

Legislation Affecting Licensing

Discussion of proposed and enacted legislation in North and South America affecting licensing

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Legislation (Bill S.814), recently submitted to the U.S. Senate by Senator Phillip A. Hart, would amend the Federal Trade Commission Act by making it an unfair act or practice to refuse to license on reasonable and non-discriminatory terms patents which are not utilized and which block the utilization of other major innovations. The proposed legislation also affects patents on products which are not reasonably available to the public and which involve the public health and safety.

The goals of the bill are two: first, to make the patent licensing system serve the public interest by providing that the system cannot be used to block the use of technology which is in the public interest; second, to codify a recent Court Decision which granted an infringer a compulsory license where the patented invention was not being used by the patent owner.

Paragraph 7 of the proposed Bill states that "it is hereby declared an unfair act or practice. . . .for the owner of a U.S. patent, or any licensee having sublicensing rights thereunder, to refuse or fail to license such patent, together with all available know-how necessary commercially to work the best modes of making, using and selling the subject matter of the patent, to any applicant in the United States on reasonable and nondiscriminatory terms, when the effect of such refusal or failure may be substantially to lessen actual or potential commerce. . . ."

Provisions

In order to come within the purview of Paragraph 7 (a), the patented subject matter must relate to public health, safety, energy, or protection of the environment; or (b) it must not have been commercially worked during any continuous period of three years following the date of issue of the patent or four years following the date of application for the patent; or (c) it is infeasible or impractical for the applicant, without the grant of a license, to operate under a subsequently issued patent which he owns or under which he has a license; or (d) the applicant commercially worked the invention in the U.S. before the actual filing date of the patent in the U.S.; or (e) the applicant is the maker or seller of a product of which the portion of the embodying of the patented subject matter constitutes less than 10 percent or is otherwise a minor part.

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As can be seen, the provisions of the proposed amendment to the Federal Trade Commission Act are sweeping. The amendment requires licensing in certain areas such as that related to public health, introduces the compulsory licensing of unworked patents, allows a company to obtain a license under an earlier patent in order to use an improvement over the earlier invention, protects a person who had commercially manufactured an item for which

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someone else later filed and then obtained a patent and permits compulsory licensing where the patented subject matter "a minor part" of the product which the licensee wishes to sell.

Senator Hart's position on compulsory licensing is that for years the Federal courts have refused to enforce the privilege to exclude others, where the infringer was practicing technology important to public health, safety, or the environment. In the most famous of these cases, *The City of Milwaukee v. Activated Sludge, Inc.*, 69 F.2d 477, 593 (7th Cir. 1934), the City of Milwaukee was held to have infringed a patent for processing sewage, but the Seventh Circuit refused to grant an injunction. The court states:

"Ordinarily courts will protect patent rights by injunctive process. . . .If, however, the injunction ordered by the trial court is made permanent in this case, it would close the sewage plant, leaving the entire community without any means for the disposal of raw sewage other than running it into Lake Michigan, thereby polluting its waters and endangering the health and lives of that and other adjoining communities."

Likewise, a Federal court refused to enforce a patent which would provide poor people a cheap cure for rickets. In *Vitamin Technologists v. Wisconsin Alumni Research Foundation*, 146 F.2d 941, 945 (9th Cir. 1945), the court noted, "It is the poor people suffering with rickets who constitute the principal market for appellee's monopolized processes and products."

Public Interest

Hart says Congress itself has recognized the predominance of this public interest by providing for the compulsory licensing of plant patents, where such "is necessary in order to insure an adequate supply of fiber, food, or feed in this country and. . .the owner is unwilling or unable to supply the public needs for the variety at a price which may reasonably be deemed fair" (7 U.S.C. sec. 2404). In addition, Congress has provided for compulsory licensing of patents involving clean air, if the patent is "not otherwise reasonably available" and the license is necessary to permit persons to comply with the Federal regulations promulgated under the Clean Air Act (42 U.S.C. sec. 1857h-6).

Senator Hart wants to bring the U.S.A. into accord with the Paris Convention for the Protection of Industrial Property of 1883 to which the U.S. is a signatory. Section 5 of that Convention recognizes that it is appropriate to have compulsory licenses if patented invention are not being utilized commercially:

"Each country of the Union shall have the right to take legislative measures providing for the grant of compulsory licenses to prevent the abuses which might result from the exclusive rights conferred by the patent, for example, failure to work."

According to Mr. Hart, in Constitutional terms, failure to use an invention is an abuse of the patent monopoly, for such nonuse fails to achieve the constitutional purpose of promoting the progress of science and the useful arts.

Practically every other major industrial nation in the world has enacted provisions to provide for the utilization of patented technology by the public where necessary to encourage rapid and open development and exploitation of such technology. The most common of these provisions in law outside the U.S.A. prevent private patentees from excluding the public from practicing (1) technology involving the public health or safety, (2) technology not being commercially worked by its owner, and (3) technology on which someone has obtained a valuable improvement patent.

Assist to Scientist

Paragraph 8 of the proposed legislation states that "it is hereby declared an unfair act or practice subject to this Act, and an inequitable practice, for any corporation to enter into, maintain in effect, or in any way enforce or threaten to enforce any contract with any employee or prospective employee of such corporation, or to assert a construction or interpretation of such contract, which provides that. . . .such employee shall not or cannot engage in any trade. . . .subsequent to the termination of his employment by such corporation, where the effect of such provision may be substantially to lessen competition or tend to create a monopoly in any line of commerce or substantially lessen the opportunity of such employee to pursue his livelihood."

In Paragraph 8, Senator Hart is attempting to assist scientists and engineers in the pursuit of their profession. Some state trade secret laws, according to Senator Hart, have the effect of denying scientists the opportunity to work for companies of their choice. He feels their mobility has been reduced, their personal freedom to change employers limited, and the bargaining positions weakened by these laws. The proposed legislation is intended to make the law in the U.S. uniform as regards employment contracts between corporations and scientists and engineers.

Indications are that this proposed amendment to the FTC Act will remain in the Senate Commerce Committee for sometime and thus will not get to the Senate floor this year. The Bill, however, is a controversial one and will get attention.

Cartagena Agreement

I would now like to talk about Decision No. 24 of the Cartagena agreement which will affect the transfer of technology in the Andean countries and then discuss

briefly the recently enacted Mexican law on the transfer of technology and the use and exploitation of patents in that country.

Decision 24 is probably the most controversial of the Andean Group's agreements. It is in effect a code for the treatment of foreign capital, patents, licenses and royalties. It also involves trademarks.

The code is the result of increasing nationalism within the Andean countries and the growing resentment of the ever-expanding foreign ownership of important economic activities within these countries. Decision 24 is an innovative and somewhat radical attempt to gain greater control over the activities of foreign interests and to channel them into closer coordination with the development plans of these countries. It represents a bold stroke, compared to what had been the practice in Latin America.

The code sets maximum applicable limits on the transfer of technology and investment of capital and the member countries are obligated not to grant more liberal conditions than those set forth in the code.

Restriction

The code places certain restrictions on the importation and use of technology, know-how and patents. All contracts for the importation of technology or the exploitation of patents must be approved by the competent national authority which will evaluate the price to be paid, the proper profitability to be derived and the overall impact in terms of industrial development. Each contract must contain an explanation regarding how the transfer is to take place, the contractual value of each element composing the new technology and the period of duration. No contracts for patents will be allowed which contain any of the restrictive clauses specified in the code. According to article 20 of Decision 24, "Member Countries will not authorize the signing of contracts concerning a transfer of foreign technology or patents which contain clauses which (a) require the recipient to acquire certain intermediate products or raw materials from the licensor, (b) allows the licensor to establish the price for sale of the products manufactured by the technology, (c) restrict the volume of product, (d) prohibit the use of competitive technology, (e) give the licensor the option to make purchases which favor the licensor, (f) compel the licensee to transfer to the licensor the inventions or improvements that may result from the use of the technology, or (g) compel the user to pay royalties for patents which are not used by the licensee."

Mexico's recently enacted law bears a similarity to the provisions of Decision 24 of the Andean Group. The purpose of the law is to eliminate obstacles of the Mexican's development and foreign trade; to adjust technology contracts to the guidelines of the Government's industrialization policy, and to stimulate the creation of a local scientific and technological infrastructure that permits the adaptation of foreign technology to the conditions and needs of the Mexican economy.

The law establishes a registry for all contracts for the transfer of technology. This provides a record of the terms in which technology is sold to Mexican businessmen, as well as permit the authorities to examine contracts and reject the registration of those containing clauses that could be damaging to Mexico's development.

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International President's Message

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LES Scandinavia will hold its annual meeting on September 12, 1975 at the Intercontinental Hotel in Helsinki, Finland, and we hope that members from other Member Societies will attend this meeting.

LES is thus preparing for a very busy season which follows an exceptionally active spring.

The International Licensing Conference sponsored by LES Japan in cooperation with Techno '75 Tokyo in May was a great success, thanks to the excellent preparation and organization by LES Japan. Morey Matsumoto especially is to be congratulated for the superb job in planning and carrying through this fine meeting. We were delighted with the quality of the presentations and the warmth and graciousness of the hospitality.

We held an informal Board of Delegates meeting in Tokyo at the conclusion of the Licensing Conference. It was participated in by LES U.K., LES Australia, LES U.S.A., the future LES Korea, and, of course, LES Japan. The Delegate from LES Australia announced that Australia is planning an international licensing conference and technology exposition from November 29 to December 4, 1976, with emphasis on licensing and technology transfer by the countries that rim the Pacific Basin.

Several of us from LES U.S.A. were fortunate enough to attend LES Mexico's First Annual Reunion, held at the Camino Real Hotel in Mexico City on June 1-4. This too was a delightful conference, both as a serious discussion and as a social event. As usual, the Mexicans were fantastic hosts, and the success of this meeting was a testament to the vigor and strength of LES Mexico after only one year of existence.

The spring series of meetings was concluded by a one day licensing conference sponsored by LES France in cooperation with Inova '75, an international technology exposition in the beautiful new Centre Internationale de Paris (CIP), at Porte Maillot in Paris. Of course, it is hard to find a better location for a meeting than "Paris in the Spring".

Hectic Pace

This succession of meetings provided a rather hectic time for me, since, in rapid succession, I was a speaker and a participant in Tokyo, Mexico City, and Paris. Hectic though it was, it certainly provided rich memories which I will reflect on in calmer years.

The amazing amount of worldwide activity I recounted here is a tribute to the fundamental soundness and success of the central idea on which LES was founded — the value and importance of establishing and treating the persons who engage in the complex and delicate art of licensing as a truly professional group possessing unique qualifications and abilities.

It is apparent that licensing executives are assuming an ever more important and influential role in the practical conduct of world affairs. Licensing, unlike war, is based on the belief that persons may come together and negotiate in a cooperative spirit toward a common goal, the purpose of which is to benefit both the licensor and the licensee, but particularly and most importantly, the licensee. Such a goal is one that we can all be proud of, and this is what LES is all about — a cooperative endeavor for the general benefit of all

through the efficient dissemination and use of valuable technology.

I'm looking forward to seeing many, many of my LES friends and fellow workers at the fall round of meetings: Helsinki (maybe), Budapest, Basle, and Scottsdale.

U.S. Patent System — Past, Future

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might relieve the courts of a considerable burden.

A second area of controversy is deferred examination. Provisions for deferred examination appear in two of the four pending bills. Proponents and opponents of this approach seem nearly equally divided, and, in my view, this issue could be decided either way. I am opposed to deferred examination because I think it hinders the transfer of technology.

In closing, let me warn you my crystal ball is far from infallible. I have learned since I have been in Washington that the Executive Branch may propose, but Congress will dispose in matters of legislation. The U.S. patent system has served as a vital agent for scientific progress, technology transfer, and economic well-being. Our Constitution states that the purpose of the patent system is "to promote the progress of the useful arts". I believe our system has done that, and will continue to serve that purpose ... not only for Americans, but for others, such as the Japanese, who have participated in and made use of our patent system.

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Contracts will not be approved when they are for technology freely available in the country; when the price is out of proportion with value of the technology acquired or constitutes an unwarranted or excessive burden on the country's economy; when they restrict the research or technological development of the purchaser; when they permit the technology-supplier to interfere in the management of the purchaser company or oblige it to use, on a permanent basis, the personnel appointed by the supplier; when they establish the obligation to purchase inputs from the supplier only or to sell the goods produced by the technology importer exclusively to the supplier company; when they prohibit or restrict the export of goods in a way contrary to the country's interest; when they limit the size of production or impose prices on domestic production or on exports by the purchaser; when they prohibit the use of competitive technology; when they oblige the importer to sign exclusive sales or representation contracts with the supplier company covering the national territory; when they establish excessively long terms of enforcement, which in no case may exceed a 10-year obligation on the importer company, or when they provide that claims arising from the interpretation or fulfillment of such contracts are to be submitted to the jurisdiction of foreign courts.

The law has a margin of flexibility that permits the Secretary of Industry and Commerce to register contracts that do not meet one or more of the aforementioned con-

ditions, when the technology transferred is of special interest to the country because of its positive effects on employment, the balance of payments, industrial development and the country's general advancement.

Not required to be registered are contracts relative to foreign technicians under contract to install factories or machinery, or to make repairs, designs, catalogues or general assistance purchased together with machinery and equipment and necessary for their installation; assistance for repairs or emergencies, and the technical instruction or training provided by schools, personnel training centers or by companies for their workers. Also excepted from the obligation to register are the operations of border assembly plants, which are governed by a special regime.

Penalty

Contracts that have not been registered, or whose registration has been cancelled, shall be null and void. Furthermore, companies that cannot show proof of registration shall not be entitled to the fiscal or other benefits granted in legal dispositions to foster industry and trade.

Official personnel working at the Registry are obliged to keep confidential the technical processes to which contracts relate.

If, after 90 days, the compatibility or incompatibility of registration has not been resolved, it shall be considered that the contract is automatically registered. The purpose of this measure is to avoid uncertainty and expedite registration procedures so as not to curb the pace of industrial development.

As a complement to this law, a Center for Industrial Information will be established, also under the auspices of the Secretary of Industry and Commerce. It will have the consultant services of the country's research centers and institutions of higher education, of the National Council of Science and Technology, and industrial organizations. The center will gather and process information regarding international technology supply and demand.

East-West Joint Ventures

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- (b) The machinery, tools, and equipment used by Licensee are in conformity with the technical documentation furnished.
- (c) The parts and materials used by Licensee in the manufacture of products meet the requirements specified in the technical documentation furnished.
- (d) The resources and skills applied by Licensee to the manufacture of [the product] are those of a manufacturer experienced in the manufacture of [a product] of similar complexity of manufacture.
- (e) The design of the product conforms exactly to the design furnished by Licensor."

In common with Western practice, Socialist purchasers of both equipment and technology usually require the seller to guarantee that he possesses the rights to the relevant patents and inventions that the purchaser can there-

fore employ such equipment and technology in the manner called for in the contract without violating the rights of third parties.

Seller Guarantees

The seller is uniformly obliged to guaranteed normal operation of the equipment for a specified period of time, typically 12 months from the date of putting the equipment into operation, but not more than 18 months from the date of delivery. The latter limitation is of utmost importance to a Western seller since Eastern buyers are notoriously late in getting new equipment into operation. New equipment has been known to sit in warehouses for many months and even years without being uncrated. If the guarantee period were defined only in terms of the date of commissioning of the equipment, the seller's guarantee obligations might not even begin to run until 2 or 3 years after delivery. Even worse, the seller would not be entitled to the 5 to 10 percent of the contract price that is often held back by the buyer during the running of the guarantee period as a kind of performance bond.

In addition to the aforementioned guarantees found in most East-West contracts, Eastern purchasers require more demanding performance and output guarantees in licensing agreements and turnkey contracts. The seller will be asked to guarantee that the equipment and/or technology being supplied will enable the purchaser to manufacture a specified quantity and quality of goods. This can be a hazardous commitment for a Western seller to make, since he may have little control over conditions surrounding the installation and operation of the equipment and technology being supplied. The seller will be asked to back up this guarantee with an agreement to indemnify the purchaser against patent infringement claims. The most typical provision calls for the seller or licensor to defend against any suit or settle any claims by a third party whose rights have been infringed by the purchaser's use of the equipment or technology which is the subject matter of the contract. Often the seller's maximum liability under such an indemnification clause is limited to a specific dollar amount.

Secrecy Agreements and Improvements

Eastern purchasers of technology are generally willing to agree to hold in strict confidence the information and technical documentation they acquire, including trade secrets and other unpatented know-how. While it is obviously difficult to police this type of agreement, there have been few if any reports of Eastern purchasers violating such a nondisclosure commitment.

Again in common with Western practice, East-West licensing agreements often contain a clause calling for the periodic exchange between the parties of information on both patented and unpatented modifications and improvements in the licensed products during the life of the agreement. The parties generally agree to grant one another the nonexclusive right to use such modifications and improvements free of charge. At the same time, each party retains the right to patent its inventions relating to the licensed product.