Demystifying the Indian FRAND Regime: The Interplay of Competition and Intellectual Property

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FRAND-encumbered SEP-holders have increasingly been involved in legal battles, arising out of the existing ambiguities in the FRAND regime. This essay attempts to deconstruct the complexities of the FRAND system and evaluate its economic soundness. In the Indian context, the development of intellectual property rights law has been intricately linked to the political ideologies that inspire the incumbent governments. The essay seeks to relate the political motivations and the economic impact to achieve a harmonious understanding of the current framework of FRAND licensing in India. In light of recent judicial developments, the growing convergence of competition law and patent law has been discussed, with particular emphasis on the competing jurisdictional claims. Undertaking a critical appraisal of the Indian model as it currently is, the essay suggests modifications to increase the suitability of the Indian economy while maintaining the balance between public policy and competitive markets.

Keywords: Standard Essential Patents, Jurisdiction of the CCI, FRAND, standard setting organization, FRAND licensing, TRIPS, Indian Patents Act, 1970

Today’s liberalized economy survives on the merits of innovation. Naturally, inventors are entitled to protect their creations and enjoy the rewards of their labor. These privileges and rights are recognized through the grant of patents. Patents are essentially monopoly rights bestowed upon human inventors by governments for a limited period of time. Upon the expiration of this period, this creation can be freely manufactured and sold. The owners are free to license or sell off their patents to third parties. Likewise, non-owners can enter into legally enforceable negotiable agreements with the patent-holders to earn access to the patented product.

As the world welcomes newer inventions, it becomes imperative for certain technical standards to be set in order to ensure compatibility in the quality of products. A standard can be defined as a document which provides requirements, specifications, guidelines or characteristics that can be used consistently to ensure that materials, products, processes and services which are fit for their purpose. A practice popularized during the Industrialization of the West, standardization ensures compatibility and interoperability in the international marketplace. It would be impossible for mobile phone operators, computer manufacturers and even television receivers to function without such interoperability.

Standard essential patents are “patents essential to implement a specific industry standard. This means that it is impossible to manufacture standard-compliant products such as smartphones or tablets without using technologies that are covered by one or more standard essential patents (SEPs).” In the case of Microsoft v Motorola, the Court defined a given patent to be essential to a standard if use of the standard requires infringement of the patent, even if acceptable alternatives of that patent could have been written into the standard.

Standard setting organizations (SSO) are entrusted with the responsibility of monitoring the interactions between competing companies in arriving at the appropriate technical standards, ensuring transparency and inclusive decision making at every stage. The Institute of Electrical and Electronic Engineers (IEEE) and International Telecommunication Union (ITU) are prominent SSOs in the cellular and Wi-Fi space.

During the development of standards, SSOs are typically presented with a range of competing technology solutions that can potentially achieve the same result. However, once an SSO chooses a particular technology, the SEP-holder’s “bargaining
power surges because a prospective licensee has no alternative to licensing the patent; he is at the patentee’s mercy.\textsuperscript{46} The \textit{prima facie} anti-competitive connotation of SEP’s cannot be ignored. In order to prevent discriminatory behavior by patent-holders, SEP-holders are permitted to license their patents only on fair, reasonable and non-discriminatory terms (FRAND), with the added incentive of immunity from punitive action. It needs to be noted that the SSO is only responsible to ensure that the licensing agreement is negotiated on FRAND terms and not for the ascertainment of the validity of the SEP itself.

The introduction of FRAND licensing has created quite a whirlwind in the patent regimes all over the globe. The ambivalence created by FRAND-encumbered SEP licenses has assumed a geo-economic color as standard setting organizations, patent-holders and the users of the inventions have all become equal stakeholders.

\textbf{Understanding FRAND Terms}

FRAND licensing was introduced to ensure that SEP-holders are bound to the standard-setting organizations by their commitments of fairness and reasonableness and prevented from obstructing technological development.

However, there is considerable dispute regarding the objective standards qualified by the FRAND commitments. The first prong deals with ‘reasonableness’. Some experts are of the view that the royalty claimed should be equal to the incremental value of the standardized technology, when compared to its alternatives. There are other proponents who argue that the royalty should target that component which is majorly responsible for the functionality of the patent. This is often referred to as the ‘smallest saleable patent practicing unit’.\textsuperscript{7}

FRAND royalty rates were determined for the first time in the case of Microsoft Corp v Motorola Inc, that involved the 802.11 Wi-fi standard and H.264 video coding standard developed by the IEEE and ITU respectively. Delivering a landmark judgement, Justice Robart considered a hypothetical negotiation setup, consistent with the Georgia Pacific factors.\textsuperscript{8} According to this approach, the negotiations between the licensor and the licensee prior to the adoption of the standards are taken into account. The Court added that the FRAND royalty rates should commensurate with the value of the technology added to the overall standard.\textsuperscript{5}

Once the patented standard receives commercial acceptance, it becomes locked in since the licensee is obligated to implement the standard. Most SEP-holders exploit this patent hold-up to their advantage. Patent hold-ups can be averted by prompt intervention of the SSO’s. However, courts are best equipped to determine the most reasonable royalty rates, evaluating the benefits of the product and the equity considerations involved.

Lately, SEP-holders have begun to engage in unfair practices such as royalty stacking in order to extract unreasonable royalties. Royalty stacking refers to the addition of royalty for each of the components of an SEP. While this is a logical and natural phenomenon in most wireless technology, royalty stacking becomes worrisome when the royalties for each component are compounded to achieve a higher aggregate than the price of the product itself. As a result, the licensee cannot bear the licensing fee while maintaining a reasonable profit margin. However, some manufacturers have been blamed for keeping profit margins too low. Recent litigations also demonstrate the lack of genuineness in royalty stacking claims, with most defendants failing to convince the judges of its actual harm.\textsuperscript{9}

The second aspect deals with ‘non-discriminatory’ practices. The ambit of this prohibition is subjected to much debate. While some scholars are of the view that patent-holders should be permitted to choose the licensees of their intellectual property at any level of the supply chain, others do not seem to support the notion of permitting SEP-holders to engage in such selective licensing practices.

\textbf{The Economics of FRAND Licensing}

Scholars have compared the system of FRAND licensing to that of a joint venture that is headed by the standard setting organizations, equating the FRAND commitments to ancillary restraints that are necessary for the collective success of the joint venture. Evolved through the course of common law,\textsuperscript{10} the Doctrine of Ancillary Restraint permits few firms to collectively restrain competition, as a trade-off for the greater good of productive efficiency.

There is no doubt that mainstream economics sees patent as a tool for granting monopoly to patentees.\textsuperscript{11} The underlying assumption of this notion, inspired by the Schumpeter Doctrine,\textsuperscript{12} is that monopoly profits are the only means of incentivizing invention since the rents generated from competitive pricing are not sufficient enough to cover the expenses incurred on
research and development. However, this assumption is laden with discrepancies that require deliberation.

Since, the standards are not substitutable; therefore, there is no question of competition between the patent-holders. In fact, the standard setting organizations promote competition among market players, not at the cost of the technology offered to the consumers. This circles back to the most important internal tool of patent law itself, which is the right to exclude. The patent itself does not guarantee the right to exclude. It is the market acceptability and non-substitutability of the product that confers such market power upon the patent-holder. In essence, the right to exclude is the property of the patent. If this right is taken away, then the patent has no value. The basic structure of the FRAND system is therefore economically sound and does not threaten the licensee’s interests. However, this system is not immune to abuse and it is this abuse that qualifies as anti-competitive behavior.

**Theory of Injunctive Relief**

Traditionally, the plaintiff in patent suits is entitled to injunctive relief. By way of issuing an injunction, the infringer is prevented from practicing the invention and compensatory damages are awarded to the patent owner for the past infringement.

Some experts are of the view that FRAND-encumbered SEP-holders should be prevented from obtaining injunctive relief. The rationale is the potential for abuse by SEP-holders who have the discretion to extract exorbitant royalties and impede the implementation of the standard. The precedent of denying injunctive relief is primarily based on the balance of convenience rule and the inadequate remedy rule. Courts did not believe in granting injunctive relief when the cost to the defendant of obeying the injunction was substantially greater than the objective benefit to the plaintiff. On the other hand, those who support the grant of injunctive relief stress on the fact-specific nature of FRAND commitments.

The United States’ Supreme Court has enunciated a four-pronged test in order to issue injunctions. According to this, “plaintiff must demonstrate: (1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.”

In the recent dispute between Ericsson and TCT Mobile in the France, the courts emphasized on the principle of proportionality of the interests involved while granting injunctions and took the contractual context into consideration while pronouncing its decision.

While most national laws allow injunctive relief in FRAND cases, the degree of discretion conferred on the injunction issuing authorities varies from country to country. In some jurisdictions such as Germany, once the fact of infringement is proved, there is no discretion conferred upon the Courts with respect to the granting of injunctions.

In contrast, China has incorporated the aspect of FRAND-based defense which is available absolutely if the patentee has participated in the standard-setting process and subsequently filed a suit for infringement. Indian courts have not adopted a consistent approach in this regard and continue to evaluate the public policy implications of denying benefit to the consumers on case to case basis. Since, standard setting organizations are not responsible for determination of the essentiality of the patent, the burden on the litigants is heightened.

**The Political Backdrop for the Indian IPR Laws**

Intellectual property rights significantly contribute in the distribution of political power among different countries. India has been able to withstand pressure from the United States and the European Union till date. The Indian Patents Act, 1970, based on the Ayyangar Committee Report is an exemplary legislation that demonstrates the importance of balancing the needs of the Indian social milieu and the international standards governing intellectual property regimes (with special emphasis on the pharmaceutical industry). After much persuasion and deliberation, India became a signatory to the Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement in 1995. A highly controversial agreement, the TRIPS, required patent agreements in all sectors not withstanding the fact that at least 50 countries did not have patents over food and other essentials.

Western lobbies have particularly expressed their disapproval of Section 3(d) of the Indian Patents Act, which was the subject of the Novartis dispute. The stated provision disallows patents for similar products so as to encourage market competition and prevent
abuse of the patent system. India has also been accused of favoritism towards patents filed by Indian companies.  

During this time, the contentious issue of parallel imports was raked up. Parallel import is the import of patented products outside the distribution channels that are contractually negotiated between the licensee and the patent holder. The doctrine of international exhaustion, which is attracted in such a scenario, states that the patentee loses his or her rights of control after the first sale of the patented product.

Under Section 107(A)(b) of the Indian Patents Act, subsequent to its amendment in 2005, such an importer need not ensure that any of the subsequent sellers from he or she buys the goods were expressly or impliedly authorized by the patentee. The Amendment seeks to ensure availability of the patented product at the minimum international market price. A harmonious construction of Section 107(A)(b) leads to the understanding that the law of the exporting country will be the applicable law, which ensures that the legislation is in compliance with the TRIPS requirements as well as Section 48 of the Patents Act itself.

Prima facie, this move embodies the spirit of international exhaustion. However, the underlying public policy considerations which are fundamentally associated with India’s founding principles cannot be undermined. This legislation essentially seeks to make life-saving drugs more affordable for the Indian populace, contributing towards the increasing price differential between developed and developing economies.

Truly, governments have persistently endeavored to accommodate the needs of the indigenous manufacturers as well the Indian population within the IPR framework, the latest efforts being the Make-in-India and Digital India schemes. While the Union Government’s flagship initiatives may be doing the rounds amidst global investor circles, they also highlight the loopholes in the existing judicial protection for intellectual property in India. The Union Budget for the 2015-16 year has provided a 11.5% duty advantage to domestically manufactured mobile phones and 10.5% duty advantage to tablets. Indirect taxes have also been slashed to reduce manufacturing costs.

Based on data released by the Telecom Regulatory Authority, India is the world’s second-largest mobile market by number of subscriptions. Its active user base is more than 770 million and there is still ample room for expansion, as this figure accounts for only 62% of the country’s population. Thriving on the government’s promises and the scope for expansion, Indian manufacturers like Spice and Lava as well as foreign firms such as Mediatek have made heavy investments in mobile phone plants. However, the IP run has not been smooth ever since.

The FRAND-ly Wars

The mobile phone industry has been severely affected by the caprices of the FRAND regime. The first Asian case involving standard essential patents was the patent dispute between mobile giants Apple and Samsung in 2012. The Grand Panel of the IP High Court in Tokyo held that seeking damages exceeding the FRAND conditions would be deemed to be an abuse of right unless special circumstances justified such behavior. Therefore, the Court ruled that Samsung could not claim damages exceeding the tune of $100,000.

Soon enough, India was chosen as the seat for FRAND-based litigation. In 2013, Ericsson, a global giant in mobile manufacturing, filed a patent suit against Micromax in the Delhi High Court seeking an ex parte and permanent injunction alongside damages for Micromax’s usage of wireless technology such as EDGE and 3G without paying royalties. This case set many legal precedents. Firstly, Ericsson claimed compensatory damages to the tune of approximately 16 million dollars, which is the highest claim for damages ever made in a patent suit in India.

A single judge of the Delhi High Court granted an ex parte injunction and ordered confiscation of Micromax consignments at customs. The Court, in an unprecedented ruling, also ordered Micromax to deposit money in the range of 1.25% -2% of sale price affected as a condition precedent to the release of such products.

Secondly, this was for the first time that the jurisdiction of the Competition Commission was invoked in a patent infringement suit as a result of the counterclaim filed by Micromax in the Competition Commission of India (CCI) alleging abuse of dominance by Ericsson. It claimed that the royalty charged by Ericsson was based on the value of the entire product rather than only the functional component.

The CCI in turn ordered an investigation of the issue and found Ericsson to have prima facie violated
its FRAND commitments to Micromax. It also expressed concern that the threat of injunctions in the patent battle (at the Delhi High Court) could distort FRAND licensing negotiations and lead to licensing terms that licensees would normally have rejected in the absence of this threat.\(^{33}\)

Inspired by the first bout of litigation, Ericsson filed a similar suit on the same grounds against Intex, a domestic manufacturer of computer peripherals, mobile phones seeking damages worth $9 million and an *ex parte* and permanent injunction. Intex adopted the non-essentiality argument and claimed that an injunction could be awarded only after validity of the patent was established beyond doubt under Sections 8 and 64 of the Indian Patents Act.\(^{34}\) However, the Court rejected Intex’s arguments and granted an *ex parte* injunction. Ericsson is also involved in a pending suit against Chinese vendor Xiaomi, alleging violation of requests for patent royalties.

The Interplay of Competition Law and Patent Law

The legal tussle between Ericsson and Micromax highlighted the growing interface between competition law and intellectual property rights law. Since SEP’s are *sine qua non* to the implementation of technologies, it is only but natural that the risk of abuse of dominance exists. The European Union Treaty prohibits anti-competitive and abusive behavior under Article 82; as does the Competition Act of 2002.\(^{35}\)

In both cases, the CCI remarked that Ericsson was a dominant player having 33,000 patents to its credit, with 400 of them granted in India. The royalty rates charged by Ericsson had no linkage to the patented product and increased proportionately with the cost of the product, thereby qualifying as discriminatory (on grounds of patent hold-up as well as royalty stacking). In the Intex dispute,\(^{36}\) each user was made to sign a non-disclosure agreement. By virtue of this arrangement, users were denied to use information pertaining to the royalty rates charged from other users. This hindered the FRAND spirit and reduced transparency. The Intex–Ericsson Agreement also barred Intex from approaching Indian courts (which is the applicable jurisdiction since both parties conduct business in India) and conferred jurisdiction to Sweden and Singapore. The CCI, therefore, held Ericsson liable for abuse of dominance under Section 19(1)(a) of the Competition Act, 2002.\(^{36}\)

The Politics of Jurisdictions

Ericsson challenged the jurisdiction of the CCI before a single judge bench of the Delhi High Court which expressed its displeasure at the CCI’s intervention and directed the Director General of the CCI to refrain from further inquiry.\(^{37}\)

In both cases, the CCI relied on the Clause 6 of the ETSI IPR policy and determined the royalty rates on FRAND rates, rejecting Ericsson’s claims that the same was a purely contractual issue.

With prominent firms embroiled in patent litigation, the debate over the jurisdiction of the Competition Commission has been rekindled. Section 3(5) of the Competition Act exempts IPR holders from the provisions of the Act, granting them monopoly over its exercise. However, Section 62 of the said Act states that the provisions of the Act are only in addition to and not in derogation of any other law. The Preamble also makes it clear that the objective of the Commission is to protect consumers from anti-competitive behavior and abuse of dominant position. The Commission, therefore, played the welfare legislation card to justify its jurisdiction.

As has been discussed above, the standard setting organizations were formed to enhance and promote competition by developing standards. Everyone competes, but not at the cost of technology reaching out to people.\(^{38}\) The licensing fees incurred imposed on non-patent owners will naturally be slightly higher owing to the lack of negotiable patents, as a trade-off giving them the opportunity to partake of the innovation and offer them to consumers. Thus, technical contributors and non-contributors can make, sell, import products compliant with the set standards and contribute to the patenting process. However, the CCI failed to appreciate this. In both the cases, the CCI arrived at its decision on the basis of circumstantial evidence ignoring the nuances of the FRAND regime.

Furthermore, the jurisdiction of the courts cannot be undermined since SEP-holders thrive on the contractual negotiating powers of the parties. Ignoring the contractual nature of SEP agreements disincentivize the SEP-holders and is an indirect deterrent to innovation itself. The threat of injunction is the driving force behind the proof of essentiality of the patent. An unwilling licensee should not be able to hide behind competition or public good to force the SEP holder into a royalty rate – that would make it a compulsory license.\(^{41}\) Surely, only time will put to rest the debate sparked over the jurisdiction of the
against pressure from the global superpowers.

abide by international standards of intellectual

Government’s recent expression of willingness to

international power-play. The criticism directed at the

naturally have deep-seated implications on the

cannot bear the costs of patent litigation. As has been

thwart innovation from the local manufacturers who

reputation of the Indian judiciary. Such decisions also

dominance of the SEP-holders, since this weakens the

interest. India cannot afford to succumb to the

licenses in the past did not fare quite well, it is but

natural that the apprehensions prevail.

As we face more IPR battles, the flaws of the

judicial system become apparent. It is amply clear that

despite its flaws, Indian courts are consciously trying to

make the Indian regime more suitable to the FRAND

requirements by arriving at legally justified decisions.

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