

royalties or technical fees which the manufacturer may pay to recipients abroad.

Also under the Law for New and Necessary Industries any business enterprise benefiting from said law must restrict its payments for the use of technology, patents, trademarks and tradenames to a certain percentage fixed in each instance to the Department of Industry and Commerce.

Also in the case of certain industries in which the Government exercises a monopoly, such as petroleum, electricity, etc. The Government corporations operating such industries have a limitation regarding the amount of royalties which they may pay for foreign technical assistance or for the use of patents, trademarks and tradenames.

While no one can say which is the amount of royalties which can be collected from a Mexican licensee without problems, one may say that any amount below 4% of net sales is quite acceptable, in general, although, of course, there may be variations in specific fields of the industry. In any event all license agreements should be in written form and while there is no general obligation to register same it is most convenient to do so specially in the case of trademarks to prevent their lapsing for lack of use. In some instances, the registration of license agreements is obligatory for tax purposes and to show that the rates charged do not exceed those set forth by the limitations established if the licensee is enjoying tax exemption benefits or if the field of its industry is subject to restrictions as I have explained above.

**About the Speaker: Lic. Jaime Delgado Reyes: Place of birth — Chihuahua, Chih. Profession — Attorney-at-Law, 1954 — University of Guadalajara, Master of Comparative Jurisprudence, 1957 — New York University. Member of the Interamerican Bar. Founder associate of A.S.I.P.I. Past Treasurer, Past Second Vice-President and active member of A.M.P.I. Active member of the Mexican National Group of A.I.P.P.I. Partner of the firm Goodrich, Dalton, Little & Riquelme.*

Publications: TRADEMARK FILING REQUIREMENTS — 1965. UNITED STATES PATENT LAW ASSOCIATION. SCOPE OF CLAIM IN MEXICAN PATENTS — 1969. AMERICAN BAR ASSOCIATION, THE INDUSTRIAL PROPERTY AND THE MEXICAN ECONOMY — 1972.

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Mariano Soni

COMMENTS ON RESTRICTIVE PROVISIONS IN LICENSE AGREEMENTS

*by
Mariano Soni**

“Industrial Property does not constitute an obstacle to the economic integration of the countries”.

“To allow a patent to fulfill its role in the access to technology and industrial development of a country or region it is necessary that a sound and efficient patent system exists and is put into practice.”

“The controversies about the eventual value of a patent system have come from the fact that in many areas the patent systems have not been kept up to date with the needs which have arisen from the economical and industrial development of countries or regions. In order to accomplish these purposes it is necessary. . . to give emphasis to prompt publication and accessibility for the interested circles, and further to have a good classification system which allows efficient searches for desired subject matters, as well as means to permit the working of a patented invention in a country or region either by the patentees or through licensees”.

“Royalties should be considered legitimate payment to purveyors of technology in consideration for their rights and in compensation for their work and investment in the creation of the technology and for their assistance to its users and to the collectivity in general”.

“Royalties must be adequate to compensate the purveyor of the technology and at the same time equitable to avoid undue hardship to the user or the owner”.

“The principle of free negotiation between the parties to agreements relating to the transfer of technology should be retained”.

"That the recognition of the rights of the suppliers of technology to receive a compensation and the declaration in favor of the principles of free registration do not imply to ignore the right, that is also an obligation, of the State to take the necessary measures to prevent any abuse from one party against the other or of any of them in detriment of the public".

The above quotations are part of the Resolutions adopted at the Third Congress of the Interamerican Association of Industrial Property, held in Caracas, Venezuela, from May 18 through 21, 1971.

We fully endorse the above mentioned principles, but we cannot and should not close our eyes to the reality that our countries are facing.

We believe that it is beyond dispute that industrial property plays an essential role in the industrialization of developing countries.

Likewise we realize that the industrialization of a developing country implies an expense. We do not challenge the right of a licensor to recover, through royalties and similar payments, the cost of research.

We feel, however, that either due to ignorance, bad faith or nearsightedness, the essence of the license agreements, for the transfer of technology, that is technical services, know-how and patents and trademarks, in general, in many instances have moved our governments, to consider them in a more deep and concerned manner and to try to regulate them.

It appears to us that the problem of currency, in those countries where an exchange control exists, has passed to a secondary place.

Our countries are now more concerned with other aspects.

It is believed that it has been tried in vain to convince the governments to the contrary, that the main purpose of the license agreements is to export currency at lower tax rates than those applicable to the ordinary income of a company (in those cases where the licensee is a subsidiary of the licensor). Moreover, in some cases the transferred technology has been inadequate, obsolete or useless.

We consider the former ideas as the cornerstone of the problem, and our governments after analyzing it, have also noted several other provisions that constitute a restriction on the development of the licensees, and consequently of the country.

Which are those provisions in the license agreements that are now under scrutiny in many countries, and specially in Latin America? We call them restrictive provisions and following are some examples of the same:

- 1) Total prohibitions to export goods.
- 2) Prohibition to export to certain countries.
- 3) Exportations may be effected only according to prefixed quotas.
- 4) Exportation prices of goods are established by the licensor.
- 5) Prior approval of the exportation must be obtained from the licensor.
- 6) Exportation may only be made to certain companies or the sales must be made through them.
- 7) Substitute products for those for which the

license is granted may not be exported.

- 8) Exportation is permitted only to determined countries.
- 9) Exportation is permitted only of certain specific goods.
- 10) Disclosure of the contents of the agreement is not permitted.
- 11) Licensee must acquire from the licensor the equipment, tools, raw materials, or the intermediary products used in the process.
- 12) Licensee is obligated to maintain production standards.
- 13) Licensee must transfer to licensor any improvement developed by the former over know-how, patents, etc.
- 14) Prohibition to export using licensor's trademarks.

Our first impression after going through the above mentioned provisions is of disbelief or amazement. We have executed or assisted in the execution of license agreements that contain, one, two or all of said provisions. How is it that these agreements are hurting the economy and development of a country?

Many of the restrictive provisions in our opinion are necessary; others may either be attenuated, softened or eliminated.

Let us try to analyze them in detail.

1. *Total prohibition to export goods*

Taking into consideration the situation of our countries, usually lower wages, cheaper power, tax incentives, preferential import duties (such as in the LAFTA countries), etc., usually goods manufactured in our countries and exported to other foreign countries, have a lower price than the same goods manufactured by the licensor.

Therefore, it is inconvenient and uneconomical for the licensor, to permit the exportation of goods manufactured under a license.

In certain instances the provision is sound and duly based, such as in the case where the licensor has licenses in other countries and obviously another licensee should not export in order to avoid detriment to the other licensee. However in these cases the interest and benefit of the developing countries is not taken into consideration, and obviously provisions such as these do not favor the economic and industrial growth of our countries.

2. *Prohibition to export to certain countries.*

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This provision may have its basis in those cases where a licensee exists in the specific country. However this is not always the reason behind the provision.

As mentioned above in many instances the licensor has established its "exclusive" zone of influence, where it does not wish competition even from its own licensees.

3. *Exportation may be effected only according to prefixed quotas.*

Usually a provision such as this fixes a quota or limit on the exportations that the licensee may make. The limit may be on the amount of the goods manufactured or on the amount of money represented by the exportations. In these cases, the licensor does not mind the territories where the exportations are to be made, but the intention is to stop in a predetermined amount the developing capacity of the licensee, to prevent competition, and to maintain the demand and price of the goods due to lack of supply.

4. *Exportation prices of goods are established by the licensor.*

This provision seeks to control the prices of the goods in the international market. In many cases a similar provision is used in order to maintain the price of the goods in the country where the licensee is established.

5. *Prior approval of the exportation must be obtained from the licensor.*

As in the former cases, the licensor seeks through this provision a control on the price of goods, the purchasers and the territory where the goods may possibly be exported.

Since it is usually on the discretion of the licensor to grant or refuse the authorization to export, the licensee may do very little or nothing at all to overcome any objection of the licensor.

6. *Exportation may only be made to certain companies or the sales must be made through them.*

As discussed before, the licensor through this provision may control the prices of the goods. Generally, the purchasing company is a subsidiary of the licensor or has a sales or distribution agreement, whereby the goods must be sold at certain prices, is determined territories and conditions.

7. *Substitute products for those for which the license is granted may not be exported.*

This we believe, is one of the most serious causes of discomfort in our countries.

It has two adverse effects: on one hand it discourages the inventive ability and the research of the licensee, in view of the fact that it may not export (and in some cases not even sell in its own country) substitute goods that may be cheaper or better than the licensed product.

On the other hand and as a consequence the licensee may not expand in a parallel manner, that may save the payment of royalties, since it may not be able to sell or export the substituted goods.

8. *Exportation permitted only to determined countries.*

As discussed in point 2 above, the provision may be based on other commitments of the licensor. That is,

the licensor may exclude certain countries, because it has in them other licensees, and allow the exportation to other or determined countries.

9. *Exportation permitted only of certain specific goods.*

This provision may be related to that discussed under point 7 above. Likewise it may be based on other agreements of the licensor. We may imagine a licensee in Mexico that is authorized to manufacture a complete TV set, and it is only authorized to export to Peru certain components, since the licensor has in the latter country a licensee that assembles the complete set.

10. *Licensee may not disclose the contents of the agreement.*

We believe that this provision should not be considered "restrictive" in the light of the previous analysis since it is beyond any doubt that both the licensor and licensee should try to protect the information, know-how, etc., transmitted under the agreement.

11. *Licensee must acquire from the licensor the equipment, tools, raw materials or the intermediate products used in the process.*

This provision is very criticized; on one hand the licensor may in good faith try to maintain the licensed goods' quality standards by furnishing itself the raw or intermediate materials for the finished good. But on the other aspect, the licensor may try to increase the revenue derived from the license by charging excessive prices for the raw materials or to establish control on the price of the finished goods and eventually of its exportation price.

12. *Licensee is obligated to maintain production standards.*

We feel that this a "must" provision in all license agreements and all governments should require that such a clause be mandatory.

The reason is that the public should be guaranteed that the licensee maintains the same standards in the product as those of similar products purchased in the international market.

Our present Law of Industrial Property establishes in Article 164, which refers to the conditions that a trademark licensee and the contents of the agreement must fulfill in order to be recorded, as "authorized user", that the degree of control that the licensor shall exercise over the use of the trademark be indicated, as well as the limitations established with respect to the characteristics of the products.

Similar requirements are provided by the Colombian Law in Article 596 of its Commerce Code to insure the quality of the licensed products or services, and in the event of default, the proper authorities may take the necessary measures to guarantee that the products meet the quality standards.

13. *Licensee must transfer to licensor any improvement developed over the know-how, process, etc.*

Usually this provision requires that the transfer of the improvements be made to the licensor free or at a token amount.

The provision in question represents a serious disadvantage for the licensee, since it is deprived of its

improvements which may represent that no more royalties are to be paid to the licensor.

In addition, we feel that it also discourages the licensee from research, since it knows that the improvements that it may develop will benefit it in a low grade.

Under our laws this provision faces another problem, that is, the ownership of the improvement.

Article 163 of the Mexican Federal Labor Law, provides that the rights to the ownership and exploitation of an invention made within a company, shall be subject to the following conditions:

a) The inventor shall have the right to have his name appear as author of the invention.

b) When the employee is devoted to research or development of processes used in the company, for the company's account, the ownership of the invention and the right to exploit the patent shall correspond to the employer. The inventor, in addition to the salary which he may have received, shall have the right to receive a supplementary payment, which shall be determined by agreement between the parties or by the Conciliation and Arbitration Board, whenever the importance of the invention and the benefits which may be derived in favor of the employer are not in proportion with the salary received by the inventor, and

c) In any other case, the property of the invention shall correspond to the person or persons that created it, but the employer shall have the preferential right, in equal circumstances, to its exclusive use or to the acquisition of the invention and of the corresponding patents.

Under the circumstances, it appears from the above, that the licensee may not freely agree to the provision in the license agreement in which it is obligated to transfer the improvements to the licensor.

On this aspect, it should be noted that under the Brazilian Law on Industrial Property, the ownership of the improvements belongs to the employer, subject to certain conditions and the Peruvian Law provides that the ownership belongs to the employee, as we will see hereinbelow.

14. *Prohibition to export using licensor's trademarks.*

This provision is of course very closely related to many of the discussed before.

We feel however that to certain extent, it is more related to the provisions prohibiting the manufacture of substituted goods, since the licensee may be discouraged from trying to improve the product, which it cannot sell with the licensed trademark.

On this aspect it should also be considered that a licensee may not try to promote a trademark as much it would be desired, since when it is not authorized to export products bearing it, the prestige and acceptance that the goods may have, will not benefit it in the international markets.

Now let us take a look at the measures that certain governments have adopted in order to curb what they consider as abuses in this field.

First of all, we should consider the provisions of

the Subregional Integration Agreement better known as the Cartagena Agreement or the Andean Pact, subscribed by Ecuador, Colombia, Peru, Chile and Bolivia.

The well publicized Resolution No. 24, was adopted in the meeting held from December 14 through 31, 1970, and it provides in Article 20 that the member countries shall not authorize the execution of agreements for the transfer of technology or patents from abroad providing:

a) That the recipient of the technology or the licensee of the patents is obligated to acquire from a determined source, assets, intermediate products, raw materials and other technology or the obligation to use permanently personnel determined by the supplier of the technology.

In exceptional cases the governments may accept such a provision when the goods or assets in question have the same value or price in the international market.

b) That the licensor fixes the price of sale or resale of the goods manufactured with its technology.

c) Restrictions on the volume and structure of the production.

d) Provisions prohibiting the use of competitive technologies.

e) Clauses establishing a preferential right for the owner of the technology to acquire all or part of the licensee's production.

f) Provisions imposing upon the licensee the obligation to transfer to the licensor the patents or improvements to the technology in question.

g) Clauses establishing the obligation to pay royalties on unused patents, and

h) Any other clause of an equivalent effect.

This article provides expressly, that only in exceptional cases, duly approved by the proper authorities, clauses that prohibit or limit in any manner the possibility of exporting the finished goods manufactured under the licensed technology will be admitted.

Likewise it is established that in no event shall clauses prohibiting exportation be admitted, when the exports are to be made to the subregion countries, or in the case of exportation of substitute products to third countries.

In the field of trademark licenses, Decision No. 24, in Article 25 establishes that the following restrictive clauses shall not be admitted in the agreements.

a) Prohibition to export or sell to determined countries products covered by the trademark or the exportation of substitute goods.

b) The obligation to use raw or intermediate products furnished by the trademark owner or its affiliates. This provision may be accepted when the prices correspond to those of the international market.

c) The fixing by the licensor of the sale or resale price of the products.

d) Payment of royalties on unused trade-

marks.

e) The obligation of the licensee to employ permanently personnel furnished or appointed by the licensor, and

f) Any other provision of an equivalent effect.

The member countries must follow the provisions of the Cartagena Agreement and in addition, some of them are establishing their own Regulations on this aspect. Such is the case of Colombia in Articles 559 and 599 of its Commerce Code in the Chapter dealing with Industrial Property, which considers null and void, clauses in license agreements that impose limitations in the commercial or industrial aspect that are not derived from the patent or trademark rights.

In Argentina, since 1970 the government began establishing certain "Policies" orienting and regulating the transfer of technology.

For instance, Policies Nos. 116 and 152 provide that the agreements for the transfer of technology should not include clauses restricting exports, and in those cases where such clauses exist, the agreements should not be renewed.

The first Argentinian Law that regulated restrictive clauses, is Law No. 19,135 of July 22, 1971, concerning the automotive industry.

Article 30 of this Law provides that the license agreements should not contain restrictive clauses such as the possibility of the licensor to regulate the production, distribution, investment, research or technological improvement of the technology; the purchase of equipment or raw materials from a determined source; prohibition to export or subject to the prior approval of the licensor; the transfer to the licensor, either by onerous or free consideration; the improvements, patents, trademarks, etc of the licensee; the fixing of sale or resale prices by the licensor; the payment of royalties on unused patents.

Of a special importance is the provision in this Law establishing maximum royalties which may not exceed two percent of the net profits produced by the licensed goods or services.

As mentioned before this is a specific law for the automotive industry. However the law applicable to all the transfers of technology was passed on September 10, 1971, creating the National Registry of License Agreements for the Transfer of Technology (Law No. 19,231).

This Law in essence is similar in its contents to the Law just discussed but it includes certain other relevant concepts and legal conditions.

Agreements containing the following provisions (we will only refer to those not already mentioned before) will not be recorded:

a) The license of a foreign trademark or of an Argentinian trademark owned by a person residing abroad, when no innovation or technological contribution is involved.

b) When the technology in question may be obtained in the country.

c) When the royalties are not balanced with the value of the transferred technology.

d) When the interpretation of the agree-

ments is subject to a foreign courts jurisdiction.

e) The Executive Branch may establish the maximum percentages of royalties to be paid.

f) Agreements not recorded with the Registry will be null and void and their observance may not be claimed in the Argentinian Courts.

g) Royalties paid under agreements not recorded with the Registry, may not be deducted for tax purposes.

h) In view of the fact that a currency exchange control exists in Argentina, foreign currency may not be obtained from the proper banking institutions, if the agreement is not recorded.

i) Tax incentives may be enjoyed by companies that record their agreements.

In Brazil, Law No. 5772, establishing an Industrial Property Code was passed on December 21, 1971.

The highlights of this Law are that the royalties shall be fixed by laws and that the improvements to the technology shall be the property of the licensee. Limitations to the marketing and exportation of goods may not be imposed by the licensor.

Of special interest is the provisions establishing that the recording of license agreements will not be effected when the licensor is domiciled abroad, and the patent in question does not enjoy priority rights according to International Agreements to which Brazil is a party (we understand Brazil is bound by the Hague Text of the Paris Convention and it is also a member of the Patent Cooperation Treaty, 1970).

By means of this meteoric trip through South America we have tried to give a general idea of the situation in the mentioned countries, and now we have finally returned to Mexico.

As indicated at the beginning, we feel that due to factors that are not worth mentioning again, the contents of the agreements for the transfer of technology have been in many cases ill advised.

Our authorities for many years have been granting tax exemptions for specific industrial areas, and with the requirements to be fulfilled, it is established that royalties, technical service fees, interest on loans, etc., paid to foreign companies should not exceed certain limits; in recent years the figure has been established at three percent, and in the last resolutions, the percentages have not been determined in the regulations and are subject to the discretionary powers of our authorities.

Our authorities and several well known economists have stated in recent months that the amounts paid for royalties are excessive (in 1966 Mexico paid 0.0166% of its gross national product, that is around \$8,500,000 U.S. dollars). The amount of royalties that our country paid in 1970 amounted to approximately \$64,000,000 U.S. dollars.

To our eyes, it seems clear that our government shortly will try to remedy or control the situation. Hearsay leads us to believe that a law, similar to the Argentinian will be enacted during this year.

Consequently, I believe it is the time to propose some recommendations.

1) In the light of the South American trends,

it is suggested that when possible no restrictive clauses, such as these discussed herein be included in the agreements.

2) Patent and trademark license agreements must include the transfer of technology.

3) Royalties should be in accordance with the value of the transfer of the technology and probably not in excess of 3% of the net sales of the product embodying the technology.

4) The terms of the license agreements should not be indefinite, probably a maximum of ten years would be advisable.

5) "Most favored country" clauses should also be considered in the agreements.

Mexico, D.F., September 1972.

**About the Speaker: Mariano Soni was born in Mexico, D.F., Mexico, December 28, 1936.*

In 1952-1953 he obtained a Bachelor in Humanities, Centro Universitario Mexico; 1954-1958 LL.B., School of Law, Universidad Autónoma de Mexico; and was admitted to bar August 21, 1959.

His professional thesis was "Extraterritorialidad de los Impuestos", 1959, Mexico, D.F.

He has been in law practice — 1956-1963 — Associate in the Law Firm of Baker, Botts & Miranda (now Miranda, Santamarina & Steta); 1963-1965 — Partner in the Law Firm of Woodson, Pattishall, Garner & Pérez Vargas; 1966-1968 — Partner in the Law Firm of Woodson, Pattishall, McAuliffe & Pérez Vargas; 1969 — Partner in the Law Firm of Pattishall, McAuliffe, Pérez Vargas & Soni; 1970 — Partner in the Law Firm of Pérez Vargas & Soni.

During 1963-1966 he was Professor of Taxes, School of Business Administration and School of Industrial Relations, Universidad Ibero Americana, Mexico, D.F.

He is a member of Ilustre y Nacional Colegio de Abogados de Mexico (Member of the Council 1966-1969) Inter-American Bar Association; Asociación Interamericana de la Propiedad Industrial, ASIPI, (Treasurer pro tempore, 1964), member of the Trademarks Committee. Asociación Mexicana de la Propiedad Industrial (President 1966-1967), former Chairman of the By-Laws Committee, member of the Legislative Committee that prepared a draft of the new Law of Industrial Property (not enacted yet); Asociación Mexicana para la Protección de la Propiedad Industrial, (Mexican Group of the Association Internationale pour la Protection de la Propriété Industrielle); Executive Secretary of the Organizing Committee of the XXVIII Congress; Academia Mexicana de Derecho Internacional.

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Thelma C. Heatwole
EDITOR: LES NOUVELLES



Bernardo Gomez Vega

**"NEW TENDENCIES IN LATIN AMERICA
FOR A CONTROL OF PATENT AND
TRADEMARK LICENSES"**

by
Bernardo Gomez Vega

Dear Colleagues:

Probably it had been announced to you that the subject of my lecture would be "New Tendencies in Latin American countries for the control of patent and trademark licenses", and I had really intended to speak to you in relation with such matter making the necessary comments on the background of the Treaty or Agreement of Cartagena, passing later to the dictatorial laws issued in Brazil and in Argentina for this control, but it so happens that the Review of the Association of Lawyers of Buenos Aires, recently brought to the public light its issue number 1/2 (Volume Twentyeight), corresponding to January to June of the year of nineteen hundred and seventy two, where two interesting and exhaustive studies on this matter were published, to wit: "Present tendencies of the Industrial Property in Latin America" by Dr. Ernesto D. Aracama Zorraquín and "Comments on the (Argentinian) Law Number 19231 (Nineteen thousand Two Hundred and Thirty One), relative to the Registration of Licenses and Transfer of Technology" by Dr. Ernesto O'Farrell, both authors well recognized as prominent Argentinian practitioners of industrial property law. Therefore, any attempt to try to prepare a short lecture on the subject in question, would be doomed in advance to be considered as a pale reflection of such interesting works which lectures I strongly recommend to you and to all those interested in the matter, be them lawyers, investigators or business men. If you are so kind to permit me to make a commercial ad, I suggest that you make a note in the