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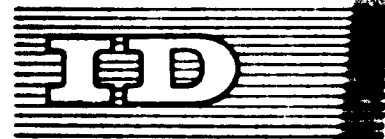
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STUDY OF THE LEGAL ASPECTS OF CONTRACT PRACTICES  
CONCERNED WITH THE TRANSFER OF TECHNOLOGY FROM  
ENTERPRISES OF DEVELOPED TO THOSE OF DEVELOPING COUNTRIES <sup>1/</sup>

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INTRODUCTION

1. Transfer of technology on a commercial basis may be brought about either by licensing contracts or by sales contracts. At the outset, it would seem that there is a great difference between these two legal procedures: in the case of a sales contract the technology becomes the property of the buyer and the buyer can use it as his discretion as it serves a useful purpose in his production; while the licensing contract is merely a temporary authorization given by the licensor to the licensee to use the licensed technology under the terms set out in the contract. In fact, the sale may be concluded subject to certain conditions similar to limitations normally set out in licensing contracts. Licensing contracts, on the other hand, may provide for a gratuitous licence after the expiration of the licensing contract which puts the licensee for all useful purposes in a situation not very different from that of a buyer of a technological process. The two legal forms of commercial transfer of technology could therefore be considered as a mere technicality, the actual problems of commercial transfer of technology being essentially determined by the technical, economic and financial content of the contractual relations of the parties rather than by the legal classification of the contract itself.

2. The strength of the bargaining position of the potential licensor has decisively influenced the content of the contractual relations between licensor and licensee in the formation of modern practices in trade of production licences. The present contract practices related to commercial transfer of technology are characterized by a narrow definition of the liabilities of the licensor and by a strict limitation of rights granted to the licensee. In the relations between enterprises of industrialized countries this situation does not seriously affect the development of commercial transfer of technology since the flow of technology normally goes in two directions, so that an enterprise which happens to be a licensee in one particular commercial operation may play the role of a licensor in others.

This sort of automatic correction does not exist in relations between enterprising developed and developing countries and it therefore appears necessary to adjust the present contract practices in trade of licences to meet the special conditions of developing countries with a view to creating for the benefit of enterprises in these countries a stronger contractual protection of their economic interests which they are generally not at present in a position to achieve in the process of negotiations. Such an adjustment of present contract practices is also of utmost importance since the transfer of technology is certainly one of the essential elements of a rational industrialization of developing countries. The various problems related to the drawing up of licensing contracts for commercial transfer of technology have therefore to be reviewed from the point of view of adequate protection of legitimate interests of developing countries. In this review the technical, economic and commercial aspects of the problem will of course be decisive. The possible legal solutions that could be recommended to enterprises and to the Governments of developing countries will have to be formulated on the basis of findings which may result from the technical and economic analyses of present relations between developed and developing countries in the field of commercial transfer of technology.

## I. CHOICE OF TECHNIQUES

3. The choice of techniques to be purchased by enterprises of developing countries is a problem which the parties have to solve before entering an agreement on commercial transfer of technology. In this respect, industrial enterprises of developing countries often complain that the present trend in commercial practices applied to transfer of technology does not give them an actual access to modern industrial techniques. Developing countries are anxious to prevent enterprises of developed countries from selling at a high price to developing countries, outdated techniques for which developed countries have themselves no further use in their own production. To protect their interests, developing countries sometimes try to insert into licensing contracts a clause according to which the licensor guarantees that the industrial processes he sells correspond to the most modern techniques known in the field of the industry concerned.

4. The practical efficiency of such a clause is rather doubtful as the phrase "the most modern techniques" is difficult to define clearly and may often lead to disputes as to its actual meaning. The latest techniques are usually sold at a high price since they may not yet have been amortized by the licensor. Also, they may not have been industrially and commercially proved, in which case the licensor may be even less inclined to guarantee their practical results and possibilities of utilization. Finally, the question has been raised as to whether certain highly sophisticated and modern techniques offer the best means for industrial development in developing countries. It has been suggested that the best solution to the problem of the choice of techniques to be acquired by an enterprise of a developing country would be for the enterprise to initially choose a well-proven classical industrial process and to stipulate in the clause of its licensing contract related to improvements that the licensee should be given the benefit of all later improvements and innovations made by the licensor to the originally transferred techniques.

5. Another problem of choice of techniques may arise with regard to patented and unpatented industrial processes. A still widely held opinion is that patented techniques should be ascribed a higher value and accordingly a higher price than unpatented techniques. Many licensing contracts contain an annex listing the patents involved in the operation, some of which have no direct bearing on the licensed techniques. The licensee would therefore be well advised to carefully scrutinize such lists of patents and to request that patents not directly involved be deleted from the list. This would give the licensee an opportunity to request a lower price. It is true that a patent constitutes a higher protection against actions in infringement but similar protection may be obtained by the licensee through a contractual clause whereby the licensor states that, to the best of his knowledge, the techniques which he has transferred to the licensee cannot be legally disputed by a third party and commits himself to assist the licensee on any action in infringement brought up by a third party against the licensee. The modern trend in patent registration is not to publicize the technical details which are essential for industrial utilization of patented techniques. Hence the mere acquisition of a patent without the relevant industrial know-how may prove to be of no practical value to the licensee. In concluding their licensing contracts the enterprises of developing countries should insist on receiving not only a patent right but also the corresponding know-how and all other relevant technical information necessary to industrial implementation of the transferred technology.

6. Even before starting to negotiate actual conditions of a licensing contract, the potential licensee will have to decide the most appropriate techniques to be acquired. This is often a difficult problem for a potential licensee and, for this purpose, he should have recourse to an engineering bureau specializing in the particular field of interest, provided one is available that has neither financial nor technical links to the potential licensor. However it should be borne in mind that useful as it may be, the intervention of an engineering bureau will involve an additional cost to the licensee.



Enterprises of developing countries may find it advisable to request the assistance of an independent expert, provided by the United Nations or by other international organizations, to help make the best possible and the most advantageous choice of techniques to be acquired. UNIDO could play a particularly important role in this respect.

7. In addition to making a preliminary decision, possibly in consultation with an outside expert, on the techniques to be acquired, the potential licensee will also need to determine whether the transfer of technology should be given the form of a separate contract or whether it should be incorporated into a complex agreement on industrial co-operation. In relations between enterprises of developed countries, separate licensing agreements are frequent, the licensee, starting from techniques he has acquired, undertakes to secure independently his own production and marketing strategy for his own products. An enterprise of a developing country may need for the same purposes not only the benefit of technical knowledge but also assistance in production, in management and in marketing. At first sight, it would seem that the incorporation of a licensing contract in a broader agreement on industrial co-operation would better serve the interests of enterprises of developing countries. Such an incorporation may, however, increase the global cost of the operation and put some restraints on the independence of the licensee. The situation has therefore to be reviewed from all possible points of view and the advantages and disadvantages of each solution have to be carefully studied so that the enterprises concerned may be aware of all factors that go into influencing their decisions.

## II. INCORPORATING LICENSING CONTRACTS INTO COMPLEX ARRANGEMENTS ON INDUSTRIAL CO-OPERATION

8. Licensing contracts dealing with transfer of technology often contain provisions concerning such related subjects as technical assistance granted to the licensee by the personnel of the licensor's firm, training of licensee's personnel in licensor's plants, use by the licensee of licensor's trademarks and the like.

As long as the transfer of technology remains the central point of the contractual relations of the parties, the question as to the preference to be given to a single contract covering all the aspects of those relations or to a series of separate and specialized contracts is a purely formal one and has no importance from a substantive point of view. However, the situation appears to be entirely different in cases where the transfer of technology is only one of the various elements of a large-scale operation designated to create or to develop an important industrial undertaking in a developing country. In such cases the Government of a developing country or the enterprise of this country will have to decide whether to obtain the necessary technology themselves under a separate licensing agreement and later take the lead in the construction and the operation of their plants, or whether to entrust the supplier of technology with the role of general contractor which means he will be responsible for supplies and services required for the construction and possibly for the operation of an industrial plant.

9. The decision to engage a general contractor has advantages for an enterprise of a developing country since the contractor will have to assume responsibility for the choice of technology and appropriate equipment. Moreover, he will be responsible for the results of the industrial project implemented by him without the client being obliged to establish proof of the contractor's negligence. However, the contractor should not be held liable if evidence proves that the client is to blame for unsatisfactory results e.g. the client's use of inferior or inappropriate raw materials, or some other default in the actual plant operation. But even in such cases the contractor may have to assume part of the liability if, for example, the contractual arrangements between the parties were extended to technical assistance to, or management contracts for, plant operations.

10. The transfer of liabilities from client to general contractor would for two reasons involve for an enterprise of a developing country a substantial increase in the global cost of the operation. On the one hand, the general contractor will be the master of the prices.

For example, in buying from a third party the necessary equipment which he does not himself manufacture, the contractor may be tempted to include his usual margin of profit on each item he will charge in his global price to his client. It is possible that there will be a considerable price difference between the global prices charged by the contractor and those which the enterprise would obtain through individual purchases of the same machinery and equipment. However, in reviewing these differences the contractor's liability should be borne in mind and he should be allowed a reasonable surplus charge for his margin of security.

11. The justification for a margin of security can hardly be disputed. Even if the licensee takes on the responsibility for the construction and the operation of his plant, he must include an appropriate margin of security for all unforeseen events in the calculation of his own cost price. In the case of a "turn-key" contract for construction of a factory and particularly in cases where a "turn-key" contract is completed by management and marketing contracts, the client is entitled to claim that the security margin of the general contractor be kept within reasonable limits. A client should also have the possibility of controlling the global price presented to him by a general contractor in order to be able to judge for himself that the contractor's prices do not unreasonably exceed those on the market. In practice, an enterprise of a developing country would be well advised to invite a proposed general contractor to submit it with a break-down of prices for each item included in the general proposal. In this way the enterprise will be in a position to compare the global price proposed by the general contractor with prices which the enterprise could obtain in concluding separate contracts for various supplies and services necessary for the construction and the operation of its plant. Only on this comparative basis will the enterprise of a developing country be able to decide whether it is preferable to conclude a separate licensing agreement for transfer of technology or to incorporate it in a more comprehensive contract dealing with several other elements which contribute to the creation and development of an industrial venture.

### III. DURATION OF LICENSING AGREEMENTS

12. The licensing agreements for transfer of technology are normally concluded for a period of time corresponding to the prospective life of the contracted technology. The contractual duration of licensing agreements varies at present from five to ten years. Since the practical value of a given technique may be longer than the original period of time provided in the contract and especially since this practical value may be extended beyond the time-limit originally set out in the contract owing to inventions and improvements brought about during the existence of the contract, it is normally stipulated in licensing contracts that they will be tacitly renewed unless one of the parties terminates it at a certain time, say, six months before its expiration as fixed in the contract. Although often used, this renewal clause may not in all circumstances be the best solution to the problem of duration of licensing agreements. If at the time of the expiration of the contract the licensed technique still has practical value, this value may have been progressively diminished so that the continuation of the agreement under the same conditions as in the original contract may become too burdensome for the licensee. Consideration should therefore be given to the idea of negotiation, before the expiration date of the original contract, for a new agreement which would take into account the actual value of the licensed technique at the moment of the conclusion of the new agreement. Another way of adjusting a licensing contract to a possible change in the practical value of the licensed techniques would be to adopt in the original contract a degressive scale of remuneration for the licence. In this case, it would be possible to combine the remuneration clause with the procedure of tacit renewal of the contract.

13. The incorporation of a licensing agreement into an over-all contract for construction and operation of an industrial project in a developing country would not necessarily alter the solution to be adopted for the problem of the duration of the licensing contract. Certain parts of the over-all contract will, of course, be terminated before the normal expiration of the licensing agreement.

It is therefore necessary to state clearly in the contract that the time-limits stipulated separately for the different parts of the contract are independent of each other and that, regardless of the termination of other parts of the over-all contract, the provisions relating to the transfer of technology will remain in force until the end of their fixed term.

14. According to general principles of law, after the expiration of the original or the renewed period of duration as fixed in the licensing contract, the licensee is not allowed to utilize the technology which has been transferred to him by virtue of the contract. This prohibition may even be extended to techniques derived by the licensee himself from the licensed technology. Licensors have included such prohibitive clauses in many licensing contracts; sometimes they even request that, after the expiration of the contract, the licensee return to them all the documentation including models, drawings and designs which were supplied to the licensee within the framework of the original contract. However, the strict application of legal principles involved would be harmful to the interests of the licensee; to undertake an industrial project based on the technology obtained from the licensor, the licensee was obliged to make important investments and to secure a market for his products. Thus it would be unrealistic to ask him after date of expiration to stop production or to reconvert his business particularly when he may not have amortized his expenses or have drawn sufficient profit from his investment. It would seem equitable to allow the licensee to continue to exploit the licensed technology even after the contract has expired. From the legal point of view, such a result could be achieved by stating in the contract that on the expiration of the time-limit originally fixed in the contract the licensee will be granted a gratuitous licence for the technology, with no set time-limit attached. If the licensor were not inclined to accept such a liberal solution, a compromise may consist in reserving contractually to the licensee the exclusive right to renew the contract at his own discretion but of course at a reduced price. In order to avoid subsequent discussions among the parties as to the reduction of the contractual price in case of a unilateral renewal of the contract by the licensee, it would be advisable to fix in the original contract the rate of the reduction in the situation envisaged here.

15. In addition to the normal termination of a contract by the expiry of the period of time fixed for its duration, a licensing contract may also be terminated during its duration period by agreement between both parties or by the decision of one of the parties if such an unilateral cancellation of the contract is supported by general law or by an expressed provision within the contract. In general, it may be stated that, as in all mutually obligatory contracts, a party to a licensing contract is entitled to cancel the contract if he can prove that the other party has not honoured his contractual obligations. This principle is firmly established and cannot be disputed in law. However, it is much too general to be applied in concrete cases without giving rise to uncertainties and litigations between the parties. In numerous licensing contracts, the parties therefore carefully enumerate the conditions under which the licensor or the licensee may cancel the contract because of actions or omissions, or because of the general attitude of the other party. This way of proceeding is certainly commendable. The usual practice in this respect is strongly influenced by the interests of licensors. It would seem useful to review the matter from the point of view of the interests of the licensee particularly to those from developing countries.

- Justification for cancellation

16. The following cases may be considered as justifying cancellation of a licensing contract by the licensor:

(a) Delay or default in payment by the licensee. The principle of cancellation of the contract by the licensor if the licensee does not make his payments at a due date is hardly questionable. However, it is customary to fix in the contract a time-limit after the due date during which the licensee will be given the opportunity to meet his payment obligation. The right of the licensor to cancel the contract should then be exercised only after the expiry of the new time-limit. The cancellation of the contract will not relieve the licensee from payment of sums due at the date of cancellation and of interests accumulated on these sums at a rate which may be fixed direct in the contract or by reference to the legal discount rate in the country of the licensor or of the licensee. Preference may be given in this respect to the official discount rate of the country of the licensor which is the normal centre of licensor's financial activities, including prima facie utilization of sums earned abroad.

Payment by the licensee of sums due plus interests is often not the only financial consequence of the cancellation of a licensing contract by the licensor because of the delay in payment by the licensee. The licensor may claim in such a case that he has suffered damages as a result of being obliged by the default of the licensee to cancel the contract before the normal date of its expiry and thus he may ask to be indemnified to the extent of all sums plus interests which the licensee would have paid had the contract not been cancelled. The problem is not purely theoretical as actual claims of this type have been made by licensors, either in negotiations for licensing agreements or in litigations. The solution to this problem will ultimately depend on the respective bargaining power of the parties concerned. The licensees may have good reasons for resisting the licensors' claims to indemnification: the transfer of technology does not represent for the licensor additional costs, the technology having been amortized to some extent by use in the licensor's own production, and the cancellation of the contract gives the licensor the possibility of granting the licence to another enterprise operating in the same country as the licensee. The problem is important enough to be clearly and specifically settled in the contract.

(b) Unauthorized transfer of licence or subcontracting by the licensee

Under a licensing contract the licensee is usually not allowed to transfer his contract or to subcontract a component part of his production to a third party without express authorization by the licensor. This solution which appears in practically all licensing contracts derives from the personal character of the licensing contract granted by the licensor to a specific person, the licensee, in whom the licensor has confidence. It would appear difficult for the licensee not to accept such a limitation of his freedom of action based on the very essence of the licensing contract. He may, however, at the time of concluding the contract foresee conditions under which he might later have to transfer his business to another enterprise or subcontract certain aspects of his production activity. In view of such contingencies, the licensee may obtain an advance authorization from the licensor, on signing the contract.

But without the authorization by the licensor either given in advance or in a concrete case, the licensee should neither transfer the contract nor subcontract. Such action could be considered as a breach of contract on the part of the licensee and could give the licensor the right to cancel the contract, the licensee remaining responsible to third parties for the non-fulfilment of obligations resulting from the transfer of licences or from the subcontract. The cancellation of the licensing contract by the licensor would not seem to give rise in this case, as in the situation treated above under (a) and for the same reasons, to any damages to be paid by the licensee to the licensor. This solution should also be expressly recorded in the contract.

(c) Cessation of activities and changes in the structure of licensee's enterprise.

It would seem natural to apply the same solution (possibility for the licensor to cancel the licensing contract, but without the right to indemnification for damages) in cases involving the transfer of licensee's enterprise as a whole to a third party such as bankruptcy, sale of business, assignment of assets to another enterprise and the like. Although the licensor may agree to listing as part of transferable assets the licensing contract for the remaining time period of duration and under the same conditions, he does have the right to cancel the contract at the time of the transfer. Most of the licensing contracts contain a further clause which states that the right to cancel the contract is granted to the licensor in cases where changes in the structure of licensee's enterprise has taken place. For example, the licensee or the partners of the licensed enterprise have transferred their participation to other persons, or a private enterprise has become nationalized. This solution is also justified by the personal character of the licensing contract but to be applicable must be expressly stipulated in the contract. Some licensors require even more stringent clauses and try to obtain under the terms of the contract the authority to cancel the licence in cases of notable diminution of licensee's credit worthiness even before the licensee's financial difficulties have become apparent through actual delay in payments or by opening of judicial "winding-up" procedures. However, it is believed that a clause to this effect would give the licensor too much power of objection.



Owing to the vagueness of the conditions under which such a clause is supposed to be applicable, its application would certainly give rise to numerous litigations. In a well-balanced licensing contract, taking equally into account well-founded interests both of the licensors and the licensees, a "credit-worthiness" clause should therefore be carefully avoided.

(d) Non-fulfilment of his specific obligations by the licensee

In addition to his essential obligation to pay the contractual price, the licensee takes upon himself several other specific obligations such as obligation to secrecy or obligation to respect the territorial limitations put on the use of the licensed technology. Under certain licensing contracts, the licensee undertakes to exploit industrially and commercially the technology he obtained from the licensor. The actual scope of the licensee's specific obligations as well as the financial consequences of their non-fulfilment are discussed below under the relevant sections (see IV, V, VI, VIII below). It will suffice to mention that in all such cases of non-fulfilment by the licensee, the licensor maintains, besides his right to claim compensation for damages proved, the right to cancel the contract if after having received from the licensor a notice to this effect the licensee does not fulfil his obligations under the contract in a reasonable time.

(e) Unlike the situation explained above in paragraph 14 for the case of normal expiry of licensing contract, a licensing contract that is validly terminated by the licensor in conformity with legal principles or contractual provisions set out in sub-paragraphs (a) to (d) of the present paragraph, allows the licensor to request the licensee to return forthwith all documentation, information, drawings, designs and models supplied to him under the contract. Also, the licensee must refrain from making any future use of the technology which was the subject matter of the licensing contract as well as of the technology derived from it.

17. The personal character of licensing contracts which results in very stringent requirements maintaining the original identity of the licensee, plays a less decisive role in so far as the personality of the licensor is concerned.

Having received initially the necessary technical documents and information from the licensor, the licensee has no valid reasons for nor actual interest in requiring that the identity or structures of the licensor remain unchanged during the entire life of the licensing contract. The necessity and the possibility of cancelling a licensing contract could only arise for the licensee if he cannot obtain from the licensor that the latter fulfils correctly his obligations under the contract and if licensor's default is going on for such a period of time that the continuation of the contract becomes of no practical value to the licensee. In such a case the licensee is prima facie entitled to appropriate compensation for damages incurred and, if he deems advisable, he also may cancel the contract. The problem of the right of the licensee to cancel the contract before its normal expiry has thus to be examined in respect of the various obligations of the licensor under the contract i.e. the supply of technical data and of improvements to the original technology, performance guarantees, if any, and technical assistance (see sections IV, V, VI and VIII below).

#### IV. TERRITORIAL VALIDITY

18. A production licence is in most cases limited to the country where the licensee's plant is located. Sometimes the production licence is granted only for a definite plant of the licensee and cannot be used in other licensee's plants without special authorization by the licensor. An expressed extension of the territorial validity of the production licence should be sought by the licensee if he intends to distribute the production based on the licensed technology among his various plants situated in his country or in other countries, as the case may be. It has already been noted that the same applies to industrial subcontracting. The licensee should also bear in mind that he cannot enter into an industrial co-operation agreement with a third party on production covered by the licensed technology without the consent of the licensor. It should therefore be recommended to the licensee that should he have previously concluded an industrial co-operation agreement with a third party he should record this fact in the licensing contract and obtain the extension of the licensing contract to his industrial co-operation agreement or agreements. He may also endeavour to insert into his licensing contract an advance authorization concerning any industrial co-operation agreement with third parties that he may conclude at a later stage.

Otherwise he will be obliged to seek the licensor's authorization each time he wishes to conclude an industrial co-operation agreement involving utilization of the licensed technology.

19. In licensing contracts, a production license is usually issued in connexion with a sales license whereas a sales license may exist independently. Since this study is concerned primarily with the problems raised by commercial transfer of technology, a discussion of separate sales licences is not relevant and is thus not included. Where a licensing contract covers both a production and a sales licence, the territorial validity of the two elements of the contract may be the same or it may differ. In the case of a licence granted to an enterprise from a developing country the most efficient solution might be to concentrate the production in one country and to grant to the licensee in that country sales licences for as many developing neighbouring countries as it would appear justified by the productivity or capacity and the licensee's plant facilities. A final decision on this point will have to be taken in each case after a careful consideration of the legal and factual situation including such elements as the licensor's own position on the markets concerned and the licences previously granted by him to other licensees.

20. Both production and sales licenses may or may not be exclusive. In conferring an exclusive licence, the licensor agrees not to grant a similar licence to others operating in the territory reserved to the licensee. On the other hand, the licensee agrees not to contract with other licensors for production and sales licences for competing products. However, there may be situations where both parties may find it mutually beneficial to allow the licensee to add complementary techniques to the technology obtained under the exclusive license and to distribute competing products if, for example, the licensee's production, supplemented as it may be by additional supplies of final products by the licensor, is not sufficient to cover all the requirements of the markets reserved to the licensee. The mere mention in the contract of the exclusive nature of the licence granted would therefore give enough clarification as to obligations imposed upon the licensor in this respect. The corresponding obligations of the licensee should, however, be specified in such a way that no confusion can arise in respect of limitations which derive, in so far as licensee's freedom of action is concerned, from the exclusive nature of the licence.

21. As regards developing countries it would seem advisable to grant exclusive production licences to enterprises from these countries in order to strengthen the productiveness of their growing industries. It may also be considered preferable to adopt the exclusive licence form for the sales licences granted in the country of production. As regards sales licences granted outside the country of production, the choice may be between exclusive sales licences for a restricted number of outside countries and non-exclusive sales licences for a large number of countries, perhaps on the regional or on a world-wide basis. A possible solution that has recently been adopted in some licensing contracts is to grant an exclusive production and sales licence for the country of the licensee, combined with a non-exclusive sales licence for the region - and sometimes for the area outside the region - where production takes place. Naturally, this solution can only be applied in countries in which the licensor has not already granted to another licensee an exclusive sales licence. Furthermore, the non-exclusive sales licence should contain a proviso according to which the licence will automatically be terminated in the region or area of concern when the licensor later grants an exclusive sales licence to another licensee in the territory. This solution may fit well into the framework of contractual licensing relations between enterprises of developed and those of developing countries provided that the contract include a proviso used in all cases of sales licensing contracts which states that the sales operation initiated prior to the termination of the non-exclusive licence may be completed by the former licensee, if necessary after the termination of his licence. Other formulas for concluding licensing agreements between a licensor from a developed and a licensee from a developing country could also be formulated. It may in particular prove to be rational - always from the same point of view of productiveness and profitability - to concede to an enterprise of a developing country an exclusive production licence in this country, completed by a series of exclusive sales licences covering a wide geographical area around the country of production, it being understood and expressly stipulated in the licensing contract that if, to foster the development of sales in various countries of the geographical area attributed to him, the licensee deems it advisable to grant in some of these countries sub-licences to local enterprises, he should be allowed to do so after having merely consulted with the licensor.

22. In introducing the idea of an exclusive licence into their licensing contracts, the parties should pay a maximum attention to the legislation which may exist in the countries concerned in respect of restrictive business practices. It is true that the industrialization process of many developing countries may induce the Governments of these countries to put more emphasis on establishing new and strengthening existing industries than on protecting free competition. However, the creation of regional common markets could operate in the opposite sense in prohibiting agreements which may hinder the free flow of goods between member countries of a common market. The precedent of the Grundig case decided upon by the Court of the European Economic Community may indicate the limits that should be imposed on exclusive licensing contracts in order to take into account the possibility of similar evolution of other regional markets. To this effect the exclusive sales licence should be construed so as to reserve to the exclusive licensee the rights of prospecting, publicity and marketing in the countries for which he has the exclusive sales licence without excluding the possibility of "parallel imports", i.e. direct purchases by a buyer outside the licensed country, from the licensor himself or from another of his licensees. However, as long as a country or a group of countries does not have legislation against exclusive licences having an absolute effect, nothing would prevent the parties to a licensing agreement from prohibiting any sale by the licensor or by another of his licensees on a market for which a sales licence has been granted to an exclusive licensee.

23. In view of the particular importance of the role which the definition of the territorial validity of the licensing contract plays in the relations between the licensor and the licensee, the respect of territorial limits set forth in the contract should be assured as strictly as possible. It is evident that if the licensor or some of his other licensees invades the territory attributed to an exclusive licensee, they diminish through their action the possible profits of the exclusive licensee and therefore owe him compensation. It is also clear that if a licensee, whether exclusive or not, acts beyond the territorial limits of his contract, he obtains a profit without rewarding the licensor and if he exercises his activities in a territory attributed to another exclusive licensee, he is encroaching on the profits of the latter.

In cases of repeated violation by one of the parties of territorial limits set forth in the contract, the other party may have reason to consider such an action on the part of his partner as a deliberate breach of an essential element of the licence, granted or received, justifying the cancellation of the contract by the injured party who, in addition to the right to cancel the contract, would have a valid claim for damages. Where the injured party would be the licensee, the damages provoked by the cancellation of the contract may be particularly important as the licensee could claim compensation for all his expenses and investments involved in building up an industrial undertaking on the basis of the licensed technology. The cancellation of the contract on the basis of territorial violations may therefore prove in practice not to be an appropriate remedy for the exclusive licensee. Furthermore, it may be difficult to assess the exact damages to be adjudicated in case of non-observance by one of the parties of the territorial limits set forth in the contract if the contract does not contain a guiding line to this effect. Since the basic damages which would result from the non-observance of contractual clauses related to territorial validity of the licence consist in a diminution of profits of the injured party, the most equitable solution may be to allocate to the injured party a compensation to be paid by the guilty party in the form of a given percentage of the total amount of sales carried out by the latter contrary to the contractual assignment of licensed territories. If such a solution is introduced into the contract, it may be considered that, provided the adopted percentage corresponds to the normal profit obtained by the injured party on his own sales, the damages suffered by the injured party are fully compensated. It would therefore be advisable to state in the contract that, besides the adjudication of a percentage on the total amount of unauthorized sales, no other indemnity or penalty will be due in case of non-observance of contractual clauses related to the territorial validity of the licence and that the parties renounce in particular their right to cancel the contract in such a case.

V. GUARANTEES TO BE GIVEN BY THE LICENSOR

24. One of the main goals of the licensee in acquiring a given technology from the licensor is to obtain as a consideration for the contractual price the benefits of the licensor's technical experience and advance. The licensee also expects that through use of the licensed technology he will be able to manufacture products of a good commercial quality at a reasonable cost and with good sales prospects. In the case of an exclusive licence, the competitiveness of the licensee may in all respects be strengthened. If patent rights are attached to the licence granted, the licensee also receives the important advantage of being protected against possible actions in infringement. The analysis of present contract practices in commercial transfer of technology shows that the contractual guarantees which the licensee normally gets under the contract are not always sufficient to ensure that he will actually achieve the results which he had hoped to obtain in concluding a licensing agreement.

Patented Technology

25. As regards patented technology, it should be stressed in the first place that the protection which a patent offers to its holder against actions in infringement is not an absolute one. Even in countries where a patent is registered after a preliminary examination, the validity of a patent may be contested either as defence on an infringement action entered by a patent holder or as a course of action in infringement directed against the holder. The holders of patents who are exposed to the danger of losing their patent rights as the result of actions in infringement would hardly be prepared to grant to their licensees a higher protection than that which they enjoy themselves. That is why in numerous licensing contracts the licensors expressly decline any liability as to the validity of patents for which they have granted a licence to the licensee. In particular, they refuse to indemnify the licensee for damages he may suffer if by reason of judicial nullification of a patent he is obliged to stop or essentially to modify his production. It would be difficult for licensors not to assist their licensees on actions in infringement directed against their licensees because of the use of a contested patent.

The licensors should bear all or part of the expenses involved in such an action as well as costs of damages which their licensees would have to pay to the successful claimant. A clause to this effect is often included in licensing contracts and the licensees have valid reasons to insist on the insertion of such a clause assigning to the licensor a maximum share of expenses, costs and possible damages to be paid to a third party. But even so the licensees may ask themselves whether the inclusion of patents in a licensing contract, without a more extended guarantee of the licensor, constitutes an actual addition to the technical value of the licence, justifying a special remuneration or an increase in the global price of the contract. The licensees should bear this in mind when discussing the price of the licence.

### Deliveries

26. The licensee's prime interest in contracting is technical value of the licence. Thus he should obtain from the licensor an adequate guarantee that the technology delivered corresponds to the conditions of contract. Such guarantees are linked on the one hand with timely delivery of all documentation, advices and technical assistance as stipulated in the contract and, on the other hand, with the results of the production to be undertaken by the licensee according to the licensed technology. Contracts usually specify an exact deadline for delivery so that licensors who failed to deliver on time the promised information or services are charged a contractual penalty calculated on either a daily, weekly or a monthly basis. As a result of the inclusion of these time limits in a contract, it is seldom a problem to assess the guilt of the licensor in not delivering on time. Furthermore, contractual penalty is normally due without the licensee being obliged to prove that the delay by the licensor has caused him any damage. To avoid difficulties in the performance of the contract and also possible conflicts of law, it would be useful to define in the contract the exact conditions under which contractual penalties may be applied and to state the rates of penalties. It is also usual to admit in licensing contracts that if the delay by the licensor exceeds a certain time-limit, the licensee is entitled to cancel the contract. However, it is debatable whether the licensee has in this case a right to claim further damages.



The licensee may of course be in a position to show that, prior to the cancellation of the contract on the basis of late delivery, he had made certain expenses and investments for the building of a plant designated to use the licensed technology. He may also be able to show that the licensor's delay postponed the execution of licensee's industrial projects beyond the time compensated by the contractual penalties. Although both parties may agree to the principle of indemnification of the licensee in cases of cancellation of the contract justified by the licensor's delayed delivery, it is in fact difficult to assess the actual damages suffered by the licensee. It is therefore suggested that the contract contain a stipulation fixing a lump-sum to be paid by the licensor, in addition to the contractual penalty charges, as recognition of the licensee's right to indemnification.

Performance guarantees

27. The problem of guarantees to be given by the licensor for the results to be achieved by using the licensed technology is a much more complicated one, particularly where the licensing contract is not issued in connexion with other contracts for industrial co-operation. As long as the licensor takes no other commitments than to deliver to the licensee technical information, documentation, description and design, he is in fact not in a position to guarantee that the parameters indicated by him in the contract as capable of being obtained by utilization of the licensed technology will actually be obtained in licensee's plants, the operation of which - in the case of a licensing contract not connected with other partial or global agreements on a more extensive industrial co-operation - the licensor has no means to control. It is true that in practically all licensing agreements the delivery of technical documentation and information is supplemented by various forms of technical assistance given by the licensor to the licensee such as sending licensor's specialists for a specified time to licensee's plants, exchanging data between the research and technical departments of the licensor and the licensee, training of licensee's personnel in licensor's plants. All these procedures of technical assistance are limited in time and do not allow the licensor to exercise a decisive and continuous influence on the manner in which the licensee's industrial undertakings are operating. The licensors are therefore generally reluctant to extend their guarantees and their liabilities beyond the limits of their possibilities of an effective control.

28. This situation is reflected in various provisions of licensing contracts defining and limiting licensor's guarantees and liabilities as regards the performances to be obtained by using the licensed technology. Many licensing contracts contain a standard clause according to which the licensor guarantees that if properly used the technical data supplied by him will permit the licensee to obtain performances stipulated in the contract. The limitation of licensor's liabilities on the basis of such a guarantee clause is sufficiently vague and general to give the licensor the possibility of invoking reasons to claim that the promised results have not been obtained by the licensee because the technical data supplied have not been properly used in the licensee's plants. The licensor may thus state and perhaps also show that the licensee has not followed the instructions given by the licensor that the productiveness of licensee's personnel is not up to normal productivity standards, that the raw materials used are not in conformity with the contractual provisions on this point, that the general set-up of licensee's industrial installations and premises is defective and so on. It may be possible to avoid the lack of clarity as regards the phrase "if properly used" by inserting in the contract a list of cases in which the licensor would be relieved from his guarantee because of shortcomings in the operations of the licensee's plant. But this solution may prove to be even more unfavourable to the licensee because it may make it easier for the licensor to get relief from his guarantee obligations in the cases expressly mentioned in the contract and it is very likely that the licensor in choosing this solution would insist on inserting in the contract a most extensive list of all possible shortcomings which may arise in licensee's undertakings. A performance guarantee given under such conditions is purely theoretical. It would therefore be in the interest of the certainty of the relations between the parties to replace it by another formula which would not lend itself to disputes and litigations.

29. If the parties agree to limit the licensor's performance guarantees and liabilities which derive from those guarantees only to supplies and services under the licensor's control, they should draft their contracts accordingly without trying to hide the actual solution behind the appearance of a more extended guarantee. Such outright solutions have been adopted in guarantee clauses of a number of recent licensing contracts in which the licensor guarantees that he will deliver to the licensee all the technical data which he, the licensor uses himself in his factory to achieve contractual performances and parameters.

The reality of this guarantee can be controlled by the licensee in two ways: first, prior to signing the licensing contract, the parties would examine together, possibly in the presence of experts appointed by the licensee, the industrial process of the licensor with a view to determining the technical data involved in this process and to drawing up a list of factors which would be annexed to the contract and would thus constitute the criteria for licensor's obligations with regard to performance guarantees given by him; second, if in using the licensed technology the licensee has difficulties in obtaining the promised results, he would be entitled to request the right to inspect the licensor's firm in order to verify whether the licensor has lived up to his agreement and has in fact delivered the complete technology necessary to achieve the results stipulated in the contract.

The first way of proceeding may at first sight appear preferable; it gives the licensee the possibility of acquainting himself in an amicable atmosphere prior to the conclusion of the contract with the details of the industrial process which he intends to acquire. Moreover, if in the course of the implementation of contract difficulties arise as to the completeness of the data supplied, the licensee can simply refer to the contractual list of promised data and assess whether the licensor has violated his agreement, without waiting for an on-site inspection as is the case in the second method.

Applicable to both methods is the provision that the licensee be given, at the time of concluding the licensing contract, authorization to visit the licensor's industrial premises and to observe the licensor's method of implementing the same technology. Thus, the licensee may have the benefit of the licensor's practical experience.

In practice, however, the first way of proceeding explained above may not always be possible as the licensor may not be willing to disclose to the licensee, before the conclusion of the contract, all the details of his techniques and processes most of which may be covered by industrial and commercial secrecy. In order to ensure secrecy during the negotiation of the licensing contract the parties could conclude a type of preliminary agreement whereby the potential licensee would agree not to use himself nor to disclose to any one the confidential information obtained in the course of the examination of licensor's industrial processes, if the licensing contract is not concluded.

Proven violations of such agreements would result in the potential licensee being forced, by terms contained in the preliminary agreement, to pay a penalty fee to the licensor. Proof of such violations is not, however, easy to establish and as a result licensors generally prefer the second solution since it does not involve the problem of protecting secrecy.

30. In the relations between enterprises of industrialized countries, the practice is usually to limit the licensor's contractual guarantees to the supply of data, designs, processes, instructions and know-how used by the licensor in his operations to achieve the same results specified in the contract, thus leaving to the licensee the risks of practical utilization of technology received. However, for an enterprise of a developing country the risk to the licensee is believed to be too great. A licensee from a developing country would need to get from the licensor not only a guarantee as to a complete supply of technical data necessary to achieve the envisaged results but also a true performance guarantee for the actual results of his production. The legal and sociological considerations stated above lead to the conclusion that under present circumstances it would hardly be possible for a licensee from a developing country to receive from a licensor from an industrialized country such an extended performance guarantee unless the licensor is associated in one or another way with the various activities of the licensee related to the industrial utilization of the licensed technology. That does not necessarily mean that, according to a complete "turn-key" formula, the licensor should be entrusted with construction engineering, supply of equipment and erection of licensee's plants in which the licensed technology will be used. But the licensor should have a decisive say on all these points as well as on the management of the plants if the licensee wants him to take over a legal responsibility for licensee's production based on the imported technology. It would therefore appear that for the time being separate licensing contracts, not inserted in a wider contractual framework, have little practical value in the relations between enterprises of developed and those of developing countries. The situation may change with the increasing industrialization of developing countries. However, for the present it is suggested that the licensor and the licensee conclude at the beginning of their co-operation an extensive network of agreements covering all elements of licensee's production process, each element being remunerated

either separately or on the basis of a global sum with the proviso that after expiry of a time-limit necessary to bring up the licensee's production to the desired level, the licensing contract remains alone in conditions similar to those which presently govern the licensing operations between enterprises of industrialized countries. It may be possible to find in this way the best compromise solution which would equally take into account the various interests, needs and possibilities of licensors from developed and licensees from developing countries.

### Indemnification

31. Whatever may be the extent of the guarantees given by the licensor for the intrinsic value of the licensed technology if the obligations of the licensor resulting from the guarantee are not fulfilled, the licensor becomes liable for damages suffered by the licensee because of the non-fulfilment by the licensor of his guarantee obligations. In cases where licensor's guarantee is limited to the supply of all technical data which he uses to obtain the results specified in the contract, the incomplete delivery by the licensor of the licensed technology as fixed by the contract is treated in the first place as a delay in delivery of the missing part, thus giving the licensee the right to claim indemnity for damages caused by the incompleteness of the information supplied. In effect, the licensee may have to change his industrial set-up or a part of the original equipment or add new equipment to correct errors which may have appeared in his original installation and organization of production owing to the erroneous or incomplete technical documentation and information supplied by the licensor. The expenses and defaults in licensee's production connected with such errors due to the non-fulfilment by the licensor of his obligations of guarantee for delivery of complete technology should in principle be compensated to the licensee by the licensor. If licensor's guarantee is extended so as to be a true performance guarantee, the mere fact of the non-obtainment of guaranteed parameters and performances, which is not attributable to the licensee, gives the licensee the right to claim indemnity either in the form of a proportional reduction of the contractual price or in the form of payment of all expenses necessary to bring the licensee's production to the contractual standards.

32. The indemnity payable to the licensee by the licensor as a result of non-fulfilment of contracted agreements is usually limited to a maximum amount fixed in the contract and calculated on the basis of the contractual price. In most cases, the upper limit of indemnity is constituted by a given percentage of the contractual price, the sum of this price being the absolute maximum. This solution has generally been adopted by enterprises of developed countries and is justified from the socio-economic point of view by the idea that industrial operations are concluded between two partners who are equally experts on the subject matter covered by the contract. They have to share the risk which is inherent in all industrial operations and to divide this risk the parties take into account the respective profits they may obtain from the operation. The profits of the licensor, as those of the supplier of engineering, equipment and other industrial services, derive from the contractual price. The contractual price or a part of this price is therefore taken as the upper limit of licensor's share in the risk of the operation i.e. the upper limit of indemnities the licensor may be obliged to pay for damages caused by him.

33. In the relations between licensors from industrialized and licensees from developing countries the technical equality which is the underlying sociological reason for the limitation of indemnities does not exist. The licensees from developing countries can hardly assume the risk involved in the limitation of licensor's liabilities in so far as the amount of indemnities is concerned. The difficulty for the licensee from a developing country to accept such a limitation is particularly evident in the case of separate licensing agreements since the licensor's remuneration would be rather insignificant in comparison with the amount of losses that the licensee may suffer in consequence of the non-fulfilment by the licensor of his obligations of guarantee for the industrial value of the licensed technology. It is easy to understand that in negotiating licensing contracts the licensees from developing countries strongly insist on the principle of full indemnification for all damages resulting from non-fulfilment by the licensor of his contractual obligations. But if licensors accept such a principle in their relations with licensees from developing countries, they would certainly include in their prices a security margin for the supplementary risk they would assume in this respect. That would mean a general price increase of licences granted to enterprises of developing countries which

would not necessarily correspond to an actual advantage for most licensees since the problem of indemnification beyond the contractual limits based on the remuneration of the supplier only arises in exceptional circumstances. Here again the most appropriate solution would probably be to connect the licensing contract with other agreements related to the construction and the operation of licensee's industry, thus increasing the maximum amount of indemnity that would then be based on the over-all remuneration of the licensor. It may also be considered to give the licensor an interest in the financial results of licensee's production in order to induce him to assume a more important share of the risk of the enterprise.

34. The limitation of the indemnity to be paid by the licensor in the case of non-fulfilment of his guaranteed obligations as regards the industrial value of the licensed technology has an effect on the use by the licensee of his right to cancel the contract. It is agreed that in the case of the non-fulfilment of such guaranteed obligations by the licensor the licensee has the right to cancel the contract if the licensor neither puts right in a reasonable time the technology supplied nor assists the licensee to remove the consequences of the licensor's default. But the licensee would certainly hesitate to take such a drastic measure, being aware of the strongly reduced amount of financial compensation he would be able to recover from the licensor. The cancellation of the contract would be of practical value to the licensee only if the licensor's default in respect of the technology supplied is so heavy that it could be considered by judges or arbitrators as gross negligence or even wilful misconduct, in which case all the contractual limitations of the liabilities of the licensor become null and void.

#### VI. REMUNERATION

35. At present, prices for licenses are established in principle on the basis of the volume of production or of sales derived from the licensed technology. If the price is expressed in the form of royalties, the remuneration of the licensor is directly assessed on the volume of production or of sales since, in accordance with the provisions on royalties, the licensee pays to the licensor a fixed rate of the cost or of the selling price of each unit produced or sold under the licensing agreement.

If the transfer of technology is rewarded by a lump-sum agreed between the parties to the licensing contract, the amount of the lump-sum is to a great extent determined on the basis of an estimated volume of production or of sales which the parties deem likely to be obtained by the utilization of the licensed technology. In some cases the remuneration of the licence comprises both a lump-sum and royalty payments. In such cases the lump-sum is designated mainly to compensate the cost and the value of the transferred technology, whereas the royalties constitute a reward for the advantages given to the licensee by the transfer of technology. It seems obvious that if the remuneration of the licence combines a lump-sum and royalty payments, the rate of royalties to be paid should be lower than in the case where the licence is remunerated by royalties alone.

#### Lump-sum and/or Royalty

36. From the point of view of the licensee, royalty payments may appear as a more convenient mode of remuneration of licensing contracts. It makes it possible to avoid the speculative element contained in the estimation of possible results of the licensed technology on which is based the fixing of a lump-sum to be paid for the transfer of technology. Especially for licensees from developing countries it would be dangerous to pay a lump-sum for a licence even if paid on the instalment basis, without being certain that the results obtained by using the licensed technology will actually correspond to the estimates on which the amount of the lump-sum was based. The combination of a lump-sum payment with subsequent royalty payment would certainly be easier to accept, provided that the lump-sum represents in this case exclusively the cost of the technical documentation supplied by the licensor and that, as suggested above, the rate of royalty payments is sufficiently reduced to take into account the prepayment of a lump-sum already made.

37. The application of the royalties system may, however, give rise to practical difficulties. As this system is based on actual figures of licensee's production or sales, the licensor must be granted extensive control possibilities over the figures indicated by the licensee. That presupposes in the first place that licensee's accountancy is organized and



kept in such a manner that it is possible to discover, item by item, at any moment the correct figures of his production and his sales. Furthermore, the licensor must have free access to the licensee's books as well as the right to verify them as often as he so desires, if necessary by an expert designated by him. To have an absolutely clear picture of the situation, the licensor will require in certain cases to supplement the verification of licensee's books by inspections in licensee's plants. The results of licensor's verifications and inspections may differ in the end from figures indicated by the licensee as to his volume of production and of sales under the licensing contract. If not amicably settled, the disagreement between the parties as to the actual figures on which the royalties should be assessed will then have to be submitted to an independent accountancy expert, chosen by common agreement between the parties, or to arbitration. All these practical difficulties as well as the risk of litigation should certainly be borne in mind by the parties when discussing the mode of remuneration to be adopted in their licensing agreements.

38. The application of the royalties system in the relations between licensors from developed and licensees from developing countries may encounter still an additional problem. In granting a licence for a payment of royalties the licensor expects that the licensee will use it in such a way that it will give sufficient results to produce important royalties. Included in some licensing contracts is a clause according to which the licensee undertakes to carry on to the best of his ability production based on the licensed technology. However, such a clause would not be precise enough to serve the intentions of the licensor since it would be difficult for the latter to establish in concrete cases that the licensee has not used the licensed technology to the best of his ability. This "best efforts" clause is therefore often completed by fixing a minimum royalty which the licensee would have to pay even if his production or his sales do not reach the level which would justify the payment of royalties equivalent to or exceeding the minimum royalty as fixed in the contract. The system of a minimum royalty is frequently applied in the relations between enterprises from developed countries. For reasons already stated with respect to the system of a lump-sum payment, it would seem that the fixing of a minimum royalty may prove to be too burdensome for licensees from developing countries.

If, in spite of the practical difficulties of controls and verifications the royalty system is adopted in licensing contracts between licensors from developed and licensees from developing countries, it would seem equitable to suggest that the contract do not include a minimum royalty.

39. In looking for a favourable solution for licensees from developing countries, mention is made again of the need to extend the over-all profit margin of the licensor by entrusting him with other supplies or services. A solution of this type is contained in some recent licensing contracts concluded between Yugoslav enterprises and foreign industrial firms. In addition to granting the licence, the foreign licensor provides the Yugoslav firm with machinery and equipment necessary for the production process based on the licensed technology, the licence itself being in this instance gratuitous. The licensee may nevertheless feel that the license is paid for by the high prices quoted for the equipment. He is, however, in a position to check the normal price of the equipment to be supplied by the licensor by collecting offers for similar equipment from other suppliers and comparing the prices quoted in such offers with the prices given by the licensor. If after enquiry the licensee finds that the prices given by the licensor are similar to those which the licensee can obtain from other suppliers or contain only a small additional profit margin which would have to be considered as a very reduced remuneration of the licence, the licensee would certainly have interest to accept this formula preferably to the classical mode of remuneration of licences. If the difference in the price of the equipment proposed by the licensor, as compared with the prices of other suppliers, appears to be important, the licensee will have to ask himself in each given case whether it would be more advantageous for him to acquire from the licensor a gratuitous licence and the necessary equipment at the higher price, or to pay the licence separately for the licence and purchase the equipment from the supplier who will grant him more attractive conditions of price and quality. It would seem useful to explore further the possibility of applying more generally the solution outlined in this paragraph to licensing contracts to be concluded between licensors from developed and licensees from developing countries.

40. Another way to possibly reduce the basic price of licences granted to licensees from developing countries would be to give to the licensor a financial interest in the results of licensee's production. In general this idea could be implemented in practice by various means: the starting rate of royalties could be fixed as low as possible although the licensor would in addition be entitled to a percentage on the licensee's profits produced by the utilization of the licensed technology; royalties could be assessed not on the value of production or sales but rather on the profits earned by the licensee through the utilization of the licensor's technology; and finally the licensor may be associated with the marketing of licensee's product, the share of the licensor in the end results being determined so as to represent the technical value of the licence and of licensor's contribution to the marketing operations. These and other similar methods should be explored by those involved with licensing arrangements.

41. In order to clarify the relations between the parties in respect of the remuneration of the licence, it would be necessary to detail in the contracts the supplies and services covered by the contractual price agreed upon by the parties to the licensing contract. In some contracts the price covers the licence itself and all the complementary services of technical assistance such as technical advice, seconding of licensor's personnel to licensee's factories, training of licensee's personnel in licensor's plants. The practical conditions of such technical assistance, its duration, the extent to which it will be granted, as well as the distribution between the parties of expenses involved in travel and of the respective personnel abroad should also be clearly indicated in the contract. It is obvious that where the technical assistance services are included in the global price of the licence, this price will be higher than in the case of separate invoicing of prices for different services. The licensees may therefore prefer to have a breakdown of prices for various items covered by the licence such as documentation, know-how, technical assistance in order to be able to better control and discuss the prices given by the licensor. It should be stressed that technical assistance plays a particularly important role in the framework of licensing contracts so that a special payment for services of technical assistance, in addition to the normal price of the licence may be considered as justified. This would entitle the licensee to put a maximum insistence

on the performance by the licensor of his obligations in this respect and even to request the contractual right to cancel the part of the contract related to technical assistance if the licensor does not correctly fulfil his obligations, the cancelling being supplemented by a special contractual penalty to be paid by the licensor.

42. The price of the licence may also be influenced by another element of licensing agreements, namely the use of trademarks. The licensor's authorization to permit use of his well-known trademark in the licensee's sale of products manufactured under the licensed technology would greatly strengthen the licensee's marketing position. In cases where the licensee is authorized to use the licensor's trademark without any qualification or restriction, it would be difficult to argue against the addition to the price for the licence of a special fee for the use of trademarks. In many cases, however, the licensor would hesitate to allow his trademark to be attached to a product, the quality of which he is not in a position to control. If the co-operation between the licensor and the licensee in licensee's production derived from the technology supplied by the licensor is sufficiently close and extended, the parties may create a common trademark distinct from licensor's own trademarks for similar products. In other cases the licensee, in using licensee's trademarks, may mention, if so agreed with the licensor, that the products so marked have been manufactured according to technology supplied by the licensor. A special fee for the use of trademarks does not seem justified in the case of common trademarks or in that of the licensee's trademark referring to the technology of the licensor.

#### Price Revisions

43. Once the parties have established the price for the licence and, as the case may be, for the connected services, they will still have to decide whether the agreed prices will remain unchanged during the lifetime of the licensing agreement or whether certain variations or adjustments of prices should be provided in the contract. As suggested in paragraph 12 above, it might be appropriate to base the remuneration of the licence on a degressive scale, taking into account general progress of industrial technology as it would affect the probability of a progressive diminution of

the technical value of the technology originally communicated to the licensee. As a counterpart or alternative solution to this suggestion the licensor may request that a general price-revision clause be inserted in the contract, stipulating that the prices as defined by the contract will be subject to revision proportional to the variations of certain factors which may decisively change the conditions of implementation of the licensing contract. Among the factors should be included the general price indices in the industrial branch to which the licensing contract relates and the currency variations in which the contractual payments have to be made.

44. A price-revision clause based on general industrial indices is very frequent in contracts related to the supply of plant machinery and equipment. It is justified by the necessity to protect the supplier against a possible increase in the prices of materials and labour needed for production, and to protect the purchaser against an unjustified profit which the supplier would obtain in the case of general decline in industrial prices. This consideration does not apply to licensing contracts since after the conclusion of the contract the licensor normally has no new expenses related to the licensed technology, with the possible exception of the cost of labour needed in the performance of his technical assistance obligations and the cost of improvements added to the original technology, the latter being done primarily in the interest of the licensor and giving only an indirect advantage to the licensee by way of the contractual clause relating to improvements. It seems therefore that there is no valid reason for introducing into licensing contracts the principle of revision of contractual prices in the case of variations of general industrial indices, even though the parties may adopt the solution suggested above as to the fixing of the price of the licence on the basis of a degressive scale.

#### Currency clauses

45. The problem of possible variations of the value of the currency in which the contractual payments have to be made is much more delicate. The definition of the contractual currency itself may already create serious difficulties to the parties. The licensor will certainly tend to obtain payment in his own currency or in some other hard currency.

The licensee from a developing country will probably have some difficulty to respond favourably to such a request, unless the creation and the development of his industry is financed by an international or a foreign, public or private, financial institution. Otherwise the licensee will be obliged to request authorization from his Government to conclude the licensing agreement in a foreign currency and to make the necessary transfers; however, in many cases such authorization is refused. One possible solution may be to have the licensor and the licensee agree to the association of the licensor with the marketing of licensee's products, the results of such an association being used to assure the payment of the licence in whole or in part. As previously suggested, the parties may make arrangements to sell in common on third markets the products manufactured by the licensee according to the technology supplied by the licensor. The share attributed to the licensor in the proceeds of such sales would then be ascribed to the payment of the licence. Another possible solution may be to repay the price of the licence by the delivery to the licensor of certain products of the licensee and at prices fixed in the contract, subject, of course, to quality conditions. In both these proposed solutions, it would seem that the problem of currency is not serious. In the case of common sales on third markets, the share attributed to the licensor constitutes his reward for granting the licence and, according to the nature of the operation, the licensor would have to assume his share of inherent risks. As regards reimbursement of the price of the licence by products delivered by the licensee, the prices of the licence and of the products to be delivered would be fixed in the same currency so that the variations of this currency would not change the original relationship between the price of the licence and the price of the products to be delivered by the licensee. Thus, the variations of the contractual currency appear to be of importance only if the payment of the licence is to be made in money and then only if the contractual currency is that of the country of the licensee. In cases where payments should be made in the currency of the country of the licensor or in another currency requested by him, the licensor should bear all the consequences of his currency requests including the devaluation of the contractual currency. As regards the currency of the country of the licensee, if the licensor accepts to be paid in this currency, he may and probably will request an appropriate exchange guarantee. However, although the licensee is willing to take on himself the corresponding risk,

he may be prevented from doing so by the monetary regulations of his country which may prohibit the insertion of gold or similar clauses in contracts concluded by nationals of the country concerned, even on matters linked with international trade.

#### VII. IMPROVEMENTS

46. The clause on improvements is among the most important provisions of the contract. If drawn up in an appropriate manner, it may give to the licensees from developing countries access to more modern techniques; it may also lead to technical co-operation between enterprises of developed and those of developing countries. In present contract practices for trade of licences, the improvements clause is often determined mainly by the idea that the licensor, in his quality as author of the basic technology, has a right to all improvements made by the licensee. On the other hand, should the licensor be obliged to communicate to the licensee improvements to the original technology made subsequent to their agreement, he may do so under certain conditions and against payment of an additional price. This general idea is particularly stressed in provisions related to patenting of improvements and to improvements radically altering the original technology.

47. The general principle embodied in all contractual clauses on improvements is that the parties have to communicate reciprocally all improvements of the licensed technology that they were able to achieve themselves. This principle is sometimes extended to improvements obtained from third parties provided that such improvements are communicated with the consent of the third party. Thus, in acquiring a licence from a third party for techniques that may be considered as an improvement to the original technology granted or acquired under a licensing contract, both the licensor and the licensee should make all possible efforts to obtain from the third party the authorization to communicate the improvements to their licensor or licensees, as the case may be. Regardless of whether the improvement has been achieved by the licensor or by the licensee, after communication of the improvement the licensor has the option to patent the improvement himself or to leave to the licensee the right to patent it. Normally, if the licensor does not think it useful or necessary to patent an improvement, the licensee is given contractually only the right to patent the improvements made by him.

It appears that the respective situations of the licensor and of the licensee are undoubtedly out of balance: the licensor has the possibility of getting the better part of both improvements made by himself and those made by his licensee; the licensee has the right only to patent all or part of his own improvements which the licensor does not think worth-while to be patented. It may be said that the problem is not as important as it may appear since it is customary between the licensor and the licensee to grant reciprocally, on the basis of improvements to the original technology, a gratuitous licence on patents taken out by either party in the course of implementing the licensing contract. In fact the ownership of a patent may mean for the licensees, especially those from developing countries who lack a quantity of patents, a strengthening of their bargaining positions in the world market. It may also encourage them to develop their indigenous research activities. It is therefore suggested that another solution for patenting improvements be introduced into licensing contracts between enterprises of developed and those of developing countries. According to a formula already adopted in some licensing contracts concluded between enterprises of industrialized countries, the licensor is entitled to patent improvements made by him while the licensee is entitled to those of which he is the author. Should the party entitled to the first right of patenting improvements not make use of it, the right is then transferred to the second party. The principle of a gratuitous licence to be given to the partner on a patent taken out under the above mentioned conditions would remain in the solution suggested in this paragraph.

48. Important for licensees from developing countries is the clarification of the boundary line which separates the improvements of the licensed technology from the absolutely new techniques related to the production covered by the licensing contract. As already stated, the licensees from developing countries may be inclined to start their production with classical techniques and to modernize it as they grow in technical skill. For this purpose they need continuous assistance from the licensor as well as communication not only of routine improvements but also of all technical innovations which may have developed in the field of the industrial processes concerned. While the licensors may, according to customary practice, agree to communicate gratuitously to the licensees the improvements which are closely related to the original technology, they would probably not be prepared to disclose



absolutely new techniques without an additional remuneration or even a new licensing contract. The dividing line between the two types of "improvements" is very difficult to draw and will have to be thoroughly discussed by all parties as will the amount of the additional remuneration which the licensor may claim. Since such discussions would probably raise difficult legal and technical questions, it would probably be beneficial to the licensees to request the assistance of an independent expert, possibly supplied by one of the United Nations agencies working in the field of technical assistance. To restate a suggestion already made in this study, a closer association of the licensor with the results of the licensee's production, especially in the form of marketing arrangements on third markets, may induce the licensor to let the licensee gratuitously benefit from all improvements, including revolutionary innovations, to the licensed techniques in order to enable the licensee to produce a maximum profit in which the licensor would have a share. This may be the most advantageous solution equally from the point of view of the licensee.

#### VIII. SECRECY

49. It has been stated in respect of negotiations preliminary to the conclusion of licensing contracts that the secrecy of the technology communicated by the licensor is an important element of the operation (see paragraph 29). When the contract is concluded this element of secrecy remains. Under the terms of practically all licensing contracts the licensee is bound not to communicate to anybody, without the authorization of the licensor, information received within the framework of the contract. Violation of this obligation to secrecy gives the licensor the right to claim from the licensee an indemnity or a contractual penalty since the licensor's actual damages may in this case be difficult to assess. In other contracts the licensors reserve the right to cancel the contract if the licensee does not observe his obligations as to the secrecy of the process disclosed to him under the licensing contract.

50. If, however, the secrecy is considered to be such an essential element of the contract that its violation by the licensee justifies the cancellation of the contract by the licensor, the licensee should be given as a counterpart the right to cancel the contract and to stop his payments or at least to reduce the price of the contract, in the case where the licensed technology becomes publically known and ceases to have a character of secrecy.

In view of the difficulties which the licensor may have in proving that the licensee has violated his obligations and which the licensee may have in establishing that the licensed technology has lost its character of secrecy and has become commonly known, it could be suggested that both parties do not put too much emphasis on the character of secrecy of a licensed technology. The cancellation of the contract is generally a disproportionate measure in comparison with the actual consequences of a possible violation of secrecy obligations in a licensing contract. To enforce this principle it may be sufficient to stipulate in the contract that, in the case where it is established with certainty that the licensee has communicated to unauthorized third persons the confidential information given him by the licensor, the licensee will be liable to a contractual penalty. As an alternative to this solution which confirms and assures the practical enforcement of the principle of secrecy of the licensed technology, the licensee should be given the right to claim a reduction of the contractual price for a licence that became commonly known and has therefore lost one of its original elements considered important by the licensee.

#### IX. SETTLEMENT OF DISPUTES

51. The foregoing analysis of substantive clauses of licensing contracts has shown that many of the disputes that may arise between licensors and licensees concern specific questions, such as the verification of licensee's accountancy, the technical value of the licensed technology, the quality of licensee's products which may be used as total or partial payment of the licence, the definition of new techniques as opposed to improvements. If submitted to classical procedures of arbitration, disputes of this kind would require the intervention of specialized experts. To speed up the procedures and to avoid unnecessary delays and duplication of subsequent decisions, it may be thought preferable to exclude from the general jurisdiction clause disputes concerned mainly with purely technical problems and to entrust their solution to impartial experts, chosen by common agreement between the parties. If, however, the parties do not agree on the designation of an expert or on a chairman for a tripartite expert committee, the parties may decide that such an expert or chairman be designated by a recognized international, public or private, organization having special knowledge of problems on which expertise is required.

The choice of impartial and competent experts may in practice prove to be difficult. But if the parties to a licensing contract succeed in reaching agreement on the designation of an expert acceptable to both, the technical difficulties that may arise in the course of the performance of their contract would be settled in a more rapid and suitable manner, provided the decisions of the experts, like those of arbitrators, are considered as final and binding.

52. For the settlement of other than purely technical disputes (which in practice may prove to be of lesser importance) the parties have the choice between judicial and arbitral tribunals. In the field of international trade, preference is normally given to arbitration procedures, especially since the recourse to arbitration under the auspices of an international arbitral institution avoids the difficult problem of conflict of jurisdictions between the national tribunals of the two parties concerned. It is true that the parties may have some difficulties in agreeing on the arbitration procedures, and in particular on the procedures for designation of the arbitrators and of the umpires, which they will have to adopt in the contract for the settlement of their disputes. They may be able to solve this problem by referring their disputes to one of the arbitral institutions active in the field of international trade which will offer to both parties sufficient guarantees of efficiency, experience and impartiality.

#### X. APPLICABLE LAW


53. As in the case of all international contracts, the problem of what legislation should be applicable to the particular situation is heatedly discussed by the parties in the course of the negotiation of a licensing contract, each party strongly insisting on the application of its national law. The importance that the parties attribute to this problem may, however, be considered as greatly exaggerated. If the contract is complete enough to cover the whole set of contractual relations between the parties, there will be practically no need for a recourse to a given national law in so far as private law relations between the parties are concerned. Under the influence of classical legal theories the parties and their lawyers nevertheless feel it indispensable to submit their contract to a given national law.

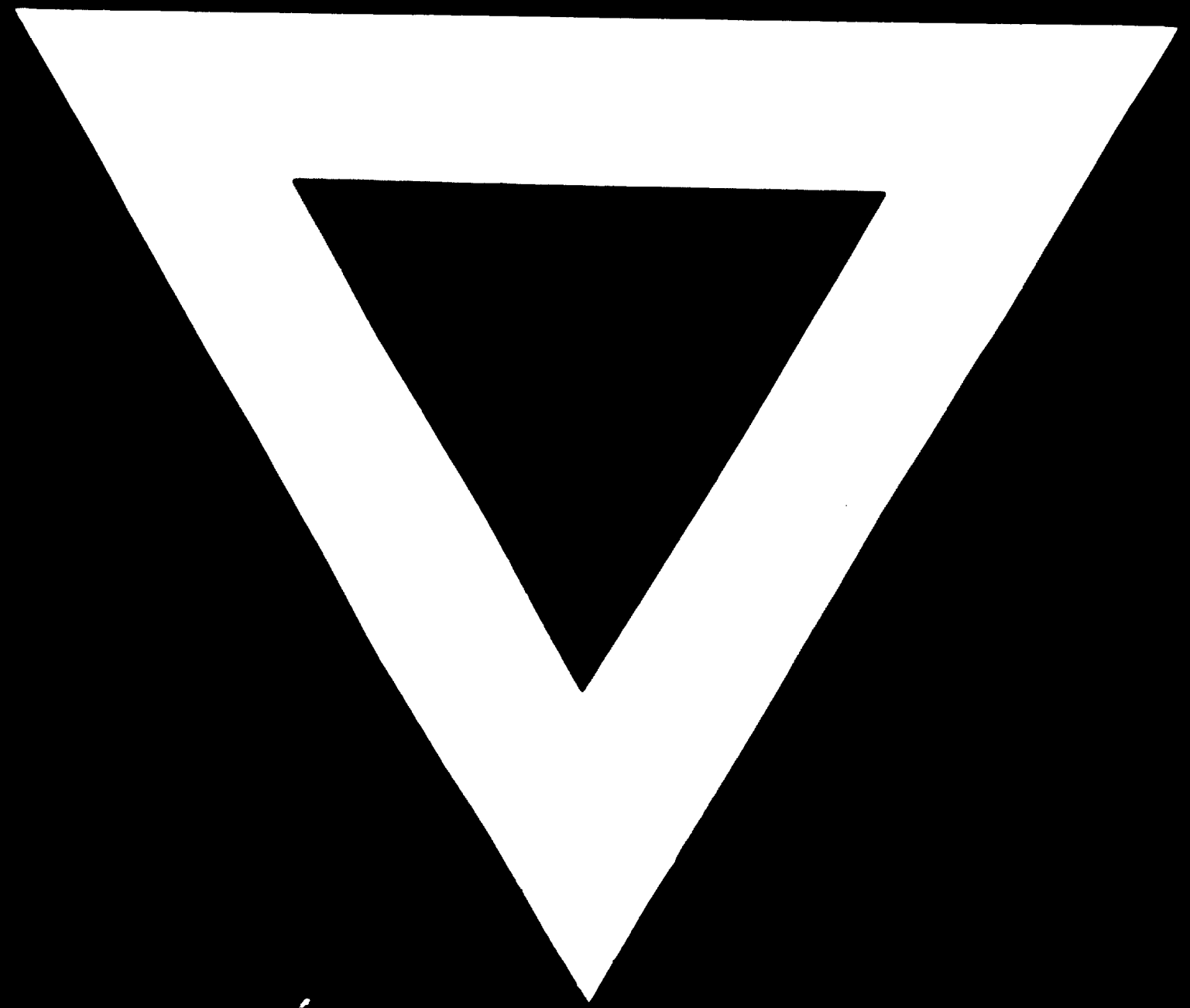
In such cases it may be suggested that, since the licensing contract produces its main effects in the country of the licensee, the law of this country be considered as the "proper law" of the contract and that the application, the construction and, if necessary, the filling of the gaps of the licensing contract be subject to the law of the country of the licensee.

54. This solution would be valid only for private law relations between the licensor and the licensee. In so far as there exist imperative public-law regulations in the countries of the parties concerned, each party will have to comply with such regulations in force in his country. It has already been shown that such is the case in respect of regulations concerning restrictive business practices, transfer of currency, exchange guarantees and, in a more general way, authorization to conclude licensing contracts which the licensees and sometimes both the licensees and the licensors have to obtain from their national authorities. The progress of industrialization of developing countries would require that such authorizations be granted very liberally; but that is a problem for Governments, the enterprises concerned being able only to present their case in the best possible way. It is also up to the Governments to solve the difficulties which may arise from conflicting fiscal requirements of the country of the licensor and of that of the licensee. In international relations the remuneration of the licence is not materially attached to a given country. Remuneration is therefore often taxed twice: in the country of the licensor as a profit accrued to a national of this country as consequence of an export operation, and in the country of the licensee as reward for services rendered in this country. To avoid such double taxation, fiscal conventions concluded between a number of developed countries grant the exclusive taxation power to the country of the beneficiary of the remuneration of licences i.e. to the country of the licensor. In most developing countries, however, the licensor is taxed in spite of the fact that he is also taxed in his own country. This situation leads to an increase in the price of the licences granted to enterprises from developing countries because the licensors either include the additional taxation into their price or contractually put on the licensee the burden of the taxes to be paid in the country of the licensee, in countries where such a shifting of taxation is not prohibited by law.

55. The excessive taxation that has a clearly negative effect on the cost of licences granted to enterprises of developing countries might be diminished if the parties choose to adopt, for the transfer of technology to developing countries, not the classical form of a separate licensing contract but one of the formulas which have been envisaged above and may include: a gratuitous licence connected with the supply of equipment, in which case the licensor will normally not be taxed in the developing country; or a joint venture of the licensor and the licensee for marketing and even possibly for manufacturing the products of the licensee, which would eliminate the taxation of the licensor in his own country. In order to permit the parties to freely choose the legal form which would best suit their contractual relations without them being obliged to take essentially, if not exclusively, into account the fiscal considerations, it would certainly be a more satisfactory solution to introduce double taxation conventions in the relations between developed and developing countries. It would, however, be difficult to base the double taxation conventions between developed and developing countries on the principle of exclusive taxation of the remuneration for licences only in the country of the receiver of the remuneration. That would diminish the fiscal resources of countries where such resources are the most needed. It may perhaps be suggested that, in the relations between developed and developing countries, the remuneration of licences be taxed only in the country of the licensee. Even if such a solution is considered not in conformity with principles of modern taxation law, the exception to be made in this respect in favour of developing countries would certainly facilitate the conclusion of licensing contracts between enterprises of developed and those of developing countries and, in this way, forcefully contribute to the transfer of technology to developing countries and to the progress of their industrialization.

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