

Non-Licensing Technology Transfers

How to transfer technology when a license agreement could result in loss of control or increase risks

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My topic is "Non-Licensing Technology Transfers," and I assume you know what a license is and does.

Simply stated, a license is a right to use property of another person. It is not a sale, it is not just a bailment or a contract to hold something. In addition, it is implicit that a licensee will work the technology with some independence. If there are ongoing responsibilities of the parties, other than payment of royalties, a license may be a joint venture, the terms of which should be agreed in advance. I hope therefore that "Non-Licensing Technology Transfers" will lead to more, not less, need for careful study by the Licensing Executives grouped in this association.

10 If I sent to an oil company a sealed system, a black box, with the right to use it to sniff for oil, that is a license to use a product, but it is not a transfer of technology, even if the black box could sniff oil from a plane.

If we look for an example of a technology transfer which is not a license, I suggest a contract to manufacture goods to order pursuant to a patented process. The fabricator has no right in the technology and no independence of action.

Joint Venture

For example, a European manufacture of automobiles has a "joint venture" in a country where only minority ownership is allowed. The venture makes little nominal profit, but the local country has created several hundred jobs and the manufacturer is profiting handsomely with almost no financial or political risk.

The plant assembles cars from kits and makes large numbers of castings to order for the European:

1. The kits transfer no right except to assemble and sell them. The chance of copying is miniscule and the stock of kits on hand under two weeks' inventory. All kits are sold transfer priced through a very small European country (no names please).

2. The assembly equipment is on a lease or bailment. No rights to any technology have been given away. Key parts are design protected.

3. The molds for the castings belong to the European which provides them on bailment or lease to the plant.

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The molds always remain its property. The molds contain the trademark. The product is bought "in the mold" so that title to all trademarked cast parts is in the European. There is no license of the trademark. Castings for the assembly operation are sold after production.

4. All castings (with trademark and some design protection), are exported through the European's dealer network, transfer priced via a very small Carribean Island and protected from unfair competition of the factory by Trademark and design protection. No license, only off-shore profits. Very neat!

Starting from that example let me explain my topic. In a world of increasing encroachment on the liberty of contract, particularly in the context of technology transfer outside the OECD area, traditional licensing is encountering a number of threats:

- Threats that a license be deemed a sale.
- Threats that technology be expropriated.
- Threats of responsibility of licensors for product defects, damage and injury due to their licensee's neglect.

The golden age of licensing 30 years ago was an age of party contracts and government *laissez faire*. Related parties were not harassed and, as we remember it, the sun always shone.

Initiatives

By the early 1960s, 20 years ago, there were initiatives directed at two types of abuses. The first was self-dealing and lack of fairness. Initiatives of the EEC here in Brussels and of France sought to avoid the use of technology licenses to obtain a monopoly greater than that given by law (e.g. patents and trademarks), or to obtain a disproportionate remuneration, usually from a related company.

The second type of abuse, phrased as in France or Spain as an exchange control license, was really a control not only of fair value of the license, but of the economic cost or value of the license to the country. That is to say that the purchase of technology or inward licensing can be considered a replacement of local, national R&D and technology development. (It can also be a means of developing the earnings to support the research, but that is apparently one of the decadent capitalist ideas I continue to have.) India thus decided to ban all technology imports and, miracle of miracles, R&D fell behind as seed ideas and technology remained unavailable.

However, the damage was done. The first clouds of the New Economic Order had started to form. Our task, as my task has frequently been, is to find the means to transfer technology on terms that will create a positive sum game with the technology owner and the user and both their countries benefiting.

By the later 1960s the storm clouds over the Andes were massive, and the New Economic Disorder was in full howl.¹ Requirements for full transfer (i.e. sale) of technology instead of licenses, and limitations on remuneration in amount and over time (e.g. for renewals) were becoming current. No particular economic logic was cited, and soon there were "77 little Indians," none of which seemed destined to encounter the fate of one of Agatha Christie's little Tribe.

Contractual Freedom

Back in the OECD things were going a little better for contractual freedom. Some lawyers got a bit too greedy and got their fingers rapped for using trademarks and other technology to create imaginative market divisions. The opening of borders among the developed countries, and in general also, led to some unpleasant surprises, as licensors, such as Fiat, found themselves obliged to compete against their licensees, whose reexport capability had been underestimated.

If, therefore, the development and ownership is to be encouraged by giving some property rights (patents, copyrights, trademarks) and some protection against copying, a return on technology must be assumed. Increased controls on the price paid for technology, less right to control licensees' use, prices, quality, and decreased opportunity to recover or ban use of misappropriated technology led to two approaches:

- Only license to friends and relatives (cross licenses and related-company licenses).
- Do not license. Use technology only in wholly-owned companies.

Alas, the next type of attack was against owned or controlled foreign subsidiaries. Besides further attacks on contracts between related parties, any intercompany contracts were accused of unfairness unless they were practically charitable acts from the parent to the subsidiary.

More dangerous for companies that place reliance in licenses to subsidiaries as a means of protecting their technology has been an increase in restrictions on ownership and the free exercise of management control imposed even on existing companies. These restrictions have taken various forms:

- Minimum local ownership.
- Local worker participation in management decisions.
- Restrictions on withdrawal of licenses, cancellation of contracts or closure of plants.

When we speak, then, of contractual means of technology transfer, we are suggesting how to find solutions that will resist such creeping expropriation of intellectual property rights.

For example, if the owner of technology contracts with another company to manufacture goods *for it*, to its specifications, the manufacturer has not acquired any right in the technology. In fact, because of the position of trust of a contract manufacturer with regard to drawings and other information made available in the course of the performance of a contract for the technology owner, any use of such know-how by the manufacturer for its own gain outside the scope of its production contract would be better protected by laws against theft, unfair competition, and fraud than would be a license. The major advantage of the license rather than the contract is that the law applicable to a license *may be* the law of the place of the

licensor. Even that distinction blurs, if the licensed process, design, or mark is registered in the licensee's country, and is thus locally-situated property.

Auxiliary Trademarks

If the purpose of a transfer of technology is to obtain presence in a foreign market, regardless of profit, a license may have that effect. Certainly, the right of licensors to control markets, prices, image, and the use of auxiliary trademarks is increasingly under attack.

Therefore the owner of technology is faced with the risk of a loss of control of all aspects of his rights to the technological property he has created unless he can exercise effective control without a classic majority capital position.

One device of control that I first used in the case of plants in duty-free zones in Mexico and in the far east was contractually to separate the ownership from the use of equipment and dies (particularly those protected by patents or design or model copyrights). We never sold the product-specific equipment to the local contractor. We did not lease it for fear that the right to use the leased machine could be transferred by the courts in case of insolvency.

We used a bailment by which we, the owner of the equipment, remained the owner.² We used a subsidiary to own the property to control any fiscal or other risks of doing business in the country of use. We kept title to the semi-finished product until after processing. We separated the marketing function by separate companies so that the manufacturing company had no right to customer or destination information. We were not entirely protected, but we were well protected.

This leads me to point out that we separated make, use, and sell. We gave no right to sell to the subcontractor manufacturer, and no right or ability to manufacture to the sales company. If you take in local partners, have different shareholdings in each company to avoid the appearance of a sham transaction.

To the extent that a manufactured product can be exported, or needs some imported proprietary components, the extent of control against state usurpation of property rights will be stronger. Any possibility of making foreign investments depend either on export sale of trademarked product or the import of trademarked components should be explored because it gives further grounds for stopping any expropriation, and can permit taking some trading profits offshore.

Royalty Payments

We are all aware of the very intense scrutiny and control to which royalty payments are subject. The subjectivity of the evaluation of the worth and duration of the value of technology has made this a continuing battlefield. Fine distinctions between registered technology (patents), trademarks, know-how, and technical assistance may give rise to substantial differences in legal and tax rights and responsibilities.

To the extent that the profit derived from technology incorporated in a product can be paid in a manner with equal or lower tax withholding, and with greater ease of appreciation of the worth of the goods or service furnished, such other contractual means for remuneration of the

technology should be investigated.

For example, where equipment and molds are leased from abroad, particularly for manufacture in bond, there will usually be no withholding tax on the rental fees.

Instead of lending directly to the technology user, loans, trade advances or other means of finance to captive suppliers of the technology user can create either interest income or trading profits, depending on the chain of title. To the extent of supply of components from abroad or sale of product abroad a substantial part of trading profits can be taken overseas. The terms of trade (cash in advance on supplies, or requirements for purchase of stock F.O.B. supplier, taken together with extended terms on goods for export can lead to a profit margin of two to five percent of sales, the equivalent of a license fee, all represented by interest value on lags and leads in payments. Consider being a predatory venture capitalist by structurally undercapitalizing your licensees, distributors and affiliates.

We therefore recommend a thorough analysis of the possibilities of contractual arrangements through other companies in a group. If there are group (trading) companies in the same country it will, of course, be easier to arrange than with foreign affiliates or parent companies. We warn that the standard of "fairness" in contracts between related parties has become ever less rational since the world multinational joined the "Index of demons" among capital importing countries.

Contractual Protection

If it is possible to arrange for contractual protection of investments and of technology without the appearance of control this is highly desirable in today's context. Control no longer means 50% or more of capital. In France, for example, 20% (less than a voting blockage minority) is considered control. Even less or *no* capital ownership may be considered control if the total business structure, capital, finance, technology, trade supply and sales are considered to give control.

France is not a radical country. This standard of control, applied without clear legislative or judicial standard is in keeping with ideas circulating at the OECD center.

Bigness may be badness to a small country. Your company may be considered to be in control even if it does not consider itself to be.

What are the consequences? You are probably aware that certain South American countries do not permit royalties and severely scrutinize any payments to related companies. Therefore, control can be a very dangerous threat to any contract, particularly licenses.

In case of litigation or claim for expropriation the "public order" of the country of production or sale will probably apply, particularly if locally registered rights are involved. Local law may say effectively that an investor in control is limited to the remuneration on his investment obtained by normal means (i.e. dividends). You may be in real trouble. The rock and the hard place both look very close.

Arbitration clauses without saving clauses can create lack of flexibility in cases of third-party claims, e.g. product liability or infringement.

For example, in the case of an engineering contact with Eastern Europe (subject to ICC Arbitration in Stockholm), my client, the overall project engineer had engaged:

- A French engineering firm to design a distillation tower (subject to an arbitration clause referring to a nonexistent arbitral body).
- An American engineering firm to perform the detail engineering of the distillation tower trays according to its process (subject to a conflict of the parties' different arbitral clauses).
- A French metal fabricator to make the trays (subject to the Paris courts).

Suffice it to say that we learned during construction that the tower would not function, and that we did not know which parties were at fault. We and they had cleverly lawyered ourselves into a box where there was no forum where we could get everyone on our initiative, or even if called to Stockholm by the client.

Caution

Please, be very careful with contracts. They are devilishly intricate things, particularly as to designing a workable choice of law, choice of forum, and choice of means of resolution of disputes. The free choice of the parties is increasingly disregarded by chauvinistic courts, particularly in cases of "control" and intellectual property. The choice of a foreign forum may bar registration of a license in Mexico and other countries. What will be next?

The classic choices are therefore cast in doubt, partly because intellectual property is more easily identifiable than other property. Your company's patents, trademarks, and know-how are recognizable as to source, and thus can relatively easily be traced and included in a decision on "control" by a company or group.

Investment with a license, or a license with indirect control may both lead to severe restrictions on obtaining remuneration for technology. The most recent trend to implied control can impair even a license to an independent licensee since, if he really needs your license, you may be deemed in control.³

Can you try to back away from control to protect a licensing arrangement? No. For there is another threat which I would be happy to discuss privately with any of you after lunch—that is product liability. Case decisions in the U.S.A. relating to Remington's Mexican licensee and other products, and part of the proposed EEC Trademark directive provide that a licensor, even of a trademark, most certainly of a patent or know-how, may be liable for damage to persons and property occasioned by his licensee's errors using his name or technology.⁴

Risks Great

The risks of having license rights pass out of your control is very great. We urge you to seek contractual means, directly or through agreements with third parties who will not be in control or considered your agents, to exercise control of the user of your technology, or his process equipment, of his supplies, and to the extent possible, of his market. If you may be treated for product liability and profit remittance purposes as being in control, take the necessary steps to assure through a number of separate contracts, subject to jurisdiction outside the place of use of technology to the extent enforceable, that you will have the control you need or that you can effectively shut the business down if the risks outweigh your benefit.

In summary, the best approach is not to use a label such as licensing but to:

- Think through your goals and prospects.
- Review your financial and human resources.
- Draft a contractual scheme with all the parties, rights, responsibilities, grant backs, and include your first and second choice of applicable law, dispute resolution and termination clauses.
- Check your draft of what you want with imaginative local and multilateral tax, legal, and accounting advisors (Do not be discouraged; I have always managed to find the right man after some search).
- Revise, repropose, prepare.
- Negotiate with the other party, refine the contracts, decide where to sign, and who will be parties.
- Continue to review for changing law and political threats.

• Do not be scared to say no. If you cannot be paid for your bread let them eat their cake.

NOTES

1. Reference is made to Decision 24 of the Cartagena Agreement and other texts. See e.g. Annex to "Egypt's Policy on Technology Transfer", W.L. Wahba, *Les Nouvelles*, 12/82, 215 at 217. "A licensing agreement will be ratified by the government only if it involves transfer of 'complete know-how' including a detailed description of methods, controls and raw materials."
2. The form used is generally called a contract of "comodato." For a discussion of the options see "Security Interests under the Laws of Venezuela: An Introductory Guide", Leiseca and Atkin, 18 *Int'l Lawyer* (1984), 625.
3. See "Looking Ahead to Year 2000," D. Banner, *Les Nouvelles* 12/81, p. 265 for a summary of restrictions.
4. See for example new Article 15-XIII of the Mexican law on technology transfer which refuses registration of agreements where the quality and results of technology are not guaranteed. (Regulation 58 may limit this to a requirement not totally to contract out of liability).