

# Suggestions for Licensing in Brazil

*A corporate view of licensing policy adopted by government; action discourages technology transfer*

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I shall present some views on an extremely important subject, the licensing of technology to Brazilian based enterprises. The word licensing is employed deliberately even though I realize that Brazil through Normative Act 15 prohibits its use with respect to the transfer of technology agreements. However, the prevailing view is that technology transfer agreements are a species of licensing agreements and it is in that generic spirit I use the term "licensing."

At the outset, the views expressed by me should not be construed as a harsh indictment of the regulatory policies of Brazil relative to licensing. It is certainly the right — indeed the mandate of the Brazilian Government as the representative of its people — to determine what is best for the economy of Brazil. Instead, please consider what I say in this light:

As a lawyer and businessman involved over the years with several major U.S. corporations, I can state with no hesitancy that the federal government of the United States has many policies and implementing regulations that serve little purpose today. Many, in my opinion, pose obstacles to the appropriate conduct of business and the resulting benefits for the people. The enormous bureaucracy and concomittant inertia and the kaliedoscopic, sometimes bewildering, set of priorities which U.S. Government gives to various matters, make changes in laws and regulations, at the very least, difficult to accomplish.

But I cannot conceive of the Brazilian Government being much different than our own with respect to bureaucratic inertia. One must first get the government's attention and somehow raise the priority level of the subject of licensing of technology in order to initiate reforms. This is no small undertaking, particularly in Brazil where the government's attention is obviously brightly focused upon conditions causing severe inflation, the country's debt situation, and the upcoming elections.

It is my hope that the comments made here today

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concerning the problems, some say disincentives, with licensing into Brazil, will help elevate licensing of intellectual property in the consciousness of the Brazilian Government to the point where a serious study will be conducted on the effect of government regulations on technology transfer. Perhaps then needed reforms will be initiated.

In preparation for this talk, I contacted a number of colleagues at various U.S. and Canadian companies and, using their comments together with some of my own experiences, I will discuss four basic problem areas: preservation of secrecy of transferred information, subsidiary licensing, term of the licensing agreement, and royalties. These problems are more often than not inextricably intertwined and play no small role in making or deterring desirable licensing relationships.

## SECRECY

The problem of secrecy is of a grave concern to those who have licensable technologies and are interested in transferring it. This is particularly true with respect to processing technology. Many companies in the United States, Canada and Europe, unfortunately, believe there is literally no protection afforded confidential subject matter in Brazil. Indeed, Normative Act 15 confirms this since it arbitrarily limits the protection of confidential information, contractual or otherwise, to the term of the agreement, usually five years or sometimes 10 years if the agreement can be renewed. In practice, the five-year renewal is infrequently permitted.

How does the business world perceive the Brazilian approach to secrecy?

The following thought processes of two technologically-oriented companies, one in the United States and one in Canada, may be helpful in determining the perception of the business community:

*—We have developed proprietary technology that has a few related patents, but, in general, the patents do not cover the major aspects of the technology. Consequently, much of the technology is maintained as a secret for purposes of gaining and maintaining a competitive edge over our competition. We have licensees in many countries and Brazil, of course, is a highly attractive market.*

*Unfortunately, due to the shortness of the permissible license term coupled to the fact that Brazil limits the confidentiality to the term of the agreement, we have decided not to license our technology to Brazilian companies. To do so would endanger the secrecy aspect of the technology, not only in the United States and Canada, but also in the countries of existing licensees and prospective licensees.*

*Our existing and potential licensees would object, and would object strenuously to anything we as licensor might do to compromise the technology embodied in the trade secrets that both parties so laboriously negotiated to transfer.*

Two companies with valuable technology decided to abandon Brazil as a market because the technology constituted an extremely valuable investment, the value of which would be at serious risk if a license was entered into under the present Brazilian regulations. Yet all each company was requesting was the survival of the secrecy term beyond the term of the agreement. No additional royalties were being sought.

### No Guarantees

A third company realizing that Normative Act 15 would require the transfer of ongoing related technology during the term of the agreement declined to enter into an agreement with a Brazilian company. Why? The reason was simply that after the term expired there were no guarantees that technology most recently transferred would be kept confidential for the reasonable life of the secret information. That company felt that the certainty it would be developing improved secret technology of value and the risk to which the technology could be exposed in Brazil outweighed any benefits that might be gained from any type of royalty agreement it might enter into with a Brazilian company. This company was not persuaded by statements that the agreement *might* be renewed or that confidentiality of technology is preserved from the date it is actually transferred.

In one man's opinion, the Brazilian Government would do a great service to its business community if an objective study were undertaken to determine whether the Brazilian Government's approach to secrecy actually assists the Brazilian economy and whether any benefit incurs to the Brazilian people. I suggest the opposite is probably true.

### SUBSIDIARIES

The question of whether royalty-bearing license agreements between associated companies should be allowed is apparently very clear to Brazilian authorities. They are not permitted. As related to me by more than one Brazilian lawyer, the current train of thought in Brazilian Government circles is that royalties on intracompany transfers are artificially high and technology potentially beneficial to an associated company located in Brazil will be transferred despite the fact that no royalties can be obtained. The current rationale is that the parent company will reap benefits ultimately through increased dividends and/or growth of the Brazilian associated company.

Is it true that technology will be transferred from U.S.-based companies to their Brazilian-associated companies free of royalties?

From my experience, this is far from an accurate portrayal of the facts. A case in point is the experience of a group of companies with the parent in the U.S. and subsidiaries in Europe, Australia, Canada and two Latin American countries, one of which is in Brazil. Numerous licensing arrangements exist between independent com-

panies and the various associated companies within the group.

License agreements also exist between all the associated companies with a notable exception — Brazil. Royalty rates whether between associated or independent companies, are the same. Recently, one of the associated companies, because of its long relationship with one of its independent licensees, was approached by the licensee who had developed a new product with supporting technology. Because of the confidence and trust the licensee had developed in the associated company over the years in the original licensing arrangement, it wished to utilize the associated company's worldwide manufacturing and marketing experience.

Following some extended negotiations, the associated company took an exclusive license with the right to sub-license and ended up sub-licensing each of its main sister companies except Brazil. With respect to Brazil, the associated company was well aware that a Brazilian license would put it in the unenviable position of not being able to get any royalties from its Brazilian sister company yet having to pay royalties to its licensor on any Brazilian sales.

As a postscript, the associated company was tempted to assign back its license rights for the country of Brazil to the licensor in return for a percentage of royalties the independent company might get from an agreement with the Brazilian company. This was ultimately rejected as not being within the spirit of the associated companies code of conduct. This type of subterfuge along with so-called side agreements is an ethical dilemma for U.S. companies.

Still another U.S. consumer product company that regularly takes licenses of technology from small, innovative companies throughout the U.S. and world refuses to sub-license its Brazilian subsidiary for virtually the same reason, namely that it would be forced to provide royalties to the licensor on sales from Brazil yet would not be able to transfer royalties from its Brazilian subsidiary company. Instead, this company generally takes an exclusive license with worldwide territorial rights except for Brazil. It invites the small licensors, if they so desire, to directly license the subsidiary in Brazil. In practice, however, this rarely occurs since small companies have little experience in international licensing nor the manpower and resources to support it.

### Perplexing Situation

Let me paint still another perplexing situation. Today, in the developed world, perhaps particularly exemplified by the United States, it is necessary for an international-based company competing in the world market to remain flexible and vigilant with regard to the "fit" of its various operations within the strategic direction as defined by its top management. This corporate strategy is often being fine-tuned and dictates the need to divest those operations or production lines not well suited for future plans of the company. The company then looks for another firm to purchase the assets of the to-be divested operation which naturally includes the relevant technology. The buying firm is usually another independent company or, as is happening with more frequent regularity in the U.S., the

management of the operation being sold. Unfortunately, the selling and buying companies are finding that the royalty-free license agreement previously entered into between parent and Brazilian subsidiary is a major stumbling block. The buying company may not want to have the associated company in Brazil as part of its organization. Unfortunately, it is unable to get royalties for this type of technology, which is being used by the Brazilian sub.

It is quite clear from my nominal survey that the concept that technology will flow into Brazil irrespective of whether or not royalties are received is not necessarily true. In fact, it appears that needed technology may not be made available because of this rigid policy of subsidiary royalties. Yet, to the extent that the problem of artificially high royalties between associated companies exists (which in my experience is rare), it could easily be solved by government review. Certain developed countries, for example, South Africa and sometimes France via French custom, closely review intracompany royalty agreements in comparison with similar agreements between independent companies to determine whether or not the royalty rate between the associated companies is within acceptable levels.

TERM

Perhaps the most objectionable feature imposed by INPI is the restriction of terms of technology agreement to five years with possible renewals. At least three companies that were contacted stated this to be the paramount reason that none will again enter into technology agreements with Brazilian enterprises. As one company said: "There's very little technology that doesn't have a life span considerably more than five years."

To argue that such agreements may be likely to be renewed is not a confidence builder. Statements that renewals were probable to two unsuspecting companies turned out to be a disaster for each. After five years, renewal for three years at 2% royalty was all INPI would permit, notwithstanding even the unsolicited, sincere plea by the Brazilian licensees to INPI. In one case, the Brazilian licensee was aware that its licensor had been developing needed technology in a related but unlicensed field. The licensor, because of the unfulfilled promise, obviously rejected any further licensing arrangement with its Brazilian partner. The loser in this situation was apparently Brazil.

ROYALTIES

Has anyone ever wondered where the 5% royalty rate received its recognition worldwide as being the maximum rate around which all royalty agreements revolve? Why not identify a maximum rate of 4.3% or 6.1%? Whatever the origin of that Ptolemaic-like view of licensing, it is highly overrated as being a licensor's rule-of-thumb. Perhaps the actual center of gravity of any licensing negotiation and arrangement should be what commercial realities dictate. After all who knows better what is fair and acceptable than the parties? Let governments step in only when the rate is obviously unconscionably high. Then, the burden can fall on the parties to the agreement to justify the rate. Or, perhaps govern-

ments could encourage or require a most-favored licensee clause as appropriate or require certification that the negotiated royalty rate is that regularly accepted in other countries in arms-length transactions.

To arbitrarily dictate a range of royalties is to fail to appreciate the nature of technology and both the short- and long-term implications. Technology is transferred uniquely in each situation, the degree and complexity of which is often determined by the needs of the licensee. Limiting royalties without pragmatic review — best determinable by the parties — is to deter the licensor from entering into negotiations without reservation. Who can afford to be a full-service licensor at 2% royalty for five years? Certainly, the medium businesses I contacted shun any consideration of Brazil as a license market for their technologies when the Japanese, Europeans, other U.S. and Canadian licensees will pay 7½% for the same technology. Since essentially every license for the transfer of proprietary technology requires the licensor to expend manpower resources in support of each licensee, Brazil becomes an unattractive area in which to license relative to other territories. These small and medium companies are in many instances the originators of technology today. They are companies unable to invest directly and are more willing to license on an acceptable and equitable basis, but they are the companies that today are avoiding Brazilian enterprises as licensees.

CONCLUSION

The regulatory policies of INPI should focus upon licensing with a broader view in mind. Consideration should be given to the beneficial — and perhaps unrecognized — side effects of a more flexible approach to licensing of technology. Such side effects manifest themselves in encouraging and establishing longstanding good relationships with enterprises in other countries in the world market. When such relationships are established — and it takes years to do so — the parties often find themselves initiating other rewarding relationships, because the previous time spent as licensor-licensee builds understanding and trust. This is a lesson which is continuously being demonstrated among enterprises in the OECD countries. It is difficult to do this, however, when artificial barriers are raised. Making restrictive policies and rules without sound economic justification and backing of the business community stifles absolutely the building of relationships. To arbitrarily say in the absence of strong supportive evidence that five years is enough for any license agreement, 5% is the maximum royalty rate, five years' secrecy is sufficient, or no royalties can be transferred between parent and subsidiary does not build confidence with those business enterprises outside of Brazil. To tell Brazilian business enterprises implicitly that they cannot effectively negotiate and extract good bargains with respect to themselves, the Brazilian economy, and its people is sending a signal erroneous in concept and possibly contrary to the original intent.

In conclusion, I propose that the Brazilian Government make a serious study conducted by an objective, independent group to determine the effect on the economy of Brazil by its regulatory policies with respect to technology transfer. Such a study should contem-

plate carefully as its premise what are the results intended by INPI regulations and then attempt to quantify the results actually obtained. Consideration should also be given to opportunities missed as a result of current policies. Past polemics as an influence on technology-transfer policies should be studiously avoided.

To properly conduct such a survey would require the objective sampling of the Brazilian private business community. There is little doubt in my mind that most

businesses in Brazil will applaud a more flexible, pragmatic position by INPI with regard to many of the items mentioned above. The Brazilian authorities will be surprised by the sophistication and ability of Brazilian businessmen to extract good bargains on behalf of the Brazilian people and economy. The world economic community would enthusiastically welcome strong, viable, and hard-negotiating Brazilian enterprises into the transfer of technology environment.