, *A Brief Overview of Qualcomm v. Korea Fair Trade Commission*, CPI Antitrust Chron. at 6, 8 (Mar. 2015(1)). Qualcomm filed an appeal with the Korea Supreme Court in July 2013. (A430)

Meanwhile, the JFTC had held hearings on 19 different dates respecting the JFTC Order. (A431) In July 2013, the EC ordered Qualcomm to produce additional documents and information respecting an ongoing antitrust investigation. (A430) Qualcomm disclosed the status of the foreign antitrust proceedings in its 2013 10-K and stated that it "cannot predict the outcome of these matters," because "litigation and investigations are inherently uncertain." (A431) Qualcomm no longer characterized the antitrust proceedings as "without merit."[2]

E. China Investigates Qualcomm, Fines Qualcomm $975 Million, and Imposes a Rectification Order

In November 2013, China's National Development and Reform Commission ("NDRC") conducted raids of Qualcomm's Beijing and Shanghai offices as part of an investigation relating to China's Anti-Monopoly Law. (A66-67 ¶¶ 109-10)

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[2] In its 10-K for 2012, Qualcomm used the same language about inherent uncertainty to describe the foreign antitrust proceedings. (A427-428) In its 10-Ks for 2008, 2009, 2010, and 2011, Qualcomm had described the then-pending antitrust litigation and investigations as "without merit." (A414; A308, A318; A418-19; A423) Not all of the above-cited pages from the 10-Ks were excerpted in the affidavits filed below, but this Court can take judicial notice of Qualcomm's public filings. *Hazout v. Tsang Mun Ting*, 134 A.3d 274, 280 n.13 (Del. 2016).

An April 11, 2014 Board package described recent meetings and a planned meeting between Qualcomm representatives and NDRC officials. (A46-47 ¶ 68) The most recent meeting revealed that the NDRC was investigating Qualcomm's licensing practices: "We understand the investigation to concern primarily the Company's licensing business, and certain interactions between the Company's licensing and chipset businesses." (*Id.*) According to the June 16, 2014 Board package, the NDRC investigation was "causing uncertainty and increasing compliance issues." (A47 ¶ 69)

Qualcomm's 2014 Form 10-K disclosed that the business practices under investigation by the NDRC included:

> how royalties are calculated in our patent licenses, the value exchanged for cross-licenses to patents of our licensees, whether we will offer license agreements limited to patents essential to certain standards, whether royalties are sought for our expired patents, our policy of selling chipsets only to our patent licensees, the alleged refusal of us to grant patent licenses to chipset manufacturers[.]

(A325)

On February 9, 2015, Qualcomm announced that the NDRC that had issued an Administrative Sanction Decision (i) finding that Qualcomm had violated China's anti-monopoly law, (ii) fining Qualcomm $975 million at then-current exchange rates, and (iii) imposing a rectification plan whereby Qualcomm would modify its business practices. (A347-51) The $975 million fine represented 8% of Qualcomm's revenues in China in 2013, and reflected the NDRC's belief that Qualcomm had "abused its dominant market position in a serious, pervasive, and long-term manner." (A195) The Administrative Sanction Decision explained that Qualcomm's abuses included:

- charging royalties for expired wireless standard-essential patents ("SEPs");
- demanding licensees to provide reverse patent licensing free of charge;
- charging excessive royalties by bundling wireless SEPs with non-wireless SEPS (that may not be valuable for all wireless communication terminals) into the same portfolio for licensing;
- adding unreasonable conditions to the sale of baseband chips by requiring purchasers to sign and not challenge the patent licensing agreement.

(*See* A182-93; A72-73 ¶¶ 125-26). These same licensing practices were at issue in one or more of the earlier Broadcom Settlement, KFTC Decision, and JFTC Order.

F. Current Status of Additional Antitrust Proceedings

The Complaint was filed on April 3, 2015. As of that time, a majority of Qualcomm's fifteen directors had been serving on the Board since prior to 2009. (A23-31 ¶¶ 14-28)

Qualcomm's most recent Form 10-Q, for the quarter ended June 26, 2016, discloses the current status of the following governmental antitrust investigations, in addition to the $975 million fine and rectification order in China and the pending appeals in South Korea and Japan discussed above:

- On September 17, 2014, the Federal Trade Commission notified Qualcomm that it is investigating conduct related to standard essential patents and pricing and contracting practices with respect to baseband processors and related products.
- On November 13, 2015, Qualcomm received a report prepared by the KFTC's investigative staff alleging that the Company is in violation of Korean competition law by: (i) licensing its patents exhaustively only to device manufacturers and requiring that its chipset customers be licensed to the Company's intellectual property; and (ii) obtaining in its licensing

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agreements certain terms, including royalty terms, that are unfair or unreasonable.

- On December 8, 2015, the EC announced that it had issued a Statement of Objections expressing its preliminary view that between 2009 and 2011, Qualcomm engaged in predatory pricing by selling certain baseband chipsets to two customers at prices below cost, with the intention of hindering competition.
- On December 8, 2015, the EC announced that it had issued a Statement of Objections expressing its preliminary view that since 2011, Qualcomm has paid significant amounts to a customer on condition that it exclusively use the Company's baseband chipsets in its smartphones and tablets, allegedly harming competition and innovation for certain baseband chipsets.
- On April 27, 2016, the Taiwan Fair Trade Commission specified that an investigation it was conducting into Qualcomm's patent licensing arrangements include whether: (i) the Company jointly licensed its patents rather than separately licensing standard-essential patents and non-standard-essential

> patents; (ii) the Company's royalty charges are unreasonable; (iii) the Company unreasonably required licensees to grant it cross-licenses; (iv) the Company failed to provide lists of licensed patents to licensees; (v) the Company violated a FRAND licensing commitment by declining to grant licenses to chipset makers; (vi) the Company declined to sell chipsets to unlicensed potential customers; and (vii) the Company provided royalty rebates to certain companies in exchange for their exclusive use of the Company's chipsets.

(A435-36; *see also* A55-85 ¶¶ 86-88, 151-57)

ARGUMENT

THE COURT OF CHANCERY ERRED IN HOLDING THAT THE COMPLAINT FAILED TO PLEAD DEMAND FUTILITY BASED ON THE BOARD'S FAILURE TO MODIFY QUALCOMM'S BUSINESS PRACTICES AFTER LEARNING ABOUT SERIAL VIOLATIONS OF ANTITRUST LAW

A. Question Presented

Did the Court of Chancery err in concluding that allegations of the Board's failure to modify Qualcomm's business practices in the aftermath of the Broadcom Settlement, the KFTC Decision, and the JFTC Order were insufficient to create a reasonable inference that the Board, in bad faith, ignored corporate law breaking? (A241-42, A272-80)

B. Scope of Review

This Court reviews dismissals for failure to plead demand futility under Court of Chancery Rule 23.1 *de novo*. *Delaware County Employees Retirement Fund v. Sanchez*, 124 A.3d 1017, 1021 (Del. 2015); *Wood v. Baum*, 953 A.2d 136, 140 (Del. 2008).

C. Merits of Argument

1. Applicable Law

The Opinion summarizes the legal standards for pleading demand futility (Op. at 15-17), pleading a *Caremark* claim (*id.* at 18-21), and pleading board inaction amounting to bad faith (*id.* at 23-24), and the rule of law that fiduciaries may not knowingly countenance corporate law breaking:

> In addition, under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity. Delaware law does not charter law breakers, and a fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law. A board also is not insulated from *Caremark* liability merely because it thinks it knew better than those charged with enforcing the law, and in fact, often argued with the law itself.

(*Id.* at 24 (quoting *Metro Commc'n Corp. BVI v. Advanced Mobilecom Techs., Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004) (Strine, V.C.), and *In re Massey Energy Co.*, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011) (Strine, V.C.) (internal quotations and footnotes omitted) ("*Massey*").)

The Opinion appropriately discusses at length two cases from recent years in which the Court of Chancery held that the facts were sufficient to plead demand futility under *Caremark*. (Op. at 28-31) Those two cases, *Louisiana Municipal Police Employees' Retirement System v. Pyott*, 46 A.3d 313 (Del. Ch. 2012) ("*Pyott*"), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013), and *Massey*, are supported by decisions of federal appellate courts. In *Rosenbloom v. Pyott*, 765 F.3d 1137 (9th Cir. 2014), the United States Court of Appeals for the Ninth Circuit quoted *Pyott* at length, and found it persuasive when sustaining a complaint that pled virtually identical facts. *Id.* at 1154-55, 1158. In *Westmoreland County Employee Retirement System v. Parkinson*, 727 F.3d 719 (7th Cir. 2013), the United States Court of Appeals for the Seventh Circuit cited both *Pyott* and *Massey* in sustaining a complaint. *Id.* at 726, 729-30.

Pyott explained how the particularized allegations in that case supported a reasonable inference that directors of Allergan, Inc. expected to drive increased sales by illegally promoting off-label use of an FDA-approved product:

> The Complaint specifically pleads that in October 2006, the Board learned that the FDA was inquiring about off-label marketing by Dr. Schim, an Allergan-sponsored speaker…. The directors were told by in-house counsel that "[t]his is a potentially serious matter and in the current environment, the chance of receiving Agency action, including but not limited to a Warning Letter, on this matter is ... very high."
>
> …
>
> … It is not unreasonable to infer that the Board and CEO saw the distinction between off-label selling and off-label marketing as a source of legal risk to be managed, rather than a boundary to be avoided. Based on this premise, the CEO and his management team devised, and the Board approved, a business plan that relied on off-label-use-promoting activities, confident that the risk of regulatory detection was low, that most regulatory problems could be solved, and that dealing with regulatory risk was a cost of doing business….
>
> …
>
> … [T]he Schim incident should have further illuminated the serious legal risks posed by Allergan's various programs for supporting off-label use, including its sponsored-speaker program, and the existence of a culture of non-compliance at the company. Despite being confronted with this red-flag, the directors subsequently

> approved iterations of the business plan that further ramped up Allergan's support for off-label use.

46 A.3d at 354-58. *Rosenbloom* concluded that the factual allegations also fit within a line of federal cases applying Delaware law "in which particularized allegations made plausible an inference that the directors at issue had remained consciously inactive in the face of wrongdoing at their companies." 765 F.3d at 1156 (citing *Westmoreland*, 727 F.3d at 727, *In re Pfizer Inc. S'holder Deriv. Litig.*, 722 F. Supp. 2d 453 (S.D.N.Y. 2010), and *In re Abbott Labs. Deriv. S'holders Litig.*, 325 F.3d 795, 809 (7th Cir. 2003)).

Massey explained why, for purposes of a preliminary injunction motion, the plaintiffs in that case likely had pled a claim under *Caremark* that met the heightened pleading standard of Court of Chancery Rule 23.1:

> [A] fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law.
>
> Regrettably, a myriad of particularized facts have been pled that create a pleading-stage inference that the top management of Massey did just that. The objective facts are that Massey had pled guilty to criminal charges, had suffered other serious judgments and settlements as a result of violations of law, had been caught trying to hide violations of law and suppress material evidence, and had miners suffer death and serious injuries at its facilities. Instead of becoming a corporation with a new attitude and commitment to safety that won recognition for that change from its regulators, Massey continued to think it knew better than those charged with enforcing the law, and in fact, often argued with the law itself. Following that continued period

> of adversarialness, the Upper Big Branch Disaster occurred, Massey miners have lost their lives at other facilities, and the MSHA has alleged that serious safety violations and an attitude of law-flouting has continued at other Massey facilities.

2011 WL 2176479, at *20 (footnotes omitted). In a footnote to the text that Massey "often argued with the law itself," then-Vice Chancellor Strine observed that "Massey ranked first among the entire coal industry in appealing [Mining Safety and Health Administration] citations, contesting 34% of its alleged violations in 2009, compared to an industry-wide average of just 27%." *Id.* at *20 n.146.

The factual allegations of the Complaint are analogous to those of *Pyott* and *Massey*. The pleaded facts of Board culpability for profit-driven violations of antitrust law at Qualcomm parallel the allegations in those cases respecting board culpability for profit-driven, illegal off-label marketing at Allergan and profit-driven violations of mine safety law at Massey.

In 2009, years after Broadcom (and other companies) had filed antitrust complaints against Qualcomm with the KFTC and Broadcom had filed suit in the United States against Qualcomm alleging antitrust violations: (i) the KFTC Case Examiner issued a report setting forth allegations of wrongdoing by Qualcomm; (ii) Qualcomm agreed to pay Broadcom $891 million to settle domestic and foreign antitrust claims; (iii) the KFTC found that Qualcomm had "abuse[ed] its dominant position" and fined Qualcomm $208 million and ordered equitable relief; and (iv) the JFTC found that Qualcomm violated Article 19 of Japan's Antimonopoly Act and issued a Cease and Desist Order that, if not stayed, could have had a significant negative impact on Qualcomm's business. (A307-08, A319; A331, A334; A342-45)

Qualcomm reacted by maintaining its patent licensing practices (except to the extent enjoined in South Korea) and by arguing with and expressing contempt for antitrust law. Despite having long since lost the argument that a Sherman Act antitrust violation could not be premised on unreasonable licensing practices, *Broadcom Corp. v. Qualcomm Inc.*, 501 F.3d 297, 314 & n.8 (3d Cir. 2007), Qualcomm denied the legitimacy of antitrust constraints on its patent licensing practices. Qualcomm propagated a mythology that its property rights, contract rights, and right to "receive a fair value for our innovations" were being seized due to meritless, competitor-driven, foreign antitrust investigations. (A307-08) Qualcomm pursued appeals in South Korea and Japan and proclaimed that the findings of antitrust violations were "without merit." (A308) Qualcomm devised a public relations strategy to counter what it referred to internally as "aggressive efforts worldwide to increase regulation of IP or create new rules / laws that devalue IP." (A339-340; A44 ¶ 64) As late as 2012, Qualcomm described new licensing regulations in China as being adopted "under [the] guise of anti-monopoly law." (A45 ¶ 66) Qualcomm's refusal to modify its highly profitable business model in the face of red flags about the model's illegality led to the NDRC's $975 million fine and rectification plan in 2015, among other ongoing antitrust investigations worldwide.

2. The Court of Chancery's Distinguishing of Pyott and Massey Is Untenable

The Court of Chancery distinguished *Massey* and *Pyott*. (Op. at 32-35) None of the stated rationales are tenable.

The Opinion states that the red flags alleged in *Massey* "were far more egregious and indisputable" than those here, and that "[r]ed flags that rise to the severity of those in *Massey* may implicate an immediate duty to alter a company's culture and business practices." (Op. at 32, 34) Nothing in *Massey* or any *Caremark* case suggests that a responsibility to alter corporate culture or alter business practices arises only if the red flag is a guilty plea to criminal charges or if it affects life or limb. *Massey* is not so fact specific. It elaborates a rule of general application: "For fiduciaries of Delaware corporations, there is no room to flout the law governing the corporation's affairs." 2011 WL 2176479, at *21.

The Opinion describes the critical red flag in *Pyott* as one in which the corporation "was advised by its general counsel that its business plan included potentially illegal conduct." (Op. at 34) The email sent by Allergan's General Counsel pales in comparison to the red flags in this case. Allergan's General Counsel identified for the Board that the FDA had sent a letter to Allergan concerning off-label marketing of Botox by an Allergan-sponsored speaker at Allergan-funded dinner programs. The email "warned that '[t]his is a potentially serious matter and in the current environment, the chance of receiving Agency action, including but not limited to a Warning Letter, on this matter is in my opinion very high.'" 46 A.3d at 320 (quoting the email).

At Qualcomm, the directors did not need to be warned by an in-house lawyer about the equivalent of "the chance of receiving Agency action, including but not limited to Warning Letter." The red flags in this case include actual agency ***findings*** of violations of antitrust law, including a $208 million fine and corrective order by the KFTC and a Cease and Desist Order by the JFTC, relating to business practices inherent in Qualcomm's global business model. Qualcomm also suffered an adverse legal ruling in the Broadcom litigation in 2007, and paid $891 million to resolve Broadcom's claims in 2009. The danger posed to Qualcomm's business model by existing and future antitrust investigations was huge and obvious, given the charges that reduced the Company's 2009 earnings by approximately 40%.

The Court of Chancery's other principal basis for distinguishing *Massey* and *Pyott* is that Qualcomm's Board "was under the impression that its conduct did *not* violate applicable antitrust laws[,] … concluded that Qualcomm's business practices were legal, appealed the regulatory findings and penalties, and publicly proclaimed the Company's innocence." (Op. at 35) These conclusions are flawed for numerous reasons. They are founded on misinterpretations of Qualcomm's 10-Ks. They are inconsistent with *Caremark* and its progeny and with Rule 23.1 jurisprudence. They are also contradicted by the Complaint and the reasonable inferences to be drawn therefrom. In sum, the Vice Chancellor gave undue weight at the pleading stage to public protestations of innocence.

The Court of Chancery twice cites the non-existent fact that the 2009 10-K "characterized the Broadcom Action as 'without merit.'" (Op. at 7, 28) As noted above, the quoted phrase refers to Broadcom's patent infringement claims, not its antitrust claims. *See supra* at 13-14. Moreover, it is not reasonable to infer that any director believed Qualcomm was paying a competitor $891 million to resolve meritless antitrust claims. After all, Qualcomm had already suffered a serious defeat when the Third Circuit sustained antitrust claims and adopted a rule of law allowing antitrust liability to be based on unreasonable patent licensing terms. *See supra* at 7-9.

The 2009 10-K separately characterized the KFTC Decision and the JFTC Order as being "without merit" (A308), but that characterization cannot bear scrutiny. Qualcomm "recorded a $230 million charge" in connection with the KFTC Decision (A312), which means that Qualcomm deemed it probable that its intended appeal of the KFTC Decision would fail.[3] In 2012, Qualcomm ceased characterizing the antitrust proceedings against it as "without merit." (A427-28)

Protestations of innocence are not a defense to a *Caremark* claim at the pleading stage. A *Caremark* claim is properly pled if "a reasonable inference can be drawn from the particularized allegations of the Complaint and the documents it incorporates by reference that the Board knowingly approved and subsequently oversaw a business plan that required illegal [conduct]," even if the Court "believe[s] it more likely that the directors acted in good faith. *Pyott*, 46 A.3d at 356; *see also Massey*, 2011 WL 2176479, at *20 ("At a trial when a crucial issue would be the state of mind of each individual defendant charged with a *Caremark*

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[3] *See* PETER J. BRENNAN ET AL., NOW, NEVER OR SOMEWHERE IN BETWEEN?: THE NUTS AND BOLTS OF SETTING RESERVES, ACC Docket, at 5 (July/Aug. 2004), *available at* http://www.acc.com/_cs_upload/vl/public/ProgramMaterial/20446_1.pdf.

violation, these arguments would require careful consideration. At a pleading stage, however, they are of little moment in light of the particularized facts pled by the plaintiffs.").

"[W]hen a motion to dismiss for failure to make a demand is made, all reasonable inferences from the pled facts must nonetheless be drawn in favor of the plaintiff." *Delaware Cty. Employees Ret. Fund v. Sanchez*, 124 A.3d 1017, 1020 (Del. 2015). The Complaint does not plead any Board investigation into Qualcomm's licensing practices, any voluntary modification of those licensing practices, or any legal advice about antitrust law received by the Board. The Complaint pleads that the Section 220 documents did not evidence any efforts or actions taken by the Board to address violations of foreign antitrust law. (A48 ¶72) A reasonable inference to be drawn from the record is that the Board used litigation appeals, litigation defense, public relations advocacy, and a willingness, when necessary, to spend billions of dollars on paying fines and settlements, as means to preserve Qualcomm's profitable business model for as long as possible, without regard for its legality under antitrust law. That is sufficient to state a claim under *Caremark*. *See Pyott*, 46 A.3d at 355 ("It is not unreasonable to infer that the Board and CEO saw the distinction between off-label selling and off-label marketing as a source of legal risk to be managed, rather than a boundary to be avoided.”).

CONCLUSION

For all the foregoing reasons, Appellant Plaintiff-Below Melbourne respectfully requests reversal of the decision of the Court of Chancery.

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CERTIFICATE OF SERVICE

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