

Two telecom giants still duking it out

by Kathryn Balint

Qualcomm and Nokia were back in the ring again in April, punching and counterpunching with lawsuits, surprise announcements and arbitration demands as the last hours ticked away on their agreement to license each other's technology.

San Diego-based Qualcomm, a wireless technology developer, and Finnish cell phone maker Nokia agreed on little pertaining to the arrangement, parts of which expires April 9. But both say the dispute goes beyond a spat between two companies and has implications for the entire wireless sector at a time when third-generation cell phones are beginning to gain popularity.

"The industry is watching," said Michael Cohen, director of research for San Diego-based Pacific American Securities.

The disagreement is over how much Nokia should have to pay Qualcomm for using Qualcomm's patented technology, which, in large part, allows today's sophisticated cell phones to surf the Internet, play 3-D video games, transmit photos and download music.

On April 2, Qualcomm filed two patent-infringement lawsuits against Nokia. On April 5, Nokia paid Qualcomm \$20 million - an amount Nokia unilaterally decided was what Qualcomm's patents were worth for the second quarter of 2007. Qualcomm responded by saying the \$20 million was a fraction of what it would be owed for the quarter and filing a demand for arbitration.

The recent battles join a long list of skirmishes between the two companies that are pending in San Diego federal court, at the U.S. International Trade Commission in Washington, D.C.; at the European Trade Commission in Brussels, Belgium; as well as in courts in England, France, Germany and Italy.

"It's like a big chess game," said attorney John Gartman, a San Diego trial lawyer at Fish & Richardson who has represented Microsoft in intellectual property litigation. "You just have to think three moves ahead."

This is just the beginning in what is an epic battle for dominance in the global cell phone market. Once again, it's Qualcomm vs. the old guard.

The outcome is about more than bottom lines and share prices. Both companies claim that innovation will be stifled and cell phone prices will rise if their opponent wins.

TELECOM FIGHT - Qualcomm and Nokia are still duking it out in court over patent issues. CNS Illustration by Cristina Martinez Byvik.

"This really is, in many ways, much more than a fight over how much in royalties Nokia is going to pay," said Qualcomm general counsel Lou Lupin. "Fundamentally, I think this is a battle between an established, large, vertically integrated company against a company that really tries to innovate and tries to make quantum leaps in technology and then which shares all those innovations with the industry. If we're successful in making a lot of handset manufacturers successful, they're going to compete on price, as well as features. That's all good for consumers."

Nokia chief financial officer Rick Simonson sees his company, the world's largest cell phone maker, as the driver of industry innovation.

"You don't hear me or others here using terms like 'Armageddon,'" Simonson said. "We're somewhat boring when it comes to the press. We are not prone to hyperbole. We try to stick with the facts. We are the leader in the industry, and one that has done more than anybody to foster the innovation and growth that has happened in the mobile industry. That's why this is a little bit more of a story of not Qualcomm vs. Nokia, but more like Qualcomm vs. the whole industry."

Qualcomm licenses its technology to 140 companies, many of them well-known cell phone makers, from LG Mobile Phones and Kyocera Wireless to Motorola. Qualcomm generally charges from about 4.5 percent to 5 percent of the sales price of cell phones that use its technology, although specific contract terms are confidential.

Nokia is among Qualcomm's licensees - but perhaps not for long. The 2001 agreement in which Nokia and Qualcomm allow each other to use their patented technologies, expired, in part, April 9. Nokia has the right to renew the terms of the current contract at any time through Dec. 31, 2008.

"We just don't seem to be making any progress," said Qualcomm's Lupin, reiterating what other company executives have been saying for weeks. "We have no reason to think we're going to reach an agreement."

Nokia's Simonson said he'd like to reach an accord before the current one expires.

"The other party (Qualcomm) has said repeatedly over the last weeks and months that they're doubtful we're going to reach an agreement," Simonson said. "Well, it takes two parties to reach an agreement."

Both parties seem firmly entrenched.

"This is about money," Simonson said. "We want a lower price. That's what this is about, and that's quite well-known. It's only about that. What's fair, reasonable and nondiscriminatory."

If Qualcomm reduces its royalty rate for Nokia, not only will Qualcomm lose out on that potential revenue, but its other licensees also will likely insist on better deals.

In fiscal 2006, Qualcomm revenue was \$7.5 billion, more than one-third of which came from licensing and royalty payments from companies using its technology.

"We have no incentive to lower the rate," said Qualcomm's Lupin.

Qualcomm did not always wield so much power. When the company introduced its innovative idea to use CDMA, or code division multiple access, technology in 1989, established industry leaders scoffed. But Qualcomm persisted in pushing CDMA, saying it was the better technology.

The company eventually won over wireless carriers, and 193 of them now use the technology and pay royalties to Qualcomm. Qualcomm also created a near-monopoly in selling CDMA chips. More than 330 million cell phone users, or about 20 percent, use CDMA-based phones worldwide.

All the while, Nokia has dominated the market for cell phones based on a competing cellular technology known as GSM, or Global System for Mobile Communications, that accounts for almost 80 percent of the global market.

Unlike in the CDMA world, the large GSM patent-holders, including Sony-Ericsson, Nokia and Motorola, have generally allowed one another to use patents royalty-free, said Steven Re, president of Quality Growth Management in San Diego. He said the patent holders keep newcomers from breaking into the GSM market by charging these newcomers combined royalties of 16 percent and more on the sale of handsets.

Cohen of Pacific American Securities said Qualcomm likes to "keep the playing field level" by keeping royalty rates similar across the board so that one licensee doesn't have a large financial advantage.

Qualcomm likes to boast that its business model has helped new cell phone makers break into the market, such as LG, Samsung and Huawei have.

"They facilitated competition," Re said. "Nokia does not appreciate that, in particular."

The clash between wireless titans Nokia and Qualcomm comes as the paths of CDMA and GSM are beginning to cross.

Cellular networks that use GSM are increasingly being upgraded to a standard known as wideband CDMA. Eventually, many, if not most, of the world's cellular networks will use one version or another of Qualcomm's patented technology.

GSM cell phone makers, which didn't pay Qualcomm if they did not use the company's technology, will need to fork over payments to Qualcomm if they want to make advanced, third-generation cell phones.

Nokia paid \$500 million or more last year to Qualcomm in royalties, according to analysts' estimates, but as wideband CDMA spreads, it could face annual payments of \$1 billion or more to Qualcomm under its current contract terms.

Nokia refuses to continue to pay the same royalty rate it agreed to in 2001. Simonson, the cell phone maker's chief financial officer, said the current rate does not give Nokia credit for its substantial portfolio of wireless patents that, under a cross-licensing agreement, Qualcomm would be allowed to use.

"A lot of what we're debating here is the fact of who has the relevant, essential intellectual property in the technologies going forward, and what are those worth," Simonson said.

No one disputes that both Qualcomm and Nokia hold patents that pertain to wideband CDMA. The question is, whose patents are more essential in making a wideband CDMA cell phone?

"The scale tips in Qualcomm's favor," said Cohen, the Pacific American Securities research director. "You could say that Qualcomm's patents are about how the wireless standard works, whereas Nokia's patents tend to be minor features in the chips or handset."

Nokia disagrees with that assessment.

"Our position in wideband CDMA is actually more significant than Qualcomm's," said William Plummer, Nokia's vice president of external affairs.

If Nokia and Qualcomm do not come to an agreement, Nokia's Simonson said "nothing really happens." In other words, Nokia will continue to sell phones that use Qualcomm's technology, and the two companies will continue to negotiate, he said. But Nokia also will no longer pay the royalty rates it has in the past, he said.

On April 5, Nokia paid Qualcomm \$20 million in what Plummer said was "a gesture of good faith."

Qualcomm's Lupin said the \$20 million was "just a fraction" of what Nokia owes for the quarter.

Unless Nokia either stops using Qualcomm's technology or agrees to pony up royalties at the rate it has been paying all along, Qualcomm is ready to pounce.

"Nokia will be infringing on our patents," Lupin said. He and other Qualcomm executives have said repeatedly that the company is prepared to sue Nokia to recoup any lost royalties, plus damages.

Nokia's Simonson insists that no court would find Nokia to be infringing on Qualcomm patents when the current agreement gives the company until the end of 2008 to renew.

"It's pretty hard to say someone is willfully infringing on a contract when that contract gives them the option to renew out until December 2008," Simonson said.

Qualcomm itself may be at the receiving end of patent-infringement suit. Nokia argues that Qualcomm uses Nokia's patented innovations in its cell phone chips. Lupin denies that claim. Even so, Qualcomm chief executive Paul Jacobs warned investors at the annual shareholder meeting in March that Qualcomm expects to be served with a patent-infringement lawsuit by Nokia after the licensing agreement expires.

The game is high stakes. Nokia is one of Qualcomm's largest licensees.

Qualcomm said if the deal expires without a new agreement and Nokia stops making royalty payments, it could knock down Qualcomm's earnings per share from 4 to 6 cents for the fiscal year.

The company had forecast earnings per share of \$1.72 to \$1.77 for fiscal 2007, not taking into account the effect of Nokia's decision to pay a much smaller amount in royalties. Last year, Qualcomm earned \$1.44 per share.

Besides its battle with Nokia, Qualcomm is engaged in legal imbroglios with other companies worldwide. Its legal fees have soared from less than \$50 million in 2005 to as much as \$200 million for fiscal 2007.

Among Qualcomm's other adversaries: Broadcom, Ericsson, NEC, Panasonic Mobile Communications, Texas Instruments, Nextreaming and Thin Multimedia.

"We think that we charge a fair value for our patents, and we don't see any reason to reduce the rate," Lupin said.

Of all the ongoing disputes, none is likely more critical to Qualcomm's future than the one with Nokia, one of only four companies whose license to use Qualcomm patents in wideband CDMA products expires in the next decade.

"Of all the companies that Qualcomm is battling in the ramp to wideband CDMA, Nokia is likely to be the one with the most significant impact on Qualcomm share prices," said Cohen, the research director.

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