

When Licensing Laws Conflict

Suggestions for approaching problem when countries' laws differ in international technology transfers

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I shall restrict myself to the question of which country's law applies (or governs) the contractual relationship between the partners of an international license agreement. This is not a question of substantive but of international private law. It is one of the nicest fields for legal controversy and sophisticated theories and, therefore, a very convenient subject for a professor of law.

I understand that the parties and the advisors don't like complicated rules and theories, but, unfortunately, those delicate questions will arise and must be answered. The only thing that parties can do is keep those questions from becoming virulent in every case. Two things can be done:

First, the parties to an international license agreement should expressly settle in the contract itself all questions which lend themselves to settlement. Which questions these are will depend upon the goals of the contract, the commercial interests of the parties and the legal situation in the affected countries.

The parties cannot, however, settle beforehand every question that might possibly lead to a dispute during the life of the contract. Nor will they be able to settle recognized problems so clearly as to foreclose all questions of interpretation. The parties are not prophets and their attorneys do not have as much time as professors are deemed to have. Frequently, commercial considerations will outweigh legal misgivings. Finally, the parties are negotiating to create a cooperative relationship of trust. They cannot confront each other with mistrust and continually propose express solutions to possible disputes, when both parties hope that such disputes will never arise.

While I prefer the old rule "*bons comptes font bons amis*," the reality is otherwise. As a result, the majority of license contracts have gaps which must be filled and ambiguities which require interpretation.

My second advice is that the parties concluding an agreement should make up their minds on the question the law of which country they want to apply to their

relationship. The question is relevant for all international license agreements whether on patents, industrial designs, know-how, or trademarks.

So far, that question has been most exhaustively considered for patent license contracts. A recent study, written by Professor Eugen Ulmer ("*Die Immaterialgüterrechte im Internationalen Privatrecht*," Munich, 1975) contains, however, a very clear and concise presentation of the problem covering all intellectual property rights.

CHOICE OF LAW BY THE PARTIES

Advantage of an Express Choice of Law

Certainty of law in best served when the parties agree on the applicable law and express their choice unmistakably in the contract. Unfortunately, here too the reality is often otherwise. Many license contracts lack a clause dealing with the applicable law, not because the parties do not think about it, but because they could not agree on the point.

In my experience, it is often easier for the parties to agree on a difficult technical or commercial issue than on a choice of law. Not infrequently, an inappropriate notion of prestige prevails on both sides, or an equally misguided mistrust as to the law proposed by the other party which is suspected of containing unpleasant surprises. Nevertheless, the parties should always try to agree on that question.

The problem is, however, which law can and should they choose.

THE PRINCIPLE OF PARTY AUTONOMY

The starting point is the principle of party autonomy, or free choice of law. That basic rule is recognized in most countries for the choice of the law governing contracts and applies also to license contracts for industrial property rights. The EEC Convention on the Law Applicable to Contractual Obligations, which was finally signed in Rome on June 19, 1980, after long preparatory work, starts from the same principle (Art. 3(1)). It means that the parties may choose whatever law they wish, even a law to which neither the subject matter of the contract nor one of the parties has a relation, provided that this freedom is not arbitrarily exercised.

No Arbitrary Choice of Law

That exception has, however, more theoretical than practical importance. It requires nothing more than the identification of some interest worthy of recognition for the chosen law to be controlling. Such a

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"reasonable interest" (as the Swiss Federal Court put it) will almost always exist.

For instance, the parties to a German-Yugoslavian license contract could, without more ado, agree to the application of Swiss law, be it that their own contract law appeared to be over- or underdeveloped, or that neither party wanted to concede to the other an advantage, so that both parties prefer to agree on a "neutral" law acceptable to both. There is always a reasonable ground for the choice of Swiss law. On the other hand, where the drafters of a Polish-Hungarian license contract were to choose the law of the Bahamas (because they find the climate there more agreeable), I do not know whether a Polish tribunal would like that free choice.

Factors Relevant to the Choice of Law

Within these broad limits the parties will usually have no trouble finding reasonable contact points for their choice. In the ideal case they would choose that legal system which is best suited to the contract, which appropriately supplements the contract's express provisions, which possibly is familiar to both parties, and which ensures an objective disposition of future controversies.

Usually that will be the law of one of the affected countries: the law of the country in which the industrial property right is protected and for which the license is to be granted, the law of the country in which the licensor or the licensee has its situs, or perhaps the law of the country in which the court selected to settle disputes sits.

The parties may, however, have good reasons to depart from these obvious contact points. For example, it might be advisable to choose the same law for the license contract that the parties have already chosen for other contracts between them, or, to that law which one of the parties regularly uses as the basis for its license agreements. At times it might be advisable for the parties to prefer the law of a third country to their own law; for example, because the third country has a better-developed license contract law, which clarifies many controversies, and because one can anticipate expert judges and the application of the principle of good faith as the guiding principle of construction.

Language

Finally, the question of language can be important for the choice of law; it may be practical to agree on the law of a country whose language both parties understand without translation and to draw up the contract accordingly. However, European companies should take this aspect of language into account with caution. They should not conclude all license contracts in English, and always adopt an American form contract, just because the overseas contract partner usually takes it for granted.

Should that widespread practice become the norm, it is unavoidable that, through the choice of the contract language, the whole set of concepts, institutions, and rules of construction of Anglo-American law will determine the content of each license contract, and it is precisely with patent, know-how and trademark

licenses that one could experience unpleasant surprises in applying common law rules.

If the parties have agreed upon a particular law, they should stipulate its application *expressly* in the contract. This could be done either for the entire contract or only for parts; for example, they could subject the license contract generally to the law of the licensor, but refer particular questions to the law of the country where the patent or trademark is protected.

LEGAL LIMITS ON PARTY AUTONOMY

While classic private international law is founded on a principle of party autonomy of almost unlimited scope, there is a new and growing tendency to *limit* the free choice of law in order to prevent that the parties escape from the application of mandatory protective provisions in national legislation. These limitations have particular importance for technology transfer transactions.

Trends in Developing Countries

The most serious potential departure from party autonomy is the demand of *developing countries* to subject technology transfer agreements to the law and jurisdiction of the receiving country. Deviating choice-of-law and choice-of-forum clauses are no longer recognized or are recognized only within very narrow limits. These demands have already been translated into action in the legislation and permission practice of many developing countries, especially in Latin America.

The Group 77 has also called for the adoption of corresponding limitations in the U.N. Code of Conduct for Technology Transfer. However, here they have run up against the resistance of the industrialized countries (the B-Group), which want to maintain the principle of party autonomy in choice-of-law and in choice-of-forum in the interest of their business enterprises.

This resistance and similar criticism expressed in the theory is justified. Of course, the developing countries have a legitimate interest in protecting their industry from abusive, unreasonable and excessively burdensome contract terms in order to strengthen the position of the domestic licensee. This happens in industrialized countries as well. They also apply mandatory provisions of their foreign exchange, restrictive trade practice, and foreign trade laws to protect their industry, even if they thereby limit the principle of party autonomy.

But the proposals of the developing countries go further. They tend to subject the entire license contract to the law and jurisdiction of the receiving country. That is, not only its acceptability, but also its construction and interpretation. This blanket claim to the application of all rules of the receiving country overshoots the mark and can hardly promote the desired transfer of technology to developing countries.

LIMITED APPLICABILITY OF THE LAW OF THE CONTRACT

There is another constraint on the principle of party autonomy. It arises from the *inherently limited scope of that conflict-of-law principle* which applies to

contracts. The law determined by the actual or the presumed will of the parties (*Vertragsstatut*) is controlling only for the formation, content, implementation, and termination of the contract. It is controlling the rights and duties of the parties, their performance or nonperformance, and the legal consequences, i.e. for the purely obligatory part of the license agreement.

The "law of the contract" does not govern that part of the contractual relationship which is withdrawn from the free disposition of the parties and which is subjected to mandatory provisions of the country of protection for sociopolitical reasons, for reasons of public policy, or because of the territorial nature of industrial property rights. I shall discuss this important problem below. First, however, we must turn to the question of what happens when the parties have made no choice of law.

THE DETERMINATION OF THE APPLICABLE LAW BY THE COURT

Fundamentals of Choice of Law for Contracts

In that case it is up to the courts to determine what law is applicable to the license contract. In so doing, they apply the rules of their own international private law which, despite all attempts at international unification, remain national law. To be sure this is less serious for the determination of the applicable law of contracts. Not only have the conflicts rules for contracts been unified within the EC, but also these rules largely start from the same fundamental point.

Differences of opinion which do exist are determined less by the application of a particular system of law than by theoretical considerations and a different appreciation of facts. This is especially true for international license contracts, since these are the subject of an international discussion which is largely uninfluenced by the peculiarities of national conflict of law rules.

In Germany, the starting point is the probable or presumed will of the parties. The courts try to find out which law the parties themselves would have chosen, if they had made a choice. As the German Federal Supreme Court has repeatedly held, this is not a question of "the determination of the presumed subjective conceptions of the parties but rather of a reasonable balancing of interests on a purely objective basis."

Thus, the traditional approach of German theory starting from the presumed will of the parties approaches the position of other countries, particularly in the common law world, where the prevailing theory increasingly looks to the *objective center of gravity* of the contractual relationship. In other words, the courts of most countries are applying the law of that country which has the closest connection to the contract (EEC Convention, Art. 4), where the interests of the parties overlap (A. Troller), where the characteristic performance takes place (Schnitzer), i.e. that law which is most suitable to the contract, "the proper law of the contract."

The Center of Gravity of International License Contracts

But where is the center of gravity of an international license agreement? With which country does it have the closest relationship? Court decisions and com-

mentators give no uniform answer. Rather, they offer a large catalog of points of contact, ranging from the law of the country in which the industrial property right is protected, the *lex loci protectionis* (hereafter referred to as "law of the country of protection"), through the law of the place of performance, of the situs of the licensor, of the situs of the licensee, all the way to the domestic law of both parties and to the law of the forum (*lex fori*). There are few judicial precedents and legal doctrine is so divided that a dominant view is difficult to identify. What are the different opinions and what is mine?

As A. Troller and other noted authors stress, the most natural law of a license agreement is that of the *country of protection*, for which the license is granted. It is here where the patent or trademark is protected, and the license produces its effects. The licensee makes use of the industrial property right, and the licensor refrains from asserting its right to exclusive use. Two of the most important connecting factors—the country of protection which controls the subject of the contract and the country of characteristic performance—come together and form the natural center of gravity of the license relationship.

A Uniform Approach for Multinational License Agreements?

Is that solution also valid for multinational license agreements, in which a license is granted for several countries or, more precisely, in which the license relates to industrial property rights existing in several countries? Most authors argue that in these cases the law of the country of protection is not suitable because that would lead to a territorial fragmentation or "splitting" of a uniformly conceived contract. The contract should be judged differently under the law of each of the various countries protecting the industrial property rights. Therefore, it is necessary to subject the contractual relations to the law of a single country. Accordingly, recent doctrine has abandoned the earlier dominant "splitting" theory. It gives preference to a uniform determination of the applicable law.

In view of the frequency with which licenses of intellectual property rights involve a multiplicity of countries, E. Ulmer has endorsed the theory of uniformity and, like Troller, Godenhilms, Vida, Schnitzer, and the Swiss Federal Court, proposed the law of the *principal place of business of the licensor*, as the primary point of the contact. He thereby follows the theory of Schnitzer (which also underlies the recent EEC Convention) that a contract has the closest relationship with that country in which the party responsible for the "characteristic performance" has its situs.

That rule is supposed to apply to the assignment of industrial property rights as well as to simple licenses, where the counter-performance of the licensee is largely confined to the payment of license fees. A departure from this basic rule, however, is called for if the licensee had a duty of exploitation or if he were granted an exclusive license.

Typically in these cases the center of gravity of the contract would shift to the situs of the licensee. Ulmer proposes this solution as a guideline for all contracts concerning intellectual property rights; without distinguishing between copyrights, patents, trade-

marks, and know-how.

Criticism

There are certainly good arguments for a uniform treatment of multinational license contracts. I do not, however, think that the multinational situation is the correct starting point for transfer of technology agreements including industrial property rights. Here the typical case is not the multinational. It is the bilateral license contract concluded between two parties but relating to one country only to which the arguments in favor of a uniform treatment do not apply.

It should be further noted that a splintered interpretation of the contract will occur only if the licensor grants the right of exploitation for the entire world or for more than one country in a *single contract to a single licensee*. One finds such contracts often in copyright law: a German author sells the "world rights" to a Swiss publisher, who grants a first license to a publisher in Paris for all French-speaking countries and a second to a publisher in London for all English-speaking countries. In patent and trademark law, such global exploitation agreements occur much less frequently. Even the grant of a regional license for several countries belonging to that region to one enterprise is only more an exception than the rule.

As an example, let us take a Swiss pharmaceutical company producing and marketing pharmaceuticals internationally. It has obtained patents and trademarks in all countries of its marketing area. Let's call it "Multipharm."

Switzerland and a part of the foreign markets are supplied with goods Multipharm has produced and trademarked itself. No license is necessary for the sale of those goods and for the related commercial activity, even if sole agents or subsidiaries are used in individual countries as distributors.

Licensees

For the remaining marketing area which cannot be supplied by exports from Switzerland, Multipharm will have a particular licensee or subsidiary in every important country to produce the drugs and to supply the relevant market. In these cases it concludes a separate license contract with every national licensee or subsidiary—with the French licensee for the French market, with the U.S. subsidiary for the U.S. market, etc.

A uniform assessment of these individual license contracts, which at any rate would not look alike, would indeed be desirable. But this is not imperative, since in every case the laws of one additional country only is involved. The contracts can therefore be subjected to the law of the respective country of protection without resulting in the much deplored fragmentation.

There remains the case of the patentee who grants a license for a larger regional marketing area to one licensee or subsidiary. Our Swiss manufacturer grants a license to a state enterprise in Budapest not only for Hungary, but for all socialist countries, to a Brazilian subsidiary for all Latin American, and to a Belgian company for all three Benelux countries. It would be

economically unfeasible to set up a separate license production for each of the markets. With such a regional license contract—we can take the Hungarian contact as an example—not only are Switzerland and Hungary involved, but also the other socialist countries and the rights protected there. In that event, the Hungarian licensee must, indeed, be authorized to distribute in the other socialist countries the goods produced and trademarked in Hungary. However, this license is a simple distribution license and therefore of subsidiary importance to the entire license relationship. It does not justify subjecting the contract of the laws of all the affected countries of protection or looking for a totally different solution.

Even for such a regional license contract, only one country other than that of the situs of the licensor seriously comes into consideration. That is the country of the *situs of the licensee*, which almost always is also the primary country of protection where the essential acts of exploitation take place, i.e. the production of the patented product, the trademarking, and the initial introduction into commerce. If the law of that country is chosen, a nonuniform interpretation of the contract is equally avoided and no "splitting" of the license agreement occurs.

The Country of Primary Protection and Performance as the Center of Gravity of the License Relationship

Which of the two remaining contact points is then the most appropriate—the country of the licensor's situs or the sole or primary country of protection? As much as I sympathize with the proprietor and licensor, I have difficulty in finding the center of gravity of a license agreement at the situs of the licensor. Apart from the fact that the situs of an enterprise is subject to change and is not always the center of the business activities of the trademark owner, e.g. the number of enterprises having their situs in the Bahamas, Luxembourg, or Liechtenstein, the law of the country where the situs is located does not typically give the contract relationship the characteristic impression. Certainly, our Swiss multinational has an interest that its own national law is to be applied to all contracts with foreign licensees, and, if he has a sufficiently strong bargaining position, he can impose his preferred choice of law by express agreement.

However, if one asks what is the objective center of gravity of a license contract—and neither express, implicit, nor presumed points of contact for the law of the licensor's situs can be inferred from the contract—then everything points to the law of the country of protection, where the license will be exercised. The licensed patents and trademarks are situated and protected there. All or at least the primary exploitation acts—the production of the licensed article, the trademarking of the product, and the initial introduction into commerce—take place there, and the characteristic performance of the licensor also occurs there, namely the waiver of his right to use the patent or trademark.

Finally, the sole or primary country of protection is usually that of the situs of the licensee, so that two of the most important points of contact coincide.

The selection of the law of the country of protection has in my view still another decisive advantage which I shall emphasize. It makes it possible to assess the

entire contract relationship in a uniform manner under the law of a single country, that of the sole or primary country of protection. It thus avoids the otherwise necessary splitting of the contract into two parts—one part, which is subject to the law of the situs of the licensor and another part, which is *compulsorily governed by the law of the country of protection*. The so-called theory of uniformity leads precisely to this awkward result insofar as it recommends the selection of the law of a country other than that of the country of protection, especially that of the situs of the licensor.

PROVISIONS GOVERNED BY THE LAW OF THE COUNTRY OF PROTECTION

Every license agreement contains a large number of provisions which are necessarily reserved to the law of the country of protection. Beyond the will of the parties is the focal point of the license agreement—the industrial property right itself. Questions concerning its creation, validity, content, scope and termination, as well as of the permissibility of its transfer and licensing, are determined solely by the law of the country of protection. This result necessarily follows from the principle of territoriality which governs the national and international protection of intellectual property rights—*de lege lata* and *de lege ferenda*—from which there is no escape. In our Swiss-Hungarian example, if the validity of the Hungarian patent becomes an issue, it can be decided only under Hungarian law. If a French firm wants to assign its trademark registered in Germany to a German firm, it must, under the German trademark law (1,8 WZG), transfer its business as well, even if the contract is otherwise subject to French law which permits free assignment.

Whether and under what conditions an industrial property right can be licensed or transferred is necessarily decided by the law of the country of protection without regard to whether the license is exclusive or nonexclusive or whether it is to be regarded as a right *in rem* or *in personam*.

Also withdrawn from the law of the contract are all questions of the license agreement that are governed by mandatory provisions of the protecting country that safeguard the *national economy* and the *public interest*. As already mentioned, these include all provisions which in a wide sense belong to the public order: the countless prohibitions and requirements of national tax and currency law, of foreign trade law, and especially of transfer of technology or antitrust law, which deserves particular attention in license contracts.

All of these provisions necessarily have an effect on the license contract, not only on its validity, but also on its content and interpretation. They must be observed by the parties, as well as by the courts of each country in which the international license contract is to have effect, whether or not the parties wish to observe them.

Example

Let us take the case of an international license contract between a German company and the Swiss subsidiary of an American company. The contract in-

cludes agreements restricting competition which will have an effect in Germany. An agreement of the parties to apply Swiss law, because Swiss antitrust law is less stringent, will not allow them to escape German and EC antitrust law.

A decision of a Swiss arbitration tribunal, which judged the antitrust validity of such a license contract with a German licensee under Swiss law (or not at all) would contravene the German “public order” and, for this reason, would not receive recognition, if the contract were inconsistent with German or EC antitrust law.

Finally, the *form* of the license contract is also subject to the law of that country of protection, to the extent at least that a mandatory provision of one of its statutes requires a particular form. According to the general rules of private international law, the form of the contract is determined either by the law of the place of conclusion (*lex loci actus*) or by the same law which governs the entire contract. These rules, however, are not suitable for agreements concerning industrial property rights, which have as their object formal rights dependent upon registration, which significantly affect domestic commerce, and which, for reasons of legal certainty, are enforceable only if concluded in a particular form or entered in a public register.

CONSEQUENCES FOR THE LAW OF CONTRACT

We have seen that almost all important questions of the license contract, not only the basis of the license, but intellectual property rights, their validity, their content, the scope of their protection, and their termination, but also all requirements of validity and the form of the contract are necessarily subject to the law of the country of protection. Furthermore, as matters stand, most of these questions necessarily also affect the purely contractual part of the license contract, setting out the reciprocal rights and duties of the parties.

Typical Solution: the Law of the “Primary Country of Protection”

Is it reasonable to subject the whole contract, the mandatory as well as the purely contractual part of the agreement to the same law and thereby secure a uniform judgment on the entire license relationship? For contracts involving only one country of protection this solution certainly recommends itself. For the reasons already discussed, I consider it also to be correct for multinational license contracts with one licensee involving rights of protection in several countries; the focus should be on the law of the country of primary protection, in which the licensee has its situs, produces, trademarks, and brings the goods into commerce.

It should be kept in mind that this is only a proposal for the *typical state of affairs*. It does not apply if the parties have expressly or implicitly agreed on the application of another law or if exceptional atypical circumstances of the case call for a different determination of law.

For example, if two German companies conclude a license contract for the exploitation of an invention patented and trademarked in Korea, the courts will

normally be inclined to apply the national law shared by the parties, that is German law. Here, typically, the presumed will of the parties to apply the familiar law they share takes precedence over the result suggested by the nature of the license relationship.

Choice of Forum

Similarly, it may be that the parties have agreed on a choice of forum in a third country, e.g. Switzerland, without making a corresponding choice of law. In such cases the court may often (although not always) decide to apply the *lex fori*, not only because of the well-known propensity of the courts to apply the law they know best, but also because it may be assumed that there is an interest of the parties in the application of law familiar both to them and to the court.

Finally, the entire set of circumstances can call for a departure from the typical solution and favor instead

the choice of the law of the situs of the licensor. This solution seems to me to deserve preference in the case of a well-known product, protected worldwide, whose marketing through foreign subsidiaries and licensees is directed and controlled from the situs of the parent corporation following uniform principles of production, licensing, trademark utilization, and advertising. I am thinking here, e.g. Coca-Cola, with its hundreds of licensees and bottling subsidiaries, or franchising companies active worldwide.

One should, however, not take these cases as the basis for the typical solution. That solution should rather be the law of the country of protection and exploitation to which the technology is transferred and where the poor licensee tries to use it. This proposition may not please many of your clients, if you are specialized in advising the "haves" rather than the "have-nots." In that case you are perfectly free to forget about my theory or to qualify it as a "poor" one.