

Restrictive Business Practices

Drawing on experience of Mexico, author focuses on the complex matter of eliminating undue restrictions

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INTRODUCTION

This paper focuses attention on the legal and economic implications that derive from international technology transfer agreements with special emphasis to *restrictive business practices* in licensing transactions.

It heavily relies on the experience of Mexico and the efforts of the National Registry of Technology Transfer to deal with the complex matter of eliminating undue restrictions that emanate from the contracting process.

BACKGROUND

As world economic and development structures are changing, technical knowledge has become an increasingly significant factor in the development process of nations. This question becomes particularly important for the developing countries that most heavily rely on the acquisition of proprietary know-how from foreign sources.

In recent years the developing countries have become better prepared to deal with the complexities of international licensing and have developed — with the assistance of International Organizations — UNIDO in particular — a system, and a coordinated approach to orient and regulate the acquisition of foreign know-how.

For this purpose national agencies have been created with the necessary authority and governmental support to rationalize licensing procedures, and to acquire technology in terms and conditions satisfactory to the recipient country's economy.

The Mexican experience can help to illustrate the difficulties and achievements obtained in this area and to ascertain future actions for increasing the technological base of the country, in order to meet the socioeconomic objectives that lie ahead.

From the outset it should be stated, that developing

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countries would need to increasingly rely and spend more for the purchase of foreign technology, mainly because technological requirements increase — both, in cost and sophistication — in correlation with the industrial development of a country. As a result, the transfer of technology from developed to developing nations is going to play an even major role in international economic relations.

Technology however, very often involves a high price, not only in terms of direct payments on royalties, but also as a result of contractual provisions that recipient companies in the developing countries are forced to accept in order to attain their main objectives.

Many licensors of "technological knowledge" — including patents, trademarks, process organization, trade secrets and the like — have managed to unduly use that knowledge as a lever to impose obligations, restrictions and controls over production in the recipient country, that otherwise would be quite impossible.

Many firms from industrialized countries that enjoyed technical advancement and expertise, have in the past been able to impose contractual provisions that not only perpetuate noncompetitive market structures but which also — and more important — tend to harm the internal economy of the recipient country.

Multiple Questions

The conditions under which the commercialization of technology operates on a world scale, has posed multiple legal, economic and political questions; and the awareness of its implications by the recipient developing countries explains the active role that the United Nations through organizations like UNIDO is now playing.

Another area of concern about this situation, which can be seen as a new variation of potential market domination, is growing on the international level. Both developed and developing countries are seeking ways to limit the influences and controls of the business interest of other nations.

In order to deal with this problem the Mexican Government enacted a specific legislation in the early part of 1973: "The Law for the Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks."

It should be mentioned that more than 80% of technological inflow (and corresponding payments) and direct foreign investment into Mexico, originates from the United States. The United States by and large has been one of the world leaders in technological developments, and likewise, U.S. enterprises have been prominent in licensing and controlling technology. Therefore the importance that the Registry of Technology attaches to legis-

lative procedures and related developments in that country.

In this context the U.S. antitrust laws provide one source of control, to the type of restrictive trade practices contained in contracts with foreign companies. Antitrust principles have been applied to such agreements in the past, but the exact scope and limitations of those principles are not precisely clear.

Under U.S. law, technological knowledge is considered as intellectual property and has special status and protection. Certain forms, such as patents or trademarks, do provide "legal monopoly" to their holder. However, even this grant protection is strictly limited in terms of scope, field-of-use, duration, etc.

It emerges from these that a legal monopoly cannot be used to obtain larger control or to work against antitrust principles. From the point of view of government authorities it becomes essential to properly define the scope of legally protected monopolies with as much accuracy as possible, since restrictive terms outside the "protected area" may be construed as violation of antitrust laws.

The Mexican experience has shown that more than 75% of technological licensing agreements do not involve patents and that they fall within the category of know-how licensing contracts. Extensive research conducted at the international level demonstrates that in the future the trend will be to rely more on know-how licensing and to gradually reduce the use of patents as a main object in the contract. (With exceptions on certain fields, such as pharmaceuticals.)

14 In this connection it is pertinent to point out that secrets and unpatented technological know-how *cannot obtain a legal monopoly* protection. In practice this becomes a fundamental issue and should carefully be studied by any developing country that wishes to regulate international licensing transactions.

The basic area of concern, is that the "non-protected category of technology" is only protectable by contractual provisions of nondisclosure and/or nonuse. Under a similar analysis, restrictions imposed in such contracts cannot be used to produce controls that go beyond the necessary scope of protection.

Basic Relationship

The basic relationship between technology licensing and antitrust regulations is that, control of technology on the one hand and legal monopolies on the other, cannot be used to give the holder more rights than are specifically defined in legal statutes. Likewise, neither contracts for technology nor specific business arrangements, such as joint ventures or wholly-owned subsidiary arrangements can be used to overcome these limitations and to create anticompetitive market structures that are otherwise illegal.

Although, this remains a highly technical and specialized field of activity, governments of developing countries must study carefully the implications that derive from contractual arrangements in the legal and economical areas.

To illustrate this point, we should refer to the Mexican experience in dealing with licensing of non-patented technology that quite frequently would call for an excessive

nondisclosure period on the part of the recipient — either an indefinite period or an obligation for more than 20 years.

Considering that the Mexican patent law only grants a maximum of 15 years of protection, one can clearly see that, as a result of a contractual provision in this area, the licensor is seeking to acquire substantially more than what he could be granted by obtaining a patent. In other words, monopoly rights are sought through contractual arrangements, even though, as already indicated, *non-patented know-how does not acquire legal monopoly protection*.

The Mexican law of technology calling for the compulsory registration of all existing agreements gives the Mexican authority a good opportunity to collect information for research and comparison in this field. Any efforts conducted in this area were to give due consideration to the provisions of article 13 of the law that requires to keep secret all technological information concerning the processes or products covered by registered agreements. This information constitutes a valuable source for understanding the nature and extent of restrictive business practices in the technology transfer process.

RESTRICTIVE PROVISIONS IN LICENSING AGREEMENTS

This paper aims at understanding restrictive licensing clauses viewed in light of the Mexican law of technology, and particularly of the provisions in article 7 of this statute.

Additionally an effort has been made to incorporate certain elements of economic nature in order to properly assess the implications of restrictive provisions in a practical and realistic manner. This might include:

- (i) financial and technological capabilities of the recipient firm;
- (ii) industry structure;
- (iii) production sectors; and
- (iv) export considerations.

In preparing this paper it was necessary to consider the types and frequency of restrictions contained in technology agreements vis-à-vis the structural variables mentioned above, and to ascertain particular trends within specific sectors of production.

Although antitrust criteria on the one hand and the provisions contained in the article 7 of the Mexican law on the other, go into considerable detail to enumerate the kinds of restrictive practices that must be eliminated from contracts in order to qualify them for registration, there are certain types of restrictions that are of greater importance than others and that should be analyzed in closer detail.

In order to elaborate on this, we will enumerate the kinds of restrictive practices that are contemplated in article 7 of the Mexican law.

In this context the registration of a contract may be denied if it contains provisions where:

1. The technology to be transferred is freely available in Mexico (clause I, art. 7).
2. Obliges the licensee to grant back to the licensor the patents, trademarks, innovations or improvements it makes (clause IV, art. 7).
3. Limits the licensee's research and development efforts (clause V, art. 7).

4. Prohibits or restricts the export of goods or services by the licensee in a way contrary to Mexico's interest (clause VII, art. 7).
5. Establishes excessively long terms of enforcement (clause XIII, art. 7).
6. Calls for disputes to be submitted to the jurisdiction of courts in a foreign country (clause XIV, art. 7).
7. Sets a price out of proportion to the technology acquired or imposes an excessive burden on Mexico's economy (clause II, art. 7).
8. Permits the licensor to regulate or interfere with the management of the licensee (clause III, art. 7).
9. Obliges the purchase of equipment, tools, parts or raw materials from a certain supplier, only (clause VI, art. 7).
10. Prohibits the use of complementary technology (clause VIII, art. 7).
11. Requires that goods produced by the licensee be sold to the licensor, only (clause IX, art. 7).
12. Obliges upon licensee to permanently employ personnel appointed by licensor (clause X, art. 7).
13. Limits production volumes or imposes sales prices on goods produced by the licensee (clause XI, art. 7).
14. Obliges the licensee to sign exclusive sales or representation contracts with licensor in Mexico (clause XII, art. 7).

Except for the first six provisions, for which no exception can be made, the Mexican law establishes that contracts that do not meet one or more of these conditions may be registered; if the National Registry of Technology Transfer believes the contract is of special interest to the country.

Our analysis of the restrictive business clauses will concentrate on the following types of provisions which in one way or another hinder upon several of the above mentioned clauses for article 7, these are:

1. various types of tying clauses;
2. excessive royalty payments;
3. field-of-use or cross-licensing restrictions;
4. territorial restrictions;
5. price fixing;
6. grantback provisions.

The Mexican experience may serve as a reference to other developing countries for the purpose of understanding the types of restrictive practices and contract provisions currently used and the manner in which the National Registry of Technology has tried to overcome and eliminate such abuses. Although it would be impossible within the scope of this paper to discuss how useful antitrust principles are and to go too deeply into the analysis of how restrictive provisions may effect the national and international legal statutes, this paper may be able to point out certain gaps in the present international legal system related to controls on patenting, licensing and business practices in general. Perhaps these should be brought into public review through information or legislation.

Tying clauses imply the requirement on the part of the recipient who wants to acquire certain goods from a sup-

plier (licensor) to also purchase other products from that supplier.

Such clauses are often considered a violation of various antitrust legislations, e.g., it should be noted that the Clayton Act, Section 3 focuses attention on sales of commodities "patented or unpatented for use, consumption or sale within the United States". On the other hand the Sherman Act is not as limited and can be applied to sales outside the United States where the United States' commerce might be affected.

The general criteria is that tie-in clauses are unreasonable whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product. The legality of this is usually established when the tying product is patented, however, when no patent is involved but only a trade secret or process know-how, this requirement may be harder to prove. Additionally, there are precedents for regarding a technology license in itself as a "tying product" upon which the licensor has economic power. On the basis of the Mexican criteria tying clauses are *per se* not acceptable. But in practice there may be some exceptions to that rule, in cases where there is a need for the tie-in product if this is considered to be essential to the protection of the patentee, or for the functioning of the patent itself. The Mexican experience shows that in the majority of cases it is possible to eliminate tie-in provisions from the contract. However, *the elimination of a contractual provision may in itself not be sufficient* to prevent a wholly owned subsidiary or a licensee with a majority foreign participation to *de facto* exercise this requirement.

In a recent paper prepared by the author concerning restrictive business practices in licensing contracts among multinational firms and their subsidiaries, it was reported that from the Mexican point of view restrictions that appear in contracts among parent and subsidiary were eliminated without great difficulties and it was recommended that additional measures had to be taken from the government in order to effectively regulate unreasonable practices in this field. A difficult case emerges when, for example, the licensor's equipment reputation in terms of efficiency and reliability is dependant on the use of other equipment or products and the licensor can prove that the original equipment does in fact perform better with the specified additions. In practice, the argument against allowing such a situation to pass legal scrutiny is that, if the assumption is correct, the licensor will be able to convince the recipient company to buy and obtain the sale of additional equipment or products without the incorporation of a tying clause.

PACKAGE LICENSING

A package license is the type of a tying agreement where the patentee conditions the signing of a patent license on the acceptance of licensing one or more additional patents. Certain valid business reasons may be behind package licensing, since it can be used to avoid problems, such as determining which sales relate to a certain license right or to apply differential royalty rates and eliminate extensive bookkeeping.

Several cases were brought to the attention of the Mexican Registry in which the licensee without prior knowledge as to the value of "all" patents involved was forced

to incorporate these in the original agreement forcing the licensee to pay a higher royalty.

FIELD-OF-USE RESTRICTIONS

A field-of-use restriction is one in which the licensor limits the licensee with respect to the scope of use of the licensed product. By imposing such restrictions a licensor could block off various fields, either to charge different royalties in each field, or to avoid licensing a recipient company in certain areas in which the patentee (licensor) plans to utilize the patent. From a practical point of view, if a restriction does not affect the manufacturing plans of the recipient company this may be accepted, however, such an arrangement should be carefully negotiated under a lower royalty basis. Finally it should be said that field-of-use restrictions will vary considerably with the type of production technology involved. From the government's point of view what is important is to assess the economic effect of such provisions.

TERRITORIAL RESTRICTIONS

According to the Mexican law, territorial restrictions are considered illegal, unless limitations on exports of goods or services do not go against the country's interest. Flexibility is needed in this area in order to eliminate restrictive clauses *only if they affect* the possibilities of growth of the recipient enterprise and the overall external policy of the country. On the other hand, it should be noted that by simply eliminating contractual clauses that limit, condition or prohibit the export of licensed products, the recipient country not necessarily will be in a position to increase its exports, as this is basically governed by economic and commercial considerations that apply to the international market, i.e., cost, quality, delivery time, etc.

Under this type of analysis any developing country trying to regulate licensing arrangements should make an effort to ascertain what legitimate business justifications could exist for restrictions in this area and to determine as well what would be the effect in the economic sense. In this connection some relevant factors to consider will be:

- (i) size of the licensor's and licensee's enterprise;
- (ii) the extent to which they are able to participate in various markets;
- (iii) the type of exclusivity involved;
- (iv) the duration and scope of the agreement;
- (v) the type of products, cost of them and whether or not a cross-licensing is involved.

The general criteria in Mexico is that the registration of a contract may be denied if:

- (i) it contains a total prohibition for exports;
- (ii) it obliges the licensee not to export to certain geographical areas where the licensor has not granted exclusive rights for manufacture or sales to third countries;
- (iii) It establishes a ceiling concerning the volume of export sales;
- (iv) it obliges the licensee to export only through the licensor to the detriment of licensee's successful market penetration in third countries;
- (v) it obliges the licensee to pay a high royalty on

export sales, etc.

In the same way, Mexico has accepted certain limitations for exports in cases where:

- (a) the licensor has previously granted exclusive manufacturing rights under a patent in a particular country;
- (b) the licensor is not authorized by legislation or decree in its own country to export directly or indirectly to certain geographic areas;
- (c) a higher royalty on export sales is applied and this contributes to the balance of payments or the development of marketing abroad of products of high local content.

Many licensors have developed particular methods of imposing territorial restrictions without having expressed clauses in licensing contracts, for instance:

- (i) by not granting patent rights in licensor countries and by the risk of infringement suits;
- (ii) by imposing prohibited higher royalties that would make uneconomic any export possibility;
- (iii) by restricting the field-of-use of a particular patent or know-how; thereby reducing the quality or specification of products.

PRICE FIXING

Under the Mexican regulatory policy a price-fixing arrangement will be considered not acceptable. Similarly, on the Section 1 of the Sherman Act once a patented product has been sold, the producer cannot fix resale prices, nor can the sales price of an unpatented product resulting from a patented machine be fixed by the patent holder. United States case history shows that certain restrictions of this kind might be valid if adapted in a reasonable manner and for the purpose of protecting the patent holder's profits that could rightfully be expected from the patent monopoly.

In connection with price fixing provisions, a developing country should carefully assess the economic implications to the local company and companies operating in the same sector. In this context it should be kept in mind that manufacturing costs in the developing countries are in general considerably higher than in the industrialized countries; additionally, there are many economic considerations that go beyond the control of the local company, such as higher cost of raw materials or equipment, market stability, inflationary trends, etc., etc. In such a situation a price fixing arrangement could negatively affect the profitability of the project and the growth of the recipient enterprise.

In recent times, international organizations have taken a leading stand in the definition of international guidelines of conduct that could orient developing countries in regulating restrictive business practices in licensing. The unacceptability of price fixing provisions has been made in all cases.

It is possible that by following very rigid recommendations that do not take into account the practical and economical realities, a developing country can be misguided. To illustrate this, we should refer to the serious efforts of many developing countries to promote and encourage the establishment of subcontracting agreements; these are arrangements in which the export element is a central one, and where certain price arrangements would

have to be made in order that the licensor or a third company may be in a position to enter into a long-term/high-volume agreement for the supply of parts and intermediates.

This serves to demonstrate that much flexibility is needed as well as guidance and expert advice to ascertain the economic implications of price fixing arrangements.

The fact remains that, from the point of view of the recipient company and host country it is always desirable to eliminate unreasonable price fixing provisions in contracts that may hinder the growth and financial stability of the recipient firm.

ROYALTY PAYMENTS

Restrictive provisions in this area are some of the most important to consider, as they could have a negative impact on the development of the country and the recipient enterprise's economy. Under U.S. antitrust policy a misuse of a patent through an improper formulation or imposition of royalties could be considered a violation. Under the Mexican criteria the basic elements for judging on the validity of royalty provisions take into consideration the analysis of their economic effect at various levels.

This is an area in which the legal, technical and economic considerations should be brought together. Although this is basically an economic and technical problem; the legal aspects, particularly in patent agreements, should also be taken into account. For example, attempts might be made to avoid price fixing charges and to achieve price control through the amount of royalties. Similarly, a licensor may condition the grant of a patent license upon payment of royalties on products which do not use the patent. Under the U.S. antitrust law, establishing different royalty rates for different licensees is considered acceptable, but it may not be used to effect certain competitors or prevent newcomers. Differential royalty rates may not be accepted under antitrust criteria in cases where this is used to achieve an unlawful allocation of markets. Developing countries should carefully consider the economic implications of this in various areas. For instance, an American firm may impose a reasonable royalty rate for domestic and export sales, but prohibit a higher rate for sales into the United States, thereby preventing access to the U.S. market. (*De facto* introduction of territorial restriction.) In principle, this will be considered illegal by the United States antitrust authorities.

Any developing country wishing to introduce policy guidelines on permissible royalty rates, should be prepared to carefully ascertain the degree of flexibility needed in view of: (i) foreign exchanges availability; (ii) industrial sector priorities; (iii) external policy concerning foreign collaboration and investment, on a sector by sector basis, etc.

The Government of Mexico has been successful in maintaining a receptive climate for technology licensing and investment, and simultaneously exercising a careful control on technology payments. Two and a half years after the enactment of the Mexican legislation, it was possible to report savings in the order of \$200 million by enabling foreign companies to directly participate in the renegotiation of contracts (this figure was computed taking into account the "modified royalty rates" through the life of the agreements). Mexico has been efficiently assisted by UNIDO in achieving this important goal. Also

with the help of UNIDO the Mexican Registry has carefully monitored the reaction of foreign enterprises that were involved in the reduction of royalty payments and the overall effect of the Mexican legislation in the external market.

This helps to demonstrate that it is possible to engage in the renegotiation of existing agreements if flexibility is applied and if these renegotiations are conducted with the participation of all interested parties, including the foreign enterprises.

It is probably too early to ascertain what has been the effect of the Mexican law of technology, but Mexico is continuously receiving an average of 50 new contracts a month.

It may be of interest to all developing countries to know of the general criteria for determining what in Mexico is considered to be an excessive payment or what constitutes an excessive burden to the country's economy.

For this purpose we will summarize the basic criteria for dealing with clause II, article 7 of the Mexican law:

Although it is not possible to establish general rules concerning the most adequate level of payments, what is important is to conduct a careful techno-economic evaluation on a case by case basis and careful techno-economic evaluation on a case by case basis and to determine whether:

- The payments involved, do in fact, relate to the services and knowledge that is to be provided.
- It is essential that either in the contract, or separately, the base and formula to calculate royalty payments is clearly specified.
- It is important that the contract clearly specifies that taxes due on royalties are the responsibility of licensor.
- A differentiation is made between payments involving know-how fees and continuing royalties.
- Contrary to what is followed in other countries Mexico has established royalty ceilings on various sectors.

In order to determine the total flow of payments involved the following is considered:

- i) The manner in which payments are going to be effected.
- ii) Projected volume of sales or production during the life of the agreement.
- iii) The duration of the contract.
- iv) The specified dates when payments should take place; given special attention to a scheduled program for implementation of an industrial project.

It was found that in practice, the various modalities for covering payments change considerably from case to case. In this context some reference points for comparison were established at the sectorial level.

In this connection, the following indexes are considered important:

- a) *Royalties related to products of the contract.* Total sales of the recipient company.
- b) *Royalties on products of the contract.* Total sales of products of the contract.
- c) *Royalties related to products of the contract.* Net income based on products of the contract.
- d) *Total payments involved.* Total investment in machinery and equipment.

The above reference indexes were found to be useful in

determining to what extent the payments involved affect the manufacturing cost and the financial situation of the recipient company.

As a general rule, minimum royalties are not accepted in Mexico. However, if the foreign licensor insists on a minimum royalty, the Mexican Registry would then request the incorporation of a maximum royalty fee.

Note: After a revision of many cases that contained minimum royalty provisions it was found that they operated only on few cases. The concept of a minimum royalty is not always acceptable because there are cases where, for reasons beyond the control of the recipient company, such as market demand, etc., the licensee may be put in an unfavorable position, particularly in cases where new products are involved, or where the sector of industry is highly dynamic and competitive.

In order to determine whether the payments involved constitute an excessive burden on the economy, it was necessary to examine, to what extent the total flow of payments (both, explicit and implicit) may be detrimental to the country.

—By explicit payments we understand, those that pertain to royalties and fees specified in the contract.

—By implicit payments we understand those that result, among other things, from tie-in clauses which normally appeared in (i) overpricing of raw materials, parts, equipment, etc., obtained from licensor, (ii) underselling of products exported through licensor, etc., etc.

Although the definition of what may be construed as a negative effect to the economy is a difficult question and requires the technical support from various agencies; the register of technology can at least examine some of the most obvious implications that result from contractual arrangements with foreign companies. In this context it was considered important to determine (i) what is the effect of payments on the recipient company; (ii) the industrial sector to which it belongs; (iii) and how it affects the country's balance of payments; additionally it should also be determined (iv) what can be the effect of said payments for technology in the cost of goods and services and how this may affect the consumer sector, etc.

Other Aspects

There are other aspects that have to be studied at the sector by sector level and at the macro-economic level, in order to define appropriate policies oriented to reduce technology payments, that could have a negative effect on the nation's economy.

It should be mentioned that clause II is closely interlinked with clauses: I, IV, VII and XII of article 7.

It is not possible, within the scope of this paper to discuss in full what is the internal criteria for the application of clause II of article 7; nevertheless, in addition to the general criteria mentioned above, each contract is evaluated from the legal, technical and economic point of view and specific guidelines have been developed for the application of clause II in the following areas:

1. Use of trademarks

- a) A deliberate effort had to be made to gradually reduce the use of foreign trademarks in the domestic

market, particularly when:

- i) They are not yet established in Mexico.
 - ii) Their impact in the sale of products is of minor significance due to the type of products or services involved.
- b) On a selective basis the use of new foreign trademarks should be encouraged and authorized:
 - i) When they are considered important for the export of products manufactured under license.
 - ii) When it brings along a recognized technical prestige and is required in a particular market.
 - c) It is important to promote the creation and development of Mexican owned trademarks.
 - i) In order to gradually identify the products as Mexican both domestically and internationally.
 - d) When licensor *does not participate* in the capital of the recipient company, payments for the use of trademarks are maintained in the range of one percent on sales.
 - e) No payments for the use of a trademark are authorized when the licensee is a wholly-owned subsidiary of licensor, or when licensor has a majority equity participation in the recipient firm.

2. The right to use patented inventions

The law of industrial property of Mexico considers three kinds of patents that are subject to regulation by the registry:

- a) Patents on inventions.
- b) Patents on improvements.
- c) Patents on industrial models or designs.
 - The duration of patents on inventions and improvements is granted for 15 years.
 - The duration of patents on models and industrial designs is granted for 10 years.

These provisions as well as others that relate to the validity, exploitation and termination of patents, are carefully appraised by the registry.

In connection with contracts that cover the use of patents the following is taken into account.

- When a patent has been requested but not yet granted by the industrial property office; payments for this concept will be conditioned to the granting of patent(s).
- When the contract covers payments for the right to use several patents, it is important to determine the duration of all of them and to differentiate the "basic" or "secondary" patents.
- It is also important to determine whether or not the patented know-how is being used in the manufacturing process, and if so to what extent.
- It is important to determine the degree of exploitation of the patents involved in the "territory" of the contract.
- The Mexican Registry will insist that any possible infringement *on licensor patent rights* by a third party, shall be the sole responsibility of licensor.
- Any contractual provision limiting the "field-of-use of a patent" in an unjustified manner cannot be accepted.
- Licensor should be responsible to defray all expenses related to the registration and maintenance of its patents in Mexico.

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3. The supply of technical assistance

Payments for technical assistance normally covered through "know-how fees" should be examined in close detail. In Mexico a differentiation is made between lump-sum payments and those that call for the continuous supply of technical assistance over the life of the agreement.

In connection with know-how payments, the following should be taken into consideration:

- When the object of the contract covers technical know-how that could be assimilated directly by licensee, i.e., formulations, drawings, specifications, etc., payments on a continuous basis are not accepted in principle.
- Concerning the know-how incorporated in drawing formulas and/or technical know-how, *no limitations*, other than those pertaining to a reasonable obligation on confidentiality, *shall be accepted*.
- The Registry *will not accept any restriction at the end of the agreement concerning the use* of non-patented know-how.

4. Basic or detail engineering

The supply of engineering services will depend on the technical capability of the licensor. In practice, basic and detail engineering are obtained from different sources, and it is therefore important to define the degree of responsibility of all parties involved.

An important aspect concerning the supply of engineering services relates to the type and scope of guarantees required by the recipient company.

When the licensor is responsible of supplying basic engineering together with process technology; licensee should obtain specific guarantees at least in the following areas:

- i) Volumes of production.
- ii) Yields.
- iii) Quality of products.

There are many considerations concerning the proper evaluation of engineering services, but it is important that the amount of payments of these services, should be evaluated, comparing them with alternative offers on substantially similar basis.

Finally it is essential that contracts covering the supply of basic and/or detail engineering should clearly specify the type and scope of these services as well as the manner in which the corresponding payments should be effected.

5. Continuing technical assistance

For the purpose of evaluation of payments concerning technical assistance the Mexican Registry uses the following criteria, and separates the following concepts:

- a) Pre-operational phase
 - i) Pre-investment studies;
 - ii) Technical assistance for the purchase of equipment;
 - iii) Technical assistance in the erection and installation of plants;
 - iv) Plant start up;
 - v) Training of technical personnel in the above areas.

b) Operational phase

- i) Assistance in the purchase of spares, raw materials, parts, etc.;
- ii) Quality control;
- iii) Assistance in plant operation including repairs and maintenance, production efficiency and others;
- iv) Technical services to clients;
- v) Technical improvements of processes, and products;
- vi) Training of technicians in licensor's or licensee's plant.

The following considerations are taken into account:

- It is important that the contract specifies the various services involved and the corresponding payment for them; *in a separate manner*.
- It is important to ascertain the time required to cover the various services related to the pre-operational phase.
- A definition of the scope of technical assistance to be provided in the operational phase.
- Determine the relationship between the kind of assistance to be supplied by licensor and the complexity of the manufacturing process in its various phases.
- The degree of technical change in the sector of industry in question.
- The technical capability of licensee.

6. Managerial assistance

The cost and scope of these services will greatly depend on the functions to be covered. In general terms, these services are obtained over a limited period of time; covering among others, the following aspects:

- i) Planning and programming;
- ii) Research and development activities;
- iii) Inventory control and accounting;
- iv) Financing and purchasing;
- v) Promotion and marketing.

Managerial or administrative services have to be evaluated in consideration of the following:

- i) The sector in which they are applied;
- ii) The requirements of the recipient party;
- iii) The type and scope of the same.

In this context the following is to be considered:

- a) A definition of the different services involved.
- b) The provision for training programs in order that the various functions can gradually be covered by licensee's staff.
- c) Payments for this concept *shall be viewed in relation* to the economic benefits of the recipient company.
- d) The responsibility and functions of licensor should be clearly delineated.
- e) Managerial assistance in the area of marketing is in principle not accepted when the recipient company has been established for the sole purpose of manufacturing and selling intermediate products.

GRANT-BACK PROVISIONS

A grant-back provision in a technology agreement is the one that requires the licensee to assign back to the licensor any new patents, improvements, or the result of technological developments, etc., conducted by the licensee during the life of the agreement.

Under this type of provision it might be convenient to consider the criteria of the Japanese Fair Trade Commission (FTC) which for all practical purpose may be considered appropriate.

Note: Interested officials of developing countries wishing to look closer at restrictive business practices in licensing agreements will be advised to obtain copies of the *Japanese guidelines* on the "recognition of standards concerning international contracts for technological introduction", published by the Fair Trade Commission on May 24, 1968.

The analysis of grantback provisions can be divided into three parts:

1. Provisions in which the licensee is obliged to inform *of all the knowledge and experience* which licensee has acquired in connection with the goods and services covered by the contract.

2. Provisions that oblige the licensee to assign the rights (patent rights or rights arising from application thereof) related to any improvement, invention or application of inventions which the licensee has made.

3. Provisions that oblige licensee to grant to licensor a license on any improvement, invention, or application of invention which the licensee has made. The criteria of the FTC of Japan considers that these provisions may not constitute an unfair mode of trade, if the licensor is *placed under the same kind of obligations and if the obligations of the licensor and licensee are properly balanced in nature.*

According to FTC "the obligations of both parties are considered to be properly balanced in nature" if the obligations of both parties are the same in kind but also that such obligations are reciprocal as to (i) royalty payments, (ii) duration of the obligation, (iii) the area in which the license is granted, (iv) degree of exclusivity applied to either party.

If both parties are mutually obligated to inform each other as to the knowledge and experience acquired, in relation to the technology covered in the contract; and the obligation *for the licensee remains during the whole duration of the agreement* and the obligation of licensor *is for a shorter period of time*; or if the licensee is obligated to pay royalties for the information while licensor is not obligated; FTC considers that the obligations of both parties *are not well balanced.*

Furthermore, if a license which the licensor grants is effective only for the duration of the contract, while the license which the licensee grants to licensor is effective during the time of validity of the patent — and this covers a longer period than the contract itself — then the obligations of both parties are not well balanced.

Strictist Form

Finally, to illustrate what would be the strictest form of grant-back restrictions:

"In case the licensee has made an improvement, invention, application of new invention, related to the patented goods during the period of the contract, the licensee shall immediately inform the licensor and *assign the right* of such an invention to licensor *without any compensation.* The licensor shall have the right to apply for a patent in any country; the licensee shall be given a nonexclusive license on the invention concerned (his own invention) only in the territory where the licensee has been authorized to manufacture or sell patented goods." In this

example it is provided:

- i) that in case that the licensee has made an improvement, invention, application of invention or new invention he must inform the licensor thereof immediately;
- ii) that the licensee *must assign all rights* pertaining to such an invention to the licensor without compensation;
- iii) that the licensee is granted a nonexclusive license as a result of said assignment;
- iv) that the granted license is effective only in the territory of the original patent license;
- v) that the licensee without due compensation acquires *exclusive rights* to exploit a patent developed by licensee in all countries excluding the "licensed territory."

The criteria developed by Mexico concerning grant-back restrictions was based on the analysis of more than 2,500 agreements and falls closely to the FTC criteria.

In this area the Mexican Government feels that the registration of a contract *will be denied when:*

- i) it establishes the obligation to assign the property of trademarks or patents that might be developed by the licensee;
- ii) it obliges the licensee to assign to licensor; licensee's own trademarks upon the termination of the contract;
- iii) the exchange of information on improvements or innovations developed by either party *is not conducted on the basis of reciprocity* in regard to: (i) the territory, (ii) the degree of exclusivity, (iii) the remuneration related to this.

CONCLUSION

It is the author's hope that this attempt to illustrate some of the basic criteria of the Mexican Government in the area of restrictive business practices in licensing contracts will serve to encourage additional research and analysis on the part of other developing countries. In preparing this paper an effort has been made to illustrate the complexities involved in dealing with this problem, and to highlight the need for joint efforts in this area among developing nations and to rely more on the assistance of the United Nations and particularly UNIDO for improving communication channels among each other.

It is quite obvious that the implications of restrictive business practices in licensing agreements are quite complex and that in order to deal with this problem and to effectively regulate these transactions the efforts of the developing countries should not be limited to legal scrutiny but rather to incorporate economic and technical considerations to properly assess the effect of these restrictions on the recipient enterprise and the economic and industrial development of the recipient country.

From the point of view of the developing countries the policy rationale is providing intellectual property protection and for the introduction of legislation to regulate in the field of technology transfer should not be viewed in isolation from the economical and technological policy of the country.

The presence of restrictive clauses in international licensing agreements could hamper the economic and technological development of the recipient nations. On

the other hand there is a need to understand that technological contracts are excellent vehicles for strengthening the technological capabilities of the recipient country. Furthermore, these agreements are to be evaluated on the basis of economic and commercial criteria in order to properly ascertain the magnitude of problems and to create and maintain a receptive climate for technology and foreign investment into the developing countries.

The author wishes to give due recognition to UNIDO for providing a highly qualified expert assistance to the Mexican Government that made possible the establishment of an efficient system, and allowed important savings and benefits for the economy as a whole. And to encourage other developing nations to support the efforts of UNIDO in the field and to rely on technical assistance projects from UNIDO in the future.

Licensing an Aid to Pharmaceuticals

(Continued from Page 24)

ment of adequate manufacturing facilities within a certain time, etc. The relative bargaining strength of the parties will determine the ultimate degree of commitment by the licensee.

Not only should the agreement set forth the objective criteria constituting "best efforts", but it should also prescribe the remedies available to the licensor for breach of such criteria by the licensee. As with failure to meet the annual minimum royalty, the licensor ought have the option of terminating the license or of converting it to a non-exclusive license.

It should be realized that, the more specific the contract language is in delineating the efforts and goals desired of the licensee, the fewer difficulties will be encountered by the licensor in an attempt to enforce the "best-efforts" provision or his remedies for its breach. Careful draftsmanship, therefore, is essential to avoid any uncertainty or vagueness in the characterization of what constitutes "best efforts" by the licensee.

6. NDA Access

As noted previously, it often occurs that the pharmaceutical entity to be licensed is not in a final stage of development and that subsequent completion is to be undertaken by the licensee. In such instance, the licensee should not be too surprised if, in addition to royalty compensation, the licensor demands the right to use for his own purposes any relevant R&D information and data evolving from the licensee's efforts as further consideration for the license. Of particular importance, for example, would be any animal and clinical data generated by the licensee that could be utilized by the licensor in obtaining his own governmental approvals to market the licensed drug.

If the intended license is exclusive, the licensor would obviously wish to use such data outside the licensed territory. Should the license be sole, which implicitly provides for licensor competition, use of the data both outside and within the licensed territory would be desirable to the licensor. Accordingly, if the licensed territory comprises the United States, the licensor would probably seek the right of access to any approved NDA subsequently obtained by the licensee including the right to use any of the licensee's data contained therein in order to support the

licensor's submission of his own NDA.

Such a demand is almost sure to bring cries of woe and dismay from the licensee. Why should he agree to complete development of the drug only to have the fruits of his labors shared with the licensor? Without some understanding on the licensee's part of the rationale behind such demand, and, perhaps, without some modification of the demand on the licensor's part, his reaction may well be justified.

"Giant Step"

The licensee must realize that the license agreement opens up a new field to him or permits him to sell a product which he otherwise would not have. Furthermore, even though he may have to expend a considerable amount of additional money and effort before marketing can be achieved, the license puts him far ahead in savings of time and capital. He completely sidesteps the synthetic, screening, selection, and testing program from which the pharmaceutical entity evolved. It is for this valuable "giant step" forward with a new field or new drug that the licensee is being asked to share his efforts with the licensor.

The licensor, on the other hand, should be willing to acknowledge the licensee's contribution in achieving marketable status for the licensed drug. Such acknowledgment can take a variety of forms. For example, upon actual use of the licensee's data, the license could provide for a reduction in the royalty rate, or, reimbursement to the licensee for part of the direct or out-of-pocket expenses incurred in accumulating the data. Another approach is to provide the licensee with a specified "lead time", sufficient to bring him a reasonable return on his development costs and a secure market position, before the licensor will be permitted to use the data, say six months or one year. Another alternative is a de-escalation approach, such as: in the event the licensor makes use of the licensee's data within one year from the date the licensee obtains his NDA approval, then the licensee will be reimbursed with up to 50% of his out-of-pocket costs; if used by the licensor within the second year, such reimbursement will not exceed 25%; and if thereafter used, no financial reimbursement will be due the licensee. Obviously, the fairness and negotiability of any of these "variations on a theme" will be determined by the particular circumstances and equities involved.

7. Grantbacks

Many licenses provide that improvements made by the licensee relating to the licensed drug, for example, a new method of synthesis, a new end use, an improved formulation and the like, are to be communicated to the licensor and made accessible to him. Such "grantback" provisions have varied in the past from a mere nonexclusive right to use the improvement, for example, in areas outside the licensed territory, to an exclusive right to use or a full assignment of ownership rights worldwide. The latter, however, have lately come under close scrutiny as a possible misuse of the basic licensed patent. The arguments are made that such grantbacks merely serve to further secure and increase the licensor's patented monopoly and to dampen the licensee's incentive to develop improvements, thereby constituting effective impediments to competition. Consequently, such grantbacks must be ex-