

Challenges And Opportunities In Licensing To Emerging Economies

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This paper will review my personal experience in licensing in emerging countries. I will discuss problems that I have encountered and those that are likely to be encountered in the future. I will then suggest how the problems can be overcome and how the opportunities can be realized. I shall end this paper with a suggestion of how we, as members of LES International, can meet the challenges and take advantage of the opportunities represented.

My personal experience in licensing to emerging economies began in the very early '70s, more than 30 years ago. The technology I was licensing was the world-famous Sohio acrylonitrile process. Sohio was the first of John D. Rockefeller's oil companies. Before the U.S. antitrust laws were passed in about 1910, Standard Oil controlled about 80 percent of the refining, transportation and marketing capacity in the U.S.

In the late 1950s, chemists and engineers at Sohio developed an outstanding technology for producing acrylonitrile (a petrochemical intermediate utilized in the production of acrylic fiber, i.e. synthetic wool, and ABS engineering grade plastics). In the early '70s, the technology was licensed to Korea, Brazil, India, Bulgaria, East Germany, Romania and the Soviet Union. Needless to say, each of these license negotiations presented many challenges and opportunities. In May, 1973, we licensed both Taiwan and China. Later, we licensed Mexico and ne-

gotiated additional licenses with Romania, Bulgaria, East Germany, the U.S.S.R. and Korea. Also, six additional licenses (each for a separately-stated royalty) were negotiated with China.

Each of the negotiations could be the subject of its own paper. Each presented tremendous challenges and actual or perceived problems; however, each was and continues to be very successful.

I feel that I must qualify my remarks and suggestions by pointing out that the technology that I was licensing was, far and away, the technology of choice for products of acrylonitrile, an important petrochemical intermediate. That is, if a country wished to upgrade its petroleum (a by-product of ethylene production or catalytic cracking) to acrylonitrile or if it wished to back-integrate its textile industry in order to produce its own acrylonitrile, it almost certainly had to negotiate a license with Sohio. In fact, when I left Sohio/BP in 1993, about 98 per cent of the acrylonitrile produced in the world was manufactured by means of the Sohio Acrylonitrile Process.

This incredibly strong position in an important technology was due not only to superior technology but also to a very well-planned and executed licensing program. When one considers that Sohio's basic patents were granted by the USPTO. in the early '60s, yet in 1993, the Sohio technology was still responsible for more than 98 per cent of the 10 billion pounds, or so, of world-wide acrylonitrile production, it appears clear that the licensing program was successful. It is also clear that the licensing program was not

based on patents alone since the program remained strong after more than 30 years.

The most significant challenges faced over my nearly 35 years of experience in licensing to emerging economies were the following:

- 1) Overly-protective laws and regulations;
- 2) Failure or reluctance to recognize that trade secrets and know-how are property; and
- 3) Utilization of disinterested intermediaries to negotiate the licenses.

The laws and regulations that, in my experience, discouraged technology transfer and presented disincentives to owners of valuable technology to transfer that valuable technology to emerging countries are:

- 1) Compulsory registration;
- 2) Limitations on confidentiality;
- 3) Limitations on royalty;
- 4) Export restrictions; and
- 5) Requirements relative to use of local technology, if available.

Compulsory registration, in effect, imposes a disinterested intermediary between the licensor and the user of the technology. Such an intermediary may only be concerned about cost, that is it's like negotiating for a Yugo when a Mercedes is wanted.

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Restrictions on confidentiality terms eliminate the possibility of receiving technology from a licensor who expects its technology to have a useful licensing life of more than the limited number of years permitted by the restrictions: royalty limitations, likewise, cause licensors of highly valuable technology to refuse to license their technology. Regulations such as these ignore the most fundamental concept involved in the transfer of useful technology, i.e. each proprietary process, product or idea is unique. If it were not unique, it would not be licensable, and it would not have very much value. Both the licensor and the licensee should be free to tailor the method of transferring technology to that which is most desirable and appropriate. Regulations that restrict either party's freedom to negotiate, in my view, discourage the transfer of valuable technology. If licensors believe a country's laws and regulations are a barrier to effective technology transfer, they will not license their valuable technology or invest their resources in the country. Instead, they will prefer to license their technology where its value will be respected and where they will be welcome.

A particularly regressive set of regulations are those which require that the licensee utilize local technology, equipment, components, etc. if they are available. This may be an acceptable regulation in theory; however it is often very regressive in practice. The infamous incident in Bhopal, India at the Union Carbide plant some 20 years ago was caused, I believe, by this requirement. Necessary safety equipment at the plant had failed and had to be replaced. It would have been relatively easy and would have required very little time to replace the equipment with equipment from outside India. This could not be done, however, unless and until it could be certified that the needed equipment was not available in India. The delay caused by the certification proved to be fatal to several hundred people.

In order to cope with the problems faced in licensing developing

countries, licensors must carefully plan and execute their licensing programs. This is easy to say, but not so easy to do.

Before embarking upon a program of licensing to developing countries, it is necessary for licensing representatives of companies owning important technology to prepare a licensing package and ensure that the technology in the package is well-protected by patents when beneficial and possible, and, more importantly, by confidentiality agreements with employees, contractors, vendors and anyone else that has access to the technology. It is also important to assess possible additional leverage your company may have. With respect to Sohio's acrylonitrile technology, this additional leverage was Sohio's catalyst which was necessary for continued operation of the licensed plant, Sohio's multilateral improvement exchange with most of its licensees and Sohio's close working relationship with only two or three international engineering contractors who were qualified to design, engineer and construct the licensed plants. Further, I recommend that you disclose the most important aspects of your technology only after payment of the royalty or a binding commitment to pay is obtained.

Why would any owner of a valuable technology put that technology at risk by licensing it to an emerging economy if all of these problems exist? The answer is simple – the emerging economies offer the most potential for business growth in the world. For example, when I became involved in licensing technology to China, it was a country with more than a billion two hundred million friendly, educable and potentially industrious people. Its economy had been growing at a double-digit rate for more than ten straight years. It was worth the risk. Eastern Europe, while laboring under the yoke of Soviet-style socialism, had a rich heritage, a civilized and sophisticated population and, thus, a great potential for growth. South American countries were natural trading partners with the United States and, inevitably, would seek to upgrade

their domestic manufacturing base. We felt we had no alternative but to license. On the other hand, we understood the potential problems and undertook an assessment of our licensing program in order to minimize potential harm.

I cannot stress enough the need, when a company embarks on a program directed to licensing in emerging economies, for the licensing team to practice the three "P's", that is *Preparation, Patience* and *Perseverance*.

With respect to Preparation, I recommend that the overall licensing project be developed in some detail at your home office before contacting potential licensees. A team (not a single negotiator) should be selected. The team should include the best people available. Especially important are a responsible management representative and an experienced technical person. The management person must have credibility within the corporation and must be able to establish credibility with the other side. The leader must be able to make decisions in areas that might not have been discussed in advance with company management and should have a general understanding of the technology being licensed. If possible, the team should include an individual who speaks the language of the potential licensee.

The technical specialist must have a thorough understanding of the technology and its potential implementation. Often, the technical representatives of the potential licensee are very well-versed in the technology and, if they know more than your technical representative, it would be embarrassing. When I had my first meeting with the potential China licensee, there were some 30 representatives on the other side of the table, each of whom knew a lot about one or more areas of the technology.

The team should also be armed with a well-drafted agreement. Some developing countries have agreement forms which they will attempt to require licensors to accept. It is my experience that these

forms are not mandatory and that an agreement draft that is suitable for licensing between western companies can be easily adapted to any local requirements.

Some emerging economies (notably Brazil) continue to limit secrecy terms and royalty payments, especially for non-patented technology. It remains the policy of the Brazilian Patent & Trademark Office (BPTO) that unpatented technology (trade secrets and know-how) is not regarded as property and cannot be licensed to a Brazilian party; it can only be sold. Further, all licenses requiring the payment of foreign exchange must be recorded and registered with the BPTO. I understand that the BPTO's policy regarding technology contracts does not allow restrictions on the Brazilian party's right to use or to disclose the licensed technology after the contract terminates (and contracts are usually limited to five year terms). Brazil is noteworthy as a country that has not awakened to the fact that, if you want industrial organizations in your country to have access to world-class, crown jewel technology, you must have laws and regulations that promote or encourage such transfers not inhibit or discourage them.

In 1986, I made a presentation in São Paulo titled "Licensing Disincentives in Brazil." The presentation was published as an article in the December 1986 (Vol. XXI, No. 4) *les Nouvelles*. In the presentation, I criticized the Normative Acts which were in place at the time and stated that U.S. technology owners were reluctant to license their most valuable technology to Brazil as long as such negative incentives for such licensing existed.

Since the autumn of 1986, many changes in the protection licensing and enforcement of intellectual property rights have occurred in emerging economies throughout the world. These changes have resulted from bilateral negotiations between the U.S. Trade Representative, especially during the first Bush administration and from the TRIPS (trade-related intellectual property

standards) chapter of the GATT. The positive results of these bilateral negotiations were usually also offered to other countries. Hungary, Taiwan and Singapore are examples of countries where such bilateral negotiations took place. China also relaxed restrictions on the transfer of technology. An excellent article outlining China's evolving legal environment for licensing was published in two parts in the June and September, 2001 issues (Volumes XXXVI, Nos. 2 and 3) of *les Nouvelles*. The onerous restrictions imposed by the Mexican and Argentine governments in the '70s and early '80s were also relaxed. A good example of the reasons for the changes is outlined in Argentina Law No. 22.496 in which

"... [the law] recognizes that parties involved can negotiate freely, and that government cannot replace businessmen in making decisions."

An Argentine policymaker summarized the new realization by Argentina by stating the following:

"... the approach to the matter (i.e. technology transfer and foreign investment) ... must be economic and not ideological. When this last happens (i.e. the ideological approach), and it has happened, technology and investments shall be farther and farther from our countries."

The Uruguay Round of GATT negotiations addressed patent rights and largely removed obstacles to protection and enforcement of patent rights. These negotiations did not, however, solve the problems of technology transfer. Many developing countries, notably Brazil and China, continue to follow the ideological approach, that is, to impose restrictions on trade secret and know-how licensing, refusing to recognize property rights in unpatented technology and limiting terms of confidentiality and royalties related to such transfers.

I pointed out early in this article that the technology which was the subject of my most successful licensing experience was successfully licensed and kept confidential for more than 30 years.

How then does an organization

owning valuable technology accomplish a successful licensing program in countries that continue to impose such restrictions? The short answer is "proceed very carefully"; the longer answer is to make it clear that, if the technology is considered critical to the recipient country, the potential licensee and the country's regulators must compromise the regulations and restrictions. I have many examples of successful efforts to accomplish such compromises. For example, the Mexican registry in the '70s imposed many restrictions on technology transfer which required foreign exchange payments. These restrictions included requiring that the confidentiality term and the term of the agreement be limited to five years. Further, the royalty was limited to a small percentage of the expected revenue over the five-year term and no payment thereafter. I happened to have known (personally) the head of the Mexican registry, at the time, Enrique Aguilar. I knew him from his position as a licensing representative from Monsanto in the U.S. My counterpart from the potential Mexican licensee and I arranged a meeting with Mr. Aguilar. In the meeting, we explained Mexico's critical need for our technology and that the terms we were requesting from the Mexican licensee were no more onerous than those imposed on our other licensees. Finally, we made it clear that we would not license our technology in Mexico under the conditions which were apparently required by Mexican law and regulations. Not surprisingly, we were permitted by the Mexican registry to conclude our negotiations with our Mexican licensee on terms and conditions similar to those in our other international agreements. We had similar experiences in India and China.

A drafting device we have successfully used in countries that continue to insist on limiting secrecy terms is to provide that the secrecy term extend to a number of years, e.g. 5 or 10 depending on the regulations, following our last disclosure of conditional information. Such a clause is only effective if the licensee agrees to

an improvement exchange and if the licensor continues its R&D relating to the licensed technology.

Once again, a full discussion of this area could occupy more time than the length and scope of this article.

If all else fails (i.e. if you are unable to achieve necessary concessions from your potential licensee or officials in its country), there still may be a possibility of licensing if you are able to exert leverage in another way. While I cannot recommend that you compromise your standards for a particular country if to do so would trigger most-favored licensee clauses with prior licensees or jeopardize your companies' assets, you may be able to exert leverage by denying the licensee access to essential components required for effective implementation of the license or operation of the licensed facility. For example, my company manufactured and supplied proprietary catalyst to its licensees. If catalyst supply were denied, the plant would have to cease operation. We chose to utilize this leverage not as a substitute for effective license provisions but as an added incentive to the licensee to abide by the terms of the agreement.

Other problems encountered in many of the emerging economies are unstable currencies and a reluctance to pay interest on delayed or installment payments. These problems were solved by bank guarantees and by first negotiating the terms of payment, i.e. installments, if any, and then negotiating the amount.

If a licensor is able to cope with the laws and regulations and, thus, negotiate an appropriate license agreement with terms consistent with the licensed technology's value, licensing in emerging economies is clearly justified. Emerging economies such as those in China, India, South American and Eastern European countries offer outstanding opportunities for licensors, equipment suppliers and engineering contractors. These countries have large populations, geographical advantages and necessary raw materials; they also present new opportunities for licensing technology which has already been licensed in the OECD (Organization for Economic Co-operation and Development) countries. My company realized several hundred million dollars from its licensing and catalyst sales in such countries. We further were able, through licensing, to establish lasting business and personal relationships with companies and business leaders in these countries which have enhanced opportunities to enter into mutually beneficial relationships, such as drilling concessions in China, joint ventures in several countries and other direct investments.

At the beginning of this article, I indicated that I would close with a suggestion of how members of LES International can meet the challenges and take advantage of the many opportunities presented by licensing in emerging economies. In 1993, in a talk in Lisbon to a group including local businessmen and lawyers and

international members of LESI, I stated the following:

"If a country wishes to encourage a rational approach to technology transfer both between developed and developing countries, and between small and large enterprises, there is no better safeguard for the interests of the weaker party than an informed and skilled corps of licensing executives and advisors."

This statement, although made nearly ten years ago, is as true today as it was then. LESI can help emerging economies achieve their technological and industrial goals through education of the countries' licensing executives and government officials. Members of LES were strong and vocal supporters of the TRIPS provisions of the GATT's Uruguay round. We have also been advocates of change in South America, China, and other developing nations. We must continue to carry the flag of effective technology transfer throughout the developing world and in national bodies and in international institutions, such as WIPO, UNIDO and UNDP. The model established by our EEC committee's negotiations with the Brussels authorities should be followed throughout the world. We should not underestimate the persuasive power and educational potential of our society, and we should use these assets for the good of the world.