Product Liability in Licensing

Licensors, licensees should work out balanced provisions covering guarantees and agreements

BY H.A. JANISZEWSKI*

Unlike process licensing, in which the liabilities and responsibilities of the licensor (supplier of the process) and licensee — (recipient of the technology), are rather clearly described and usually incorporated into appropriate provisions of the license agreement, the current practice in product licensing seems to be much more fluid. Moreover, there is no general consent as to the scope and level of guarantees and liabilities of the licensor in such an agreement.

I will attempt to furnish a few examples of provisions in various licensing agreements describing product liability of licensors as well as responsibilities of licensees,, in order to illustrate different approaches to the issue of product liability. I will attempt to draw conclusions.

In tme case of process licensing, the situation is to a great extent clarified in the sense that the licensor is liable for a licensed process, which simultaneously provides guarantees in terms of the product quality, volume of the production, etc.

The licensor therefor provides the licensee with a kind of double guarantee — one in terms of the process (yield, utilities consumption, consumption of raw materials per unit of the production, etc.) and the second one in terms of the product quality, output per unit of time and similar measures.

We may conclude in this respect that in process licensing, the licensor is also held responsible for the quality of the products manufactured by the licensee using the licensed process.

The product liability of the licensor in those cases will be therefore similar to the product liability of the manufacturer of the products vis-a-vis the buyer of the said products.

Limitations

Naturally, there are certain limitations concerning the liability of the licensor in the sense that the licensee will use the process as designed by the licensor, that he will use only the prescribed raw materials, etc. In any case the licensor is liable vis-a-vis the licensee and the product itself.

The product liability of the licensor in process licensing will be and usually is based on so-called performance guarantees, which usually consist of certain critical parameters of the process, which are warranted or guaranteed by the supplier of the technology.

If those mutually agreed upon parameters are not met the licensor is obliged to remedy the faults and improve the performance of the process according to expressed guarantees in the contract.

It should be mentioned, however, that so-called product liability of the licensor usually constitutes only a part of the total liability arising out of an individual contract. This ratio between product liability and process liability (expressed for example in terms of raw materials and utilities consumption, etc.) can be negotiated and agreed between parties of the agreement and depends on the criticality of individual parameters included in the warranty provided by the licensor.

LES International Conference, Geneva

In the above context it is obvious that, from the licensor's point of view the scope of his process and product guarantees should be minimal. The licensee will tend to maximize such guarantees, because the scope of his involvement in terms of investment is much higher than the licensor (at the moment of concluding a particular transaction) and he needs maximum insurance in order to receive fast and reasonable return on his investment.

Product Licensees

When dealing with product licensees, where no process in a technological sense is being transferred, the scope of the guarantees relating to products manufactured under the license, is, so far as can be ascertained, much more limited.

It is not uncommon, for the licensor to go as far as disclaiming any liability as to the quality of the product and to provide only a rather vague and general guarantee to the effect that when the technology is used in accordance with supplied documentation and information that the product will meet agreed standards of quality.

This is particularly true when licensing new technology or new products and when the licensor himself does not have much production experience. In such situations it seems to be only reasonable to accept that the licensor can not be liable for the quality of the product, when the licensee was fully aware of deficiencies or lack of extensive experience with the technology or product. Conversely, in terms of mature products and technologies, the licensor should be held fully liable for the product manufactured under his license.

*Industrial Development Officer, UNIDO, Vienna.

As mentioned before, there are circumstances when he cannot be held liable. These include responsibility for the licensee who is supposed to strictly observe requirements of the particular technology, use only specified raw materials, and in general apply all specific conditions needed for the manufacture of a given product under a given license, spelled out by the licensor.

In this context it will be interesting to look at the current practice of technology licensing to developing countries, particularly the position which government regulatory agencies take vis-a-vis product liability of licensors.

A short review of the current legislation and practices reveals, understandably enough, that regulatory agencies, attach great importance to this issue in the sense that the licensor should provide the maximum guarantee in terms of product quality (and therefore be held maximally liable for quality of products manufactured).

For example, Algeria has developed a new type of turnkey agreement called *produits en main* (run-in contract or product in hand), which apart from delivery of plant provides for the participation of the supplier in management during the start-up period with the idea of achieving high quality and quantity of manufactured products.

Short of Need

The experience of Algeria in the late 60s showed that contractors' guarantees against equipment defects resulting from faulty design, faulty assembly or manufacturing deficiences do not fully meet the need of a developing country — as such liability usually covered the acceptance/performance period during which the contractor/supplier of technology was in a position where it was relatviely easy to disclaim his liability.

In this context, practice and experience in Algeria led both investors and suppliers to extend the guarantee period and output — naturally against additional renumeration — by giving the supplier a great deal of authority over organizations and management of a given plant.

Thus, in run-in contracts provisions may be found to the effect that "the contractor recognizes that the obligations assumed by him under this contract are not only obligations to provide means but also obligations to achieve results", which means that, if his obligations are not fulfilled, it is difficult for the contractor to escape responsibility.[1]

It should be mentioned that in such agreements in addition to know-how transferred, vocational training and long-term technical assistance constitute important parts.

In principle, in no national legislation in developing countries is the product quality issue explicitly spelled out. However, as mentioned, the current practice of all regulatory agencies in developing countries is to pay close attention to the scope of product guarantees provided by licensors in licensing agreements.

Act 15 of the Brazilian legislation states that in both agreements involving technology and technical industrial cooperation, the agreement shall not exempt the party who supplies technology from responsibility regarding possible suits by third parties carried out by "faults or defects" or by infringements of industrial property rights with regard to the technological content to which the agreement refers.[2]

Legal Liability

There we see that the Brazilian Government takes care of not only product liability by the licensor in the technical sense (quality, etc.) but also in the legal sense in terms of his liability vis-a-vis infringements of rights of third parties.

This "extension" of licensor liability seems to be quite reasonable and acceptable.

The text of the Code of Conduct goes much further on the subject of transfer of technology in Chapter V, "Guarantees," which spells out the nature and scope of technical and legal guarantees of suppliers of technology. It also provides government regulatory agencies with specific guidelines as to scope of guarantees to be included in licensing agreements.

In the context of the provisions of the Code of Conduct which is still under discussion, it is worth mentioning the trend toward maximum utilization of local (recipient country) resources in designing and supplying technology, which in my view may further complicate the issue of the scope of licensor liabilities.

CONCLUSIONS

It is obvious from the above that a serious effort should be made by both licensors and licensees to reach balanced provisions covering guarantee and liability, if reasonable agreements are to be reached.

The trend toward "over insurance" by the licensees in terms of excessive liability provisions, which sometimes can be observed, usually leads to over-designing on the side of the licensor, with the result that excessive cost of technology and overall investment must be paid by the licensee.

Moreover, respectable suppliers of technology are very sensitive to their image and often will go very far —on their own initiative—to fully meet their guarantee obligations.

Finally, it seems that both licensors and particularly licensees should be fully confident in their own technical staff members, who are usually responsible for the content of guarantee/liability clauses and therefore fully equipped and prepared to deal with the scope and reasonableness of individual conditions.

NOTES

1. See Gross B, "La Notions d'obligation de garantie dars le droit des contracts" Partis, 1963.
2. See D. A. Daniel, "The pulse of Brazilian INPI" in *Les Nouvelles*, March 1979, p. 44-55.