Venezuela Awakens Licensing Law

BY VICTOR BENTATA*

After 15 years, Venezuela updates laws to stimulate market economy, encourage technology licensing

Decree 727 of 26.1.90 comes as a strong wind in the direction of a market economy. All in all, Venezuela wakes up from 15 years of slumber — "technological decolonization" and reduced restrictions to foreign ownership and rights in the country, and enters an era of contractual freedom geared to stimulate private initiative.

A bit of history, in 1974, Venezuela became a member of the Cartagena Agreement (Andean Pact). It jumped from a completely liberal economy to a tightly-controlled system as regards, not only technology imports, but foreign investments. The restrictions were immediately felt and stopped, as it were, the international aspect of the economic development.

Venezuela turned inward, reduced its economic scale and began losing technological speed. The progressive technical loss and impoverishment was exhaustively documented in this writer's book, "Licensing in the Andean Pact: Myth and Reality," published in 1985 and partially reproduced in the September 1986 *les Nouvelles*.

On the basis of this publication, a swing to liberalization began with Decree 1200 in force since 16 August 1987. It ended in actually a half-way house. It certainly improved certain aspects. But it created as many problems as solutions. Its effect has been exceedingly modest.

After reaching a most delicate point of inaction and concern, the new market-economy policy begun by the present government decided to do away with a bulk of restrictions and opened up licensing to free contractual arrangements.

◄ May Choose Terms ►

At present, the parties to any arm's-length relation may freely establish the terms and conditions they choose. The only existing limitation in terms of royalty fixing is in the parent/subsidiary relation where up to 5% of the "net technological sales" is entirely free. Over and above this percentage, an authorization of the Foreign Investments Authority (SIEX) is required. This reproduces the terms of the Argentine legislation, which has been the spearhead and the most sensible in Latin America for a few years now.

"Net technological sales" is understood to be net sales minus the FOB value of the raw materials and other supplies originating with the licensor, excepting machinery.

All licensing contracts must be registered with SIEX within 60 days from execution. But, what happens in case this formal requirement is not met? The sole sanction provided is the suspension of the royalty payment.

The expression "technology transfer" does not appear to have limits. It encompasses any and all supply of knowledge, either in the form of sale, lease or transfer and generally of intangible rights. Although copyrights are not expressly included the expression that closes the enumeration seems to include it as being "any other good or service of similar nature that SIEX qualifies as such."

Another interesting provision, but most difficult to understand and justify, is the obligation to register commercial distribution agreements involving products with a foreign trademark.

What is the purpose of any such registration? What are the effects of nonregistration? Are only exclusive or nonexclusive agreements included? Questions may be multiplied. The answer is perfectly unclear. If it is argued that failure to register prevents contractual effects with regards to third parties, what do third parties have to do with a private commercial agreement? Are we then to say that a bilateral agreement concerning the distribution of goods is not *per se* binding on its parties?

The fact of the matter is that this provision, long existing in the statute, has not been applied in practice. No court case on the point has either indicated what its legal situation involved actually is.

◄ Quality Control ►

Another provision of interest has to do with quality control. This is obviously an essential provision not only when a foreign trademark is involved but also on the transfer of know-how and possible product liability. Yet, it is still quite unclear. The methods of quality control can be freely agreed upon between the parties. The stronger the quality control procedure is, clearly the highest risk of product liabilities involved. But one is surprised to see the lack of emphasis on such an essential point.

A characteristic improvement has been, over the years, the progressive lengthening of the duration of the technology transfer contracts. It went from 5 to 15 years and now from 15 years to a non-limited possible duration. While this is encouraging, we remain surprised to see that the confidentiality period, after termination of the contract,

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may not exceed a period equal to that of the duration of the contract itself. What is the significance of this limitation?

Say a contract of unlimited duration, subject to termination for a variety of causes, is terminated 10 years after execution. What is here the situation of confidentiality? Confidentiality itself loses interest after a certain period of time, especially in the area of technology subject to continuous improvements.

At any rate, the legal picture has improved, but the rationale behind it is still difficult to understand due to the deeply rooted tendency of proceeding by State "grants" or "permissions" instead of flatly revoking the limitations in this respect.

The ruling has not taken care of the licensor's interests by requiring a detail of the currency of payment of the royalty. This may only favor the licensor in case of exchange controls. But in a country without exchange controls the purpose of it has little meaning.

And now we come to a most intricate chapter of *restrictive clauses*. Restrictive clauses are those provided in Decision 220 of the Andean Pact. They boil down essentially to export limitations, the obligation of purchasing raw material and equipment from the licensor (with exceptions), price fixing, the payment of royalties for unused trademarks, the obligation of permanently using the licensor's personnel, and other equivalent ones. The decree adds that the government may determine other prohibited restrictive practices.

So far so good. But we have a most unfortunate Decree 746, which was not revoked. After termination of the contract, according to the Decree, the licensee may use *confusingly similar marks to those* of the licensor. Decree 746 adds a number of other restrictive practices. What to do about this? We do not know.

◄ Space ►

Decree 746 is a decree-law and can only be abrogated by another law, while Decree 727 is an ordinary decree regulating Decision 220 of the Andean Pact. But a clear conflict is established between Decree 746 and Decree 727. We like to believe that Decree 727 should have preference in its application, but the respective ranks of the two regulations seem unfortunately to weigh in favor of Decree 746. Under these terms, how will a foreign licensor consider licensing to Venezuela the manufacture of some of his trademarked products? If the licensor expressly states in the contract that the licensee may not use confusingly similar marks after termination of the contract, can this clause stand? It seems not. But there is no public policy situation involved, so that it would seem that the right of the licensee to proceed as indicated can be waived. The point has never been put to test, and it would be most interesting to see how a liberal market economy can cope with this sort of dilemmas and uncertainties.

We may now take a look at a special chapter indicated as "special services." These services are of two categories, quite difficult to differentiate from each other unless one takes the initiative of considering the first as dealing with forceable factors in the development of business and the second as deriving from unexpected circumstances.

In the first case, what the law phrases as specific occasional services are in principle understood to be of a nonrecurring nature. What are these specific occasional services accruing in the normal development of business? It is difficult to say. But the second category concerning nonrecurring services, as one understands it, would refer to accident losses, fire, earthquake, *force majeure* or acts of God generally, but include as well financial, economic, legal or marketing reports.

We are not for the time being in a position to improve very much on these tentative definitions, and are confident that the practice may unveil some of the solutions no doubt lurking behind these quasi-mysterious designations.

Finally, the prohibition to capitalize technology has been lifted. It is now possible to capitalize it, but only when royalties are overdue. For this purpose, obviously, the shareholders' approval is necessary, as is that of SIEX.

The authorities retain the right of inspection as to whether the technology "is being actually exploited in adequate economic conditions." We do not know what the sentence means and how far it stretches. Are we talking of exclusively reflecting the contractual conditions? Are we otherwise talking in general of adequate economic conditions in the cost and pricing of the final product? Very much depends on the political attitude that SIEX will adopt to tackle these obscure and abstruse mentions. But the fact remains that both licensor and licensee must inform SIEX within 60 days from the close of the economic year as to the actual form of use of the technology transfered.

If we now take a look at the penalties provided by the rulings, they are extremely lenient if existent at all. The worst that could happen when the SIEX inspection, if any, reveals that the application of the contract is at variance with the terms of record, is that SIEX may suspend or revoke the registration of the contract. The implication is that a nonregistration situation would ensue whereby the only sanction provided is the suspension of the royalty payments. But it is far from clear what would happen to the technology transfered, or being transfered, or about to be transfered. This is a most important point on which there remains much to be seen.

The ruling hardly refers to taxation, if only that royalties are payable only after income tax has been withheld, requiring in any case a later notification to SIEX.'

Net of tax royalties are now commonplace but, as is the case in many countries, the licensee bears the burden of payment but does not exclude the licensor's direct liability toward the Administration should the part fail to comply. Furthermore, the licensor must file a yearly tax declaration globalizing his local income.

Another noteworthy situation refers to the categories of taxation in the transfer of technology. Decree 746 has not been revoked. For undisclosed reasons it substantially favors, taxwise, the transfer of know-how (technological assistance) as opposed to patents (technical services) and royalty income proper based on industrial property rights. Penalizing royalties on trademarks shows the political determination to favor the transfer of know-how.

All in all, the jump was taken in the right direction. Unfortunately, it did not pay heed to several aspects raised in the above-mentioned publication on licensing in the Andean Pact. It would have considerably eased the wording and interpretation of the sensitive issue involved in technology transfer. The latter, however, has now at least acquired certain status vis-a-vis investments while it used to be considered as simply ancillary to them until now.

So we have good news from Venezuela, hoping that the interpretation will consolidate them and make of them a practical success.