

real effort to take advantage of the technology made available to him. In practically all instances it declined to pickup the new improvements. As a result although the second agreement has been a profitable arrangement, by most standards it pales by comparison to the first.

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*Albert J. Coakley, Jr.*

**"THE SNAP OF REVAMPING A MAJOR  
INTERNATIONAL LICENSING PROGRAM  
AFTER ACQUISITION"**

*by  
Albert J. Coakley, Jr.\**

I soon decided, as I reviewed the files and collected my thoughts, that I would never be able to relate, even in thirty minutes, all there is to tell about TRW's experiences in recent years in revising, preserving and managing a very profitable foreign licensing

program of an acquired company. Accordingly, I have chosen to discuss with you what I believe are the most interesting and, hopefully, the most instructive of our experiences.

First, some background. TRW Electronics is a major operating unit of TRW Inc. TRW, as the ads say, is not an airline nor, as most L.A. residents think, an aerospace company. We are principally a parts manufacturer, some 70,000 products in all. You can hardly fly a plane, drive a car, watch TV without depending on TRW-made parts. About 40% of the business is auto parts. Approximately 26%, including about half of the auto business, is foreign, principally foreign manufacturing. Almost 25% of the business is designated in the annual report as electronic. This includes electronic systems and equipment. But TRW Electronics is principally an electronics parts house — including advanced semiconductor products like high power transistors for mobile communications equipment, capacitors, TV coils, miniature transformers and motors, connectors, resistors and potentiometers. Today's story concerns the resistors and potentiometers.

TRW Electronics is largely a grouping of several independent companies, each significant in a particular product line, which TRW acquired in the acquisition happy days of the 1960's. But TRW is not a conglomerate. The objective was to put together a blue chip electronic component house that would be the most widely based electronic parts supplier in the nation.

International Resistance Company was a major resistor and potentiometer firm — which had profited successfully from the advent of TV and the space age. A resistor is just what the name implies, a device to resist, that is to impede the flow of electrical current. In a TV set there are many resistors (175 to 200 in a color TV set). The objective is to control voltage levels within the set. A potentiometer is a type of resistor, that is a variable resistor. In a TV set it would control volume levels. A potentiometer is a more sophisticated device than a fixed resistor. It can be adjusted within the circuit to provide the specific resistance required.

TRW acquired International Resistance Company (IRC as it is known and as it will hereafter be referred to) in 1969. Besides about 50 million of sales, IRC had a worldwide network of resistor licenses. Annual royalties in 1968 exceeded \$800,000. And as luck would have it, the license agreements, dating back to the late 1950's, (and even earlier) were up for renewal in 1969, the first year of TRW's operation of IRC.

The licensees, located in England, Denmark, Germany and Italy for Europe; Japan and Australia for the Far East; and Canada and Mexico for North America outside the U.S., were without exception exclusively resistor houses. Their total business was in IRC-developed or related products. IRC had generally put them into the business. IRC provided the technology. IRC had also built a substantial U.S. patent portfolio and procured counter part patents in the principal countries where the licensees sold IRC products. IRC had a 105-man research and development lab in Philadelphia, a small staff of inside house patent

counsel, and an administrative office of several people. Their task was to interface with the eight foreign licenses (there were U.S. licensees also) and to process the requests for assistance, for special tools and manufacturing equipment and for sources of special supplies and to assure that the monthly royalties were promptly paid.

TRW's first task on taking over IRC was to get all the licenses renewed. We shuddered to think of the domino effect if one refused to do so. The problem simply put was this: The licensees were manufacturing the older product lines. There was too little growth and so too little royalty improvement prospects for these products. TRW, as IRC before it, was anxious that the licensees assume the manufacture and sales promotion of the more advanced and higher priced products, like the potentiometer. But the licensees generally hesitated to make the capital investment and sales efforts this would entail. TRW, on the other hand, wanted the freedom itself to sell, and perhaps even to make and sell, these new products abroad, if the licensees chose not to do so, that is to seize the opportunities the licensees *resisted* (no pun intended).

The idea was to negotiate a clause that in effect would recover the rights to new products, if within say six months, the licensees did not elect to make any product being manufactured in the U.S. by TRW or if a licensee, having elected to do so, failed to achieve and maintain a certain level of production within a certain time. TRW envisaged either forcing the licensees into greatly expanding their businesses and so upping the royalties or conversely recapturing the opportunity of developing the foreign market directly for IRC's newer products. The negotiating hurdle, however, was that before TRW got control of the situation and set out to put this idea across, IRC (responding to the usual pressures of licensees seeking lower royalties as a condition of renewal) had already agreed to substantial cuts in the royalty rates.

With the economic lever (the carrot of lower rates) gone, TRW's businessmen faced a most difficult negotiating task. How did they carry the day? It was a SNAP! Each agreement had a clause that provided if the licensee terminated, he would have to return all the IRC know-how, drawings, specifications, etc., and could not use any of the technology for a period of ten years. Virtually none of the licensees had any technology that hadn't come from IRC.

Being a lawyer, and a general lawyer at that, I wondered of course about the enforceability of such a clause. In the one instance where I actually had to investigate the matter, I found that such a clause is clearly legal under the Italian Civil Code for five years, and if a longer term is specified, it is still good for the five years.

Also, there were IRC's still effective patents. Yet I don't think it was either the obligation to return the technology nor the outstanding patents that carried the day, but the number of licensees. At least the Europeans, I believe, feared that those who stayed with TRW would get all the new developments and be able to capture the national markets of the others. Each company accordingly renewed the license with

TRW for ten years because it believed the others would renew. Our management also convinced the licensees that with TRW in the picture they could expect a dynamic upsurge in technological flow.

Not that negotiating the final text of the agreements was all that easy. The four Europeans who *typically* met periodically anyway, formed themselves into a committee of negotiators and each was privy to the other's deal. They intended that whatever one got in the way of terms from TRW the others would get also. Besides, quite properly TRW adopted as its policy that, insofar as possible and practical, all the licensees would be treated equally. However, coordinating all the licensees — at least in Europe — as you can appreciate — prolonged matters considerably. The Japanese licensee's approach was typically Japanese. As soon as TRW acquired IRC, the top executive of TRW Electronics teamed up with the former president of IRC and took a swing around the world visiting each licensee. While the dignitaries sped to the plant sites and later to dine, the TRW executives assured the licensee managers that they had nothing to fear from the change of ownership — that TRW would regard each licensee as a co-partner in the resistor business. The Japanese president, duly impressed, took these words to heart. And so when the negotiating specialists were sent forth to restructure the license arrangements, the Japanese president would bargain with no one but the head of TRW Electronics. He would write to no one else, talk to no one else, meet with no one else, which posed no end of problems as our top man had neither the time for nor interest in detailed negotiations. As you might imagine, the Japanese license was done first and differs somewhat from the others, but the basic concepts are still the same.

The Italian negotiation took a stranger twist. During contract negotiations the licensee pressed for TRW's acquisition of his business — a proposition that raised several concerns. First, what would be the impact on the other (at least the European) licensees — particularly on top of TRW's insistence on recovering rights not utilized — if TRW became a direct factor on the continent? Was Italy the place to be? Labor problems were intense. What was the company worth? The resistor plants were but a subdivision of a firm that made TV sets. That firm, in turn, was a partnership, not a corporation, and the general partner was a man with a taste for the good life. His books would hardly stand a review by TRW's cautious accountants.

While the Italian maneuvered for an offer for his business, it was not surprising that the last, last draft of the new license remained unsigned, but the old agreement with its higher royalties continued to apply on a year-to-year basis. However, despite numerous dunning letters from the Philadelphia administrative office and repeated assurances from the Italian General Manager, royalties were late by more than a year and the bills for certain equipment and material IRC had supplied had not been paid.

At an emotional dinner party in Milan, the Italian owner insisted he had an understanding with IRC that they would buy his resistor business whenever he

chose to sell. There was no written evidence of any such understanding. TRW had in fact made a modest offer to purchase after first advising no interest because we believed any offer we'd make would be an insult. As expected, the offer was rejected. Not too long, thereafter, with the recession intensifying in Europe, the Italian, beset by a huge inventory of TV sets and unable to lay off his employees because he lacked the cash to meet the severance pay requirements of Italian law, (totalling in the millions in U.S. dollars), filed for "controlled administration," the Italian equivalent of a U.S. reorganization. A moratorium or hold was placed on all past liabilities. At this point, TRW was a creditor for back royalties and supplies in excess of \$300,000. I was about to learn bankruptcy practice in the land of the Romans.

The Italian government would not allow hundreds of workers to be thrown out of work in Turin. FIAT and a group of Savoyard bankers were forced to set up a new company to continue the business, TV sets and resistors, of the Italian licensee. The employees got their severance pay, even those whose jobs were not interrupted by virtue of their transfer from the old company to the new. The new company, however, assumed none of the past liabilities. It merely rented, for a nominal sum, from the trustee in bankruptcy those buildings and equipment it needed for the then level of the business. The new company also continued to make resistors to the plans and drawings of IRC. Meanwhile there developed an intrigue worthy of the descendents of the deMedicis.

It appeared an agency funded by the Italian government for the purpose of rescuing ailing businesses (in the interest of the workers and the economy but not the ruined owners) would eventually take over the new company from FIAT and the bankers. The new company, however, planned to buy only the assets it needed for the reconstituted business. The old company had too many plants, too much equipment. And, of course, the new company would not assume the multi-million dollar debts of the old, including the \$300,000 plus owed TRW, nor pay the owner anything for his equity.

The bankrupt was to lose more than his equity, however. Under Italian law if the creditors of a bankrupt do not get 40 cents on the dollar, then the bankrupt is not exonerated. He cannot borrow money again nor get a passport, evidently to prevent a flight to Zurich for funds hidden away in unnumbered Swiss accounts.

In a desperate attempt to avoid these dire consequences, the former licensee continued to look for someone who would buy out the entire operation as a going business, at a price that would assure the creditors at least 40 cents on the dollar. Alternatively, he hoped to maneuver the new company into paying for the assets at a level that would achieve this objective. Suddenly, in this game the TRW license agreement became the key pawn.

Though bankruptcy was a cause of termination, as well as nonpayment of royalties, TRW had not cancelled the old agreement, while promising the new company we would be pleased to negotiate a new

license when and if it emerged with the business.

Some six months after the moratorium began, with the help of able counsel from Rome, we succeeded in getting the trustee, on behalf of the bankrupt, to sublicense the new company with TRW's consent. This meant a resumption of royalties payable direct to TRW and retroactive to the moratorium date, but, more significantly, acknowledgment by the new company that it couldn't manufacture the resistors except under license. Also by taking a sublicense from the trustee, the new company agreed that the basic license was still the property of the debtor. This sublicense became our comeback tool.

The old agreement, under which the sublicense had been granted, continued on a year-to-year basis only, subject to cancellation by either party at year end and by TRW at any time for default. Yet, it represented to the bankrupt and the new company the asset that might cause payment for all the assets to generate the 40 cents per dollar for the creditors, including TRW, that would mean complete exoneration for the bankrupt.

The old licensee, therefore, sought to avoid a declaration of bankruptcy and an auction by proposing assignment of all the assets to the creditors. He thus hoped to force the new company to negotiate for the assets and so pay a higher price. But the Italian government, which was financing the transaction, had no intention of paying a penny more than was necessary. Accordingly, about this time a year ago, TRW was asked to default the old company for nonpayment of royalties and grant a new license to the new company. Our Italian counsel advised that TRW was completely within its rights in terminating the former licensee for default (even pursuant to a contract with a third party). He also advised that whatever TRW might be paid for taking this step would not be reclaimable by the other creditors as a preference.

Accordingly, our European manager executed at the Milan airport a letter of intent, pursuant to which for a \$180,000 downpayment TRW was to terminate the old agreement, and license the new company on the same terms on which in 1969 we had licensed the other European licenses.

On about three days notice I flew to Rome allegedly to pick up our check and finalize the document. The first shock was that our overseas manager and the Italian lawyer had mailed off the letter of default on the basis of the letter of intent and before we had gotten either our money or been assured that the text of the license agreement would be accepted. Once again the bargaining wedge had been thrown away before the deal was set.

Despite a very tight deadline if the scheme was to work, the lawyers for the new licensee (actually lawyers for the Italian government) at first couldn't find time to meet. They were busy reading TRW's license form and revising it. We finally met in a palazzo near the Via Veneto at 6:00 p.m. on a Saturday night. Time doesn't permit elaboration of the details of the negotiation. But one point worth mentioning is that since they represented the government, the Italian lawyers naturally insisted on Italian law. The con-

sequence, my Italian counsel told me, was to make unenforceable several of the provisions of the agreement favoring TRW that were to be found in all the other licenses. Also, the Italian attorneys further insisted that the letter of intent was governed by Italian law because it had been executed by our European manager in Italy.

Still, like the other licensees before them, the Italians felt — especially now that their sublicense had been terminated as a consequence of TRW defaulting the old license — that they had to come to terms with us or face the possibility that they couldn't operate the business. In the end, despite several tense moments, the deal closed. Suffice it to say the agreement provides that California law will apply, but we did have to modify some of those clauses that would have been unenforceable under Italian law.

The next shock was that the new company's general manager insisted that our European manager had also agreed that TRW would vote at the creditors meeting for bankruptcy and against assignment to the creditors, as the new company directed us. Again, there was nothing in writing on this point and our European manager was insistent he hadn't agreed to sell our vote. On the other hand, he didn't see why we shouldn't cooperate. The new company was now our licensee and deserved our support.

We first offered not to vote at all. This was not enough. The government wanted at least one major creditor to prefer auction to assignment, and under the Italian law a composition of creditors is not conclusive. The bankruptcy court can still declare a bankruptcy if that appears to be the better course to follow in the interests of all concerned. The Italian government wanted a bankruptcy and they needed every tool they could develop that would establish that bankruptcy was the better course. Eventually we voted for bankruptcy. Most of the other creditors voted for assignment of the assets to them, but in due course the Italian court ruled for bankruptcy. The old licensee was ruined.

The auction is still to be held, and TRW is not precluded by its deal with the new company from participating in any distribution to unsecured creditors. But it is not expected after the secured bank loans are satisfied that the unsecured creditors (including other American interests) will get the proverbial dime.

Simultaneous with the Italian crisis, the English licensee had a management change. The general manager after 30 years quit and set up a distributorship to handle the sales in the United Kingdom of the Danish licensee's products. The English company had made much of its profit as distributor for the Dane. They wanted TRW immediately to stop the Danes doing business with the ex-manager. But the cartel days were over. The new agreements, to satisfy the Rome Treaty and other anti-trust law requirements, eliminated any export prohibitions. Without a legal wedge we got nowhere trying to reconcile the irate English licensee, the vindictive ex-manager and the happy Dane who was jointventuring with the ex-manager which meant a better profit on his sales in the U.K. Also, if the English licensee was hurting,

TRW enjoyed a royalty on the Dane's continuing English sales.

In the midst of suits and countersuits at law between the English licensee and its former manager, a heart attack on the *Edinburgh Express* took the life of the ex-manager. Shortly thereafter the English licensee was acquired by a mini-conglomerate. The Dane still sells in the U.K. independent of the English licensee.

While all these developments were going on, TRW disbursed the technical assistance responsibility to the various IRC plants, a la TRW's decentralized management concepts. The licensees, being used to dealing centrally, were most unhappy. Also, as the royalty revenues were not similarly disbursed but all credited to the Electronics group, rather than IRC, the IRC plants — less than ever — cared little for supporting the licensees. Eventually the licensees became so unhappy that the Philadelphia administrative office was reinstated as a single liaison point.

TRW is not yet half way into the ten-year term of the licensing program renewed in 1969. Already one licensee went bankrupt, another was acquired and it is possible another is for sale. The manner of supporting the licensees has been twice changed. Organizationally within TRW responsibility for the licensees has been reassigned at least half a dozen times. The size of TRW has created a gap of several levels between the plants with the technology and the license administrators.

Revamping a long-term, worldwide licensing arrangement has turned out to be anything but a SNAP.

*\*About the Speaker: Al Coakley is Vice President & Senior Counsel, TRW Electronics, Westwood, California. He is a graduate of Manhattan College in New York and Columbia University Law School. He was revising editor of Columbia Law Review and an Associate of Dewey, Gallentine, Bushley, Palmer & Wood, on Wall Street until 1959. His general commercial corporate experience includes: labor, anti-trust, tax and litigation — specialist in acquisitions and mergers. He was Assistant General Counsel North American (now Rockwell International) First at North American's Columbus Division in Ohio 1961-67 at NA's General Offices in El Segundo working with the Rockedyne and Atomic International Divisions. He joined TRW Systems in 1967 as Counsel and became General Counsel of TRW Electronics in 1969 at their Westwood headquarters. In 1972 he was named Vice-President and Senior Counsel of TRW Electronics. He has had extensive experience in patent and know-how licensing since 1960 in his association with NA and TRW: domestic and foreign — with most emphasis on the foreign and has traveled extensively in Europe and Asia.*