

# Licensing Disincentives in Brazil

*Reasons U.S. corporations find it difficult to license in climate created by Brazilian government*

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My comments may be considered by some as overly critical since I will emphasize the reasons U.S. technology owners are not encouraged to license their most valuable and useful technology in Brazil. It is my intent to be as constructive as possible — to explain what it is about the Normative Acts that are negative incentives to technology transfer and, thus, how Brazil can induce the owners of valuable, commercial technology to transfer it to Brazil.

I realize that abuses in the past and a critical shortage of hard currency for uses other than servicing Brazil's enormous debt have provided the driving force behind the strict rules with respect to technology transfer in the Normative Acts. A 10% royalty for 25 years for shirt collars and the Arrow trademark is, I agree, unreasonable. The Brazilian rules are based on well-intentioned objectives; that is, to provide a basis for obtaining needed, satisfactory and up-to-date technology at an equitable price and to encourage development of local technology. It is my sincere doubt, however, that the approach codified in the Normative Acts will accomplish the well-intentioned objectives.

I do not object to the regulations in their entirety. In fact, a substantial portion of the rules are, not surprisingly, similar to the U.S. antitrust laws — laws with which I have to contend everyday. There are, however, some regulations and tendencies in the rules and in their application that are unnecessarily harsh and counter-productive. These provide the basis for my remarks and the areas about which the authorities in Brazil should be informed.

I realize that a developing country may, in its wisdom, adopt certain measures which, in a developed country, may seem out-of-place. The U.S.A. was once a developing country and, sure enough, adopted some discriminatory laws. During its first 100 years of existence as a country, the U.S. was a net importer of creative works and technology. Foreigners were treated, under the U.S. intellectual property laws, much the same as developing countries treat us today. For example, from 1793 to 1836 our patent law expressly prohibited granting a patent to a foreigner unless he had lived in the U.S. for at least

two years and intended to become a citizen. When the laws were amended in 1836, discriminatory fees were established. Under the new laws, a U.S. citizen paid \$30 to apply for a patent, foreigners paid \$300 (a princely sum), and British citizens paid \$500.

We still have a provision in our copyright law (the "manufacturing" clause) that requires printing of an English language U.S. copyrighted article to take place in the U.S. or Canada; otherwise, the copyright is not enforced.

I am not here today to criticize the Brazilian rules and represent that those in the U.S. are free from fault. The reason I am here is to indicate what aspects of the Brazilian Normative Acts and their enforcement are negative incentives to the transfer of useful and valuable technology from U.S. companies to Brazilian enterprises; and, why, notwithstanding Brazil's clear right to adopt such rules, U.S. technology owners are reluctant to license their most valuable technology to Brazil.

## Nature of Company

First, I would like to describe the nature of my company's business and the type of technology we own. The Standard Oil Company was the first of John D. Rockefeller's companies and is the only one of the original companies still to bear the Standard Oil name. Standard Oil is a technology-oriented petrochemical company that spends considerable money on research and development, last year nearly \$200 million. Research is not only expensive; it is also very risky. It is estimated that no more than 10% of all research projects result in successful commercial developments. To justify spending these amounts of money to management and shareholders, a substantial incentive must be identified. In our domestic market, our incentive is the opportunity to realize a profit. It is necessary to identify similar incentives to convince our management and shareholders that we should transfer technology to other companies in the U.S. and abroad. It is in the area of incentives, that the major thrust of my remarks will be directed. It is my view that the technology transfer regulations in Brazil destroy incentives to undertake the transfer of technology, especially into Brazil from the U.S. In many ways, the mere existence of a regulatory agency stepping in after an arm's-length negotiation has been satisfactorily concluded creates a negative incentive to technology transfer. I would like to repeat — because I think it is so important — a U.S. company that owns valuable and important technology requires substantial incentives to convince its management and shareholders to part with the technology.

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My company owns several important and valuable technologies, the most important of which (the acrylonitrile process) has been employed in two of our own plants in the U.S. and in more than 60 plants throughout the world including Brazil. Acrylonitrile is the raw material for acrylic fibers such as Orlon and Acrilan and is one of three ingredients in ABS plastics. It is significant that acrylonitrile is manufactured from propylene, a byproduct from refineries or ethylene plants, and ammonia, an abundant product usually manufactured in large volumes for fertilizer use. Thus, any country with a refinery and a fertilizer industry can enter this field and provide a very important means to further industrialization; that is, forward integration into labor-intensive industries that provide substantial added value to a material that is regarded as a byproduct. The acrylonitrile process has had more than 25 years life. Its preeminent position is as secure today as it has ever been. Additionally, Standard Oil, like many technology owners, does not have to transfer its technology to receive a return.

To representatives of U.S. companies that have invested substantial money and R&D time in a major project, the technology (know-how) represented by the project is valuable *per se* with no room for argument. Proprietary technology that is consistently and uniformly maintained in confidence either through a refusal to disclose it or to disclose it only under a suitable secrecy agreement is, in fact, property whether it is covered by a patent or not.

Intellectual property is subject to certain fundamental rights of ownership, rights that protect the owner and give him control over the property. Intellectual property can consist of patents under which the granting government gives exclusive rights to inventors for a limited time. It can also consist of know-how, i.e. trade secrets. Know-how is property that an owner, at his discretion, may keep confidential or may, without losing ownership, transmit to another for a fee while at the same time obligating the recipient to keep it secret. Patents and trade secrets, i.e. know-how, do not guarantee success. They do, however, provide the basis for a profit-making enterprise.

#### Incentive for R&D

Unless intellectual property rights are enforced, companies would have much less incentive for research and development since would-be competitors could capitalize unfairly on technology belonging to others without being required to share in the tremendous costs involved in its development. To take the position that know-how cannot be licensed, i.e. that it is a knowledge and not a legal right as has been stated to be a fundamental concept regulating Brazilian practice, is illogical and not in accord with practice throughout the world including Japan (a country whose experience Brazil is allegedly trying to emulate).

An important point to take into consideration is that companies like Standard Oil do not license technology as their principal business. Rather, R&D is conducted and new processes are developed in order to improve and diversify its own commercial operations. Usually, U.S. industrial companies receive a much larger rate of return from using its technology in its own operations

than it does from licensing others. Generally, U.S. companies spend more money in research than they receive in royalties. Most such companies are willing, however, to make their technology available to others on a limited basis provided that a sufficient incentive is given for the transfer.

It is a major and critical step for a government to decide to become involved in regulating technology transfers. Does it want to encourage or discourage the transfer of new and useful technology into its country? It is unlikely that any government will say it wants to discourage such transfer. However, most such regulations have this effect.

When a country concludes that it needs technology, it may provide incentives to third-country licensors or it may provide incentives to its own companies to conduct the necessary research and development for its creation. The second alternate is very costly and risky and, in a country without a significant technology infrastructure such a plan is unlikely to be successful. The first alternative involves arm's-length negotiation. If either party is dissatisfied with the negotiation, there is no transfer. Without appropriate inducement, a company is unlikely to agree to license its technology, unless it can license technology that is out-of-date or non-competitive. The Normative Acts and their administration by the INPI discourage the transfer of truly useful technology.

#### Ignore Concept

The Normative Acts ignore what I believe to be the most fundamental concept involved in the transfer of useful technology. That is that each proprietary process, product or idea is unique. If it were not unique, it would not be proprietary technology. And it would not have very much value. Both the licensor and the licensee should be free to tailor the method of transferring technology that is most desirable and appropriate. Regulations that restrict either party's freedom to negotiate, in my view, discourages the transfer of technology. If licensors, i.e. technology owners, believe Brazil's regulations are a barrier, they will be reluctant to invest their resources in Brazil. Instead, they will prefer to move their technology elsewhere.

Among the regulations that I believe discourage technology transfer to Brazil are the following:

##### 1. Compulsory Registration

Under current practice in Brazil, the INPI controls and approves all licensing and transfer of technology agreements. Agreements that are not approved are unenforceable and hard currency payments provided in the unapproved agreements cannot be made.

In the U.S., agreements are considered private and may be (and usually are) kept secret. Thus, the mere requirement of registration is difficult to accept. As a practical matter, however, registration is not in itself enough of a negative incentive seriously to deter licensors from licensing in Brazil.

##### 2. Confidentiality

A matter of considerable importance in the transfer of technology from Standard Oil is whether adequate protection for the confidentiality of its technology can be

provided in the agreement. Successful research can result in patentable inventions and also important (and often critical) technical information that is not patentable.

Often this unpatentable technology is the technology that is the most important to the licensee. What the licensee wants is the information relating to the construction and operation of a plant. He is unconcerned about the licensor's patents, except he knows that he does not want the licensor to sue him. An owner of valuable, commercial technology is not willing to license under terms that may make it available to potential competitors who are under no obligation to the technology owner, a situation that could occur in Brazil after only five years.

Standard Oil is simply unwilling to make its valuable commercial know-how available to licensees unless and until it is assured that the technology will be kept confidential for a period of time justified by the know-how itself. Whether the term is 5 years or 10, 15 or even longer depends on the nature of the know-how. This is what I referred to earlier as the unique nature of technology. A secrecy term should not be arbitrarily regulated by government decree. It should be negotiated, if only a 5-year term is permitted, only out-of-date and/or noncompetitive technology will be licensed.

It is particularly disquieting that the Brazilian authorities say that know-how cannot be licensed, that know-how is not a legal right. This is destructive to the concept of intellectual property rights and cannot be accepted. INPI has indicated that Brazil hopes to follow the example of Japan where MITI's control of technology transfer agreements disappeared when Japan's industry became relatively self-sufficient. Japan never had regulations that arbitrarily limited secrecy terms. If they had had such regulations, they would not have achieved the tremendous industrial and technological performance since World War II.

A licensor, in a technology license, is disclosing technology and licensing its use. It is not selling the technology. A much higher price than is permitted under Brazilian practice would be required if the technology is to be sold rather than licensed. The purchaser would have to assume a much greater proportion of the costs of development of the technology. Under the circumstances of a low royalty ceiling and a limited secrecy term, only second-rate technology will be acquired.

### 3. Royalties

It should be obvious that a company owning valuable, commercial technology will not ordinarily agree to transfer its technology unless it can be assured of a fair return. The management and shareholders will not allow it. To assume that a fair royalty can be set by regulations is illogical. To say that a 5% royalty over five years is an absolute maximum is unfair and unreasonable. In fact, with some technologies a 1% royalty may be too high. On the other hand, some technologies are worth much more and only the licensor and licensee are in a position to determine its worth — certainly in a better position than a disinterested government body. If a technology is truly unique and commercially valuable and its use could save substantial foreign exchange through import substitution or earn foreign exchange through export, it may well be worth much more.

If, in fact, the Normative Acts limit the permissible royalty to 5% or less over five years, few licensors will offer their technology in Brazil unless, of course, it has little or no *real* value.

I realize that, in the past, large and sometimes excessive payments have flowed out of Brazil and reasonable safeguards may be justified to avoid such unreasonable and unjustified payments. On the other hand, if the royalties are regularly accepted elsewhere — for example, in Japan and Europe — royalties should be considered as representing the fair value of the technology. The same mechanism, that is, a showing that the licensor is not discriminating against the Brazilian licensee, should be accepted by INPI as justification for some of the other objectionable items as well.

In the royalty area, the reluctance of the laws and the manner in which they are applied fail to recognize the unique and individual nature of the technology is a major problem. By definition, different technology has a different value. Furthermore, different purchasers may require different know-how packages. A technically sophisticated company may require only a base patent license. A less-sophisticated company may require a turnkey plant. The different packages require and justify different royalties.

An even more sensitive matter in the area of royalty payments is the prohibition against payments from subsidiaries to foreign parents. Such laws diminish the incentive of parent companies to provide their most valuable and commercial technology to their Brazilian subsidiaries.

### 4. Export Restrictions

The Normative Acts appear to prohibit export limitations of any kind. It is a proper objective to encourage local companies to compete in the world market and thereby increase hard-currency reserves. It is my opinion, however, that the absolute prohibition against export restrictions is unnecessarily harsh and creates difficult conflicts of law.

In the U.S., as most of you are aware, we must be mindful of the Commerce Department rules against reexportation of technology and products made from the technology to some communist nations. A requirement that we must not prohibit exports could, therefore, create a serious problem with respect to the law, a problem that could prevent the technology transfer. Several U.S. companies have complained to me about this policy, indicating that the Brazilian licensee will often agree to the restriction, in a separate document. But I question whether this type of agreement could be enforced and, if it cannot be, whether a U.S. licensor could in good faith agree to it.

Another problem created by prohibiting export limitations occurs when a licensor has previously granted an exclusive license in a third country. Obviously, the company would be in breach of the earlier license if it granted a license without restriction to a Brazilian licensee. Also, it is implicit in the patent laws of all countries that the patentee has the right to exclude others. Where a licensor owns patent rights that would otherwise be infringed by exports from a Brazilian licensee, the Brazilian licensee should be required to negotiate and pay for the patent rights. Government regulations that require an absolute right to export to these coun-

tries violate the essence of patent laws around the world and, thus, add additional negative incentives to the transfer of technology. I'm told that, upon presentation of proper evidence, INPI will approve exceptions for exclusive licenses already granted but will not permit subsequent exclusives.

#### *Available Local Technology*

The requirement that licenses will not be approved when the same, or substantially the same, technology is available within the country is acceptable on its face. However, unreasonably strict interpretation of this rule could cause problems. Who qualifies to determine whether or not "substantially the same technology" is locally available? Certainly not the technically unsophisticated employees of the INPI. It is substantially impossible for two independent technologies to be identical. Subtle differences that are not apparent in a cursory review may make the difference between a successful and an unsuccessful venture. There is an additional and very important point. That is the reliability of the technology available from different sources. The INPI should be very careful in rejecting a technology transfer agreement on this basis.

How can an unsophisticated, nontechnical bureaucrat be sufficiently qualified to decide whether a similar but untested Brazilian technology will be satisfactory for a Brazilian company that wishes to invest millions of dollars in a plant in Brazil. This is easy for the bureaucrat since he is not responsible for operation of the plant. If the plant is unsafe, whose fault is it? I am sure the bureaucrat would accept no responsibility.

#### **Real Impact**

What has been the real impact of the Normative Acts? Are my comments theoretical or real? I did not intend merely to criticize the policies. What I intended was to demonstrate how companies that own valuable, commercial technology view the acts and why the acts discourage technology transfer into Brazil. In researching this paper, I was informed by many U.S. technology owners of actual problems with the INPI policies. For example, a major U.S. company has been forced to withdraw from a license negotiation because of Brazil's refusal to permit a provision requiring compliance with the U.S. export Administration regulations. Still, another U.S. company aborted a pulp and paper mill joint venture when the INPI required it to guarantee its technology that was being made available without charge to the joint venture and which would be protected by a secrecy term of only five years. What possible incentive did the U.S. company have to imperil its technology worldwide in a transaction for which it

would receive no royalty and incur considerable technical risk? Still, another example is a large arrangement including technology, patents and trademarks that was not consummated because the INPI would not approve a trademark license agreement providing for a royalty.

When the five-year term, 5% maximum royalty, extremely limited export restrictions, and the 25% withholding tax are considered as a whole, I fail to see how Brazil can expect to obtain commercially valuable technology. I suspect that the technology that is licensed under these terms is either noncompetitive, out-of-date, or ancillary to another agreement under which the licensor receives fair value.

It is my contention, and that, I believe, of the overwhelming majority of owners of valuable technology in the U.S. — the very companies who should be encouraged to transfer technology into Brazil — that:

1. In order for these companies to be encouraged to transfer their valuable technology, sufficient incentives must be provided.

2. Technology is developed for a company's own commercial use — not for licensing.

3. Reasonable ground rules for technology transfer to prevent abuses are justified.

4. The objectives of the rules are not objectionable.

Some say that the regulations are needed in order to improve the bargaining position of Brazilian businessmen. I submit that this feeling of inherent inferiority is incorrect and misplaced. Anyone who has negotiated with these businessmen realize that they are excellent negotiators who need no help from their government.

What is required to encourage the transfer of meaningful technology is the preservation of an open atmosphere for honest, arm's-length bargaining in which the licensor and licensee can obtain the very best possible result.

What I have indicated is not merely the words of an American lawyer who desires a perfect world, a Utopia for American licensors. Rather, I am echoing the sentiments of the majority of U.S. technology owners. Mr. James Thwaites, President of 3M International, said at the 1985 Annual Meeting of LES U.S.A./Canada, "We all can summarize the position of most owners of intellectual property in one sentence — if there is inadequate incentive for introducing invention into another country, they simply will not do it. Potential recipients have to understand this." Further, Standard Oil's Chairman recently said, "The misguided credo that intellectual property is the common heritage of mankind assaults the basic morality of good business.

"What I have invented I own.

"I certainly don't mean this as a threat, but I am simply not going to license a process or build a plant in a country which turns around and steals my technology."