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CONTRACT PRACTICES IN COMMERCIAL  
TRANSFER OF TECHNOLOGY FROM ENTERPRISES OF  
DEVELOPED TO THOSE OF DEVELOPING COUNTRIES 1/

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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 at 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 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, in a market where objective prices are difficult to determine because of the widespread "imperfections" of market for technology, 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 still too often 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 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 that happens to be a licensee in one particular commercial operation may be a licensor in others. This sort of automatic correction does not exist in relations between 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.

through negotiations. Such an adjustment of present contract practices is also of utmost importance, since the transfer of technology is essential for a rapid industrialization of developing countries. Furthermore, the financial, commercial and technical positions of the two prospective parties are unequal. It is true that the strength of the bargaining position of the licensor may be limited by regulations concerning granting compulsory licenses for patents, restrictive business practices and other legal restrictions. The parties may also try to avoid the most striking adverse effects of the present situation as described above by exercising particular care in the conduct of the negotiations preceding the conclusion of a licensing contract, both parties having an equal interest in ascertaining before the conclusion of the contract that the technology to be contracted is the most suitable for the licensee's needs and that the licensee is in a position to make the best use of it.

3. For the reasons stated above, various problems related to the drawing up of licensing contracts for commercial transfer of technology have 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 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 that 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. DECISIONS REGARDING THE TECHNOLOGY TO BE LICENSED

4. The decisions regarding the technology to be chosen 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 to them at a high price outdated techniques for which developed countries have themselves no further use. 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.

5. The practical efficiency of such a clause is rather doubtful, since 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 higher 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. Moreover, the decisions regarding the selection of a particular technology need to be guided not only by the present resource-base of the developing country concerned, but also by the requirements of the future development of its resources as well as its technological capabilities. It may therefore be suggested that even an enterprise of a developing country that initially chooses a well-proved classical industrial process stipulates 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.

6. Another problem of choice of techniques may arise with regard to patented and unpatented industrial processes. Patented techniques are normally ascribed a higher value and, accordingly, a higher price than unpatented techniques. A patent generally confers a stronger protection against infringers and a somewhat better defensive position against actions for infringement brought up by third parties; in case of unpatented technology, similar results can be obtained only if the applicable law protects the know-how - which in most cases depends on the condition that it has been kept secret - and if the licensor is willing to accept a guarantee clause against actions brought up by third parties, for instance, if he states that, to the best of his knowledge, the techniques that he has transferred to the licensee cannot be legally disputed by a third party and if he commits himself to assist the licensee on any action in infringement brought up by a third party against the licensee. However, 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 scrutinize such lists of patents carefully 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. Furthermore, 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.

7. Even before starting to negotiate the actual terms of a licensing contract, the potential licensee, after having thoroughly prospected all possible markets for the technology he needs, will have to decide which are the most appropriate techniques to be acquired. This is often a difficult problem for a potential licensee and, for this purpose, he may wish to 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 potential licensors. 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. Another procedure that has been followed in certain cases could therefore be envisaged. The potential licensee would draw up a questionnaire defining the types of production he desires to undertake and send it to potential licensors. If need be, the potential licensors would return to the potential licensee another questionnaire designated to ascertain more precisely the actual needs of the licensee and the terms of a possible contract. If the licensee and one of the licensors come to a final agreement, the exchange of their preceding correspondence based on the questionnaire and the replies may be of use in interpreting the contract, especially with regard to performance guarantees. In this connexion, it will be extremely valuable to the developing countries if the various organizations within the United Nations system and other bodies concerned were to organize international consultancy services to help choose the most appropriate technology, to assist the developing countries at the pre-negotiation stage and to help them to finalize the legal details of the contract.

8. In addition to making a preliminary decision on the techniques to be acquired, possibly in consultation with an outside expert, 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, under which the licensee, starting from techniques he has acquired, undertakes to secure independently his own production and marketing strategy for his own products. Some of the developing countries with advanced national technological capabilities may be able to follow this practice. But enterprises in many other developing countries 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 incorporation may, however, increase the global cost of the operation and put some restraints on the independence of the licensee. The situation, therefore, must be reviewed from all possible points of view, and the advantages and disadvantages of each solution must be carefully studied, preferably with the help of international consultancy services, as mentioned above, so that the enterprises concerned may be aware of all factors that influence their decisions.

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

9. 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 trade marks and the like. All such questions should be treated by the parties with special care. In so far as the licensor's technical assistance and training of licensee's personnel are concerned, the parties should determine, in particular, the frequency and duration of the assistance and training operations, the places to which access should be given, the division of cost, the repatriation of income earned as salaries, the responsibility for travelling and living expenses, the liability for accidents etc. But 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 aspects of these 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. The situation appears to be entirely different when the transfer of technology is only one of the various elements of a large-scale operation designed 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 necessary technologies themselves under separate licensing agreements 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 who will be responsible for supplies and services required for the construction and possibly for the operation of an industrial plant.

10. There are several advantages to a developing country if it can obtain, as the developed countries generally do, the necessary technologies under separate licensing agreements. In this case, it should be able to reduce over-all costs, develop national technological capabilities, make the most rational use of its own natural resources and keep an over-all control over its industry. Quite clearly, this applies to only those developing countries that have already demonstrated the capability of undertaking industrial projects.

11. There may be certain advantages to an enterprise of a developing country in engaging a general contractor within the framework of a so-called "turn-key" contract, since the contractor will have to assume responsibility for the choice of technology and appropriate equipment. Moreover, if the contract does not contain a provision to the contrary, the contractor will be responsible for obtaining the results of the industrial project implemented by him without the client's 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 then 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.

12. The transfer of liabilities from client to general contractor would involve for an enterprise of a developing country a substantial increase in the global cost of the operation. In such a case, the general contractor will be able to determine the prices of his services and supplies, including supplies of intermediate products. For example, in buying from a third party the necessary equipment that 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. There may 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, the contractor's liability should be borne in mind, and he should be allowed a reasonable surplus charge for his margin of security.

13. The justification for a margin of security can hardly be disputed. Even if the licensee assumes 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 when a "turn-key" contract is supplemented 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 whether the contractor's prices are reasonable. In practice, an enterprise of a developing country would be well-advised to invite a proposed general contractor to submit his offer with a breakdown 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 that the enterprise could obtain in concluding separate contracts for various supplies and services necessary for 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. It is clear that in making this decision, the developing country will have to weigh the technical security it may gain against a possible increase in cost and relative diminution of its economic independence.

### III. DURATION OF LICENSING AGREEMENTS

14. As the licensing contracts are normally subject to governmental authorisation, they cannot validly enter into force before all the necessary approvals and authorisations have been obtained. The effective date of a licensing contract signed by the parties shall therefore be the day on which the last of the required approvals or authorizations have been granted.

15. The licensing agreements for transfer of technology are normally concluded for a period corresponding to the expected value 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 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 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 that would take into account the actual value of the licensed technique at the moment when the new agreement is concluded. 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 declining 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.

16. 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. Since certain parts of the contract will be terminated before the normal expiration of the licensing agreement, it is 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 contract, the provisions relating to the transfer of technology will remain in force until the end of their fixed term. It should, however, be borne in mind that certain links may exist between the different parts of the contract so that their respective duration periods should be harmonized.

17. In many licensing contracts the licensors include a clause according to which, after the expiration of the period of duration as fixed in the licensing contract, the licensee is not allowed to utilize the technology that has been transferred to him by virtue of the contract. This prohibition is sometimes even extended to techniques derived by the licensee himself from the licensed technology. In certain contracts, the licensors request that, after the expiration of the contract, the licensee return to them all the documentation, including models, drawings and designs that were supplied to the licensee within the framework of the original contract. However, the strict application

of such clauses may not be considered as valid in a number of legal systems in so far as non-protected technology is concerned. In many cases such clauses would be harmful to the interests of the licensee, especially where, to undertake an industrial project based on technology obtained from the licensor, the licensee is obliged to make important investments and to secure a market for his products. Thus, it would be unrealistic to ask the licensee after the 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 at a reduced price. 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 and the new time limits in the situation envisaged here.

#### IV. PREMATURE TERMINATION OF THE CONTRACT

18. In addition to the normal termination of a contract by the expiry of the period fixed for its duration, a licensing contract may also be terminated by agreement between both parties or by the decision of one of the parties if such a unilateral cancellation of the contract is supported by 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 committed a breach of the contract. However, this principle 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 licensees, particularly of those from developing countries.

19. The licensee's right to cancel the contract may be envisaged inter alia in the following cases:

- a) Default in supply of technical data (see para. 48);
- b) Non-fulfilment of performance guarantees (see para. 48);
- c) Insufficient technical assistance (see para. 48 and 57);
- d) Violation by the licensor of clauses concerning the territorial validity of the contract (see para. 31);
- e) Violation by the licensor of clauses concerning improvements (see para. 24);
- f) Changes in the structure of licensor's enterprise (see para. 24);
- g) Disappearance of the element of secrecy or invalidity of a patent (see para. 70).

20. The cases in which the licensor may have the right to cancel the contract according to present contract practices, can be inter alia as follows:

- a) Delay or default of payment (see para. 63 and 64);
- b) Changes in the structure of the licensee's enterprise (see para. 22 and 23) or unauthorized transfer of licences or sub-contracting (see para. 25);
- c) Non-respect by the licensee of territorial limitations (see para. 31);
- d) Violation by the licensee of the obligation to secrecy (see para. 70).

21. The conditions under which the licensee or the licensor, as the case may be, would have the right to cancel the contract as well as the financial consequences of such a cancellation are discussed below under the various paragraphs related to the specific obligations of the parties the violation of which may allow the other party to cancel the contract. It will suffice to mention here that in certain cases the faulty party will have to compensate the other party for damages suffered and proved and that normally the right to cancel the contract should only be given to this other party if after having received a notice to this effect, the faulty party does not fulfil its obligations under the contract in a reasonable time. It should also be noticed that, unlike the situation considered above in paragraph 17 for the case of normal expiry of licensing contracts, a licensing contract validly terminated by the licensor in case of violation by the licensee of one of his contractual obligations, allows the licensor to request the licensee to return forthwith all documentation,

information, drawings, designs and models supplied to him under the contract, and to refrain from making further use of the information that was the subject matter of the licensing contract, unless the laws applicable to the contract do not permit the licensor to prevent the licensee from making use of non-protected technology.

V. CHANGES IN THE STRUCTURE OF LICENSEES' OR LICENSERS' ENTERPRISES, TRANSFER OF LICENCES OR SUBCONTRACTING BY LICENSEES

22. Owing to the personal character of licensing contracts concluded between two parties who have confidence one in another, in cases involving the transfer of licensee's enterprise as a whole to a third party - bankruptcy, sale of business, assignment of assets to another enterprise and the like - it would seem natural to give the licensor the right to cancel the contract. The cancellation of the licensing contract by the licensor would not seem to give rise in this case to any damages to be paid by the licensee to the licensor: the transfer of technology does not represent for the licensor additional costs, the technology having been "amortized" in most cases 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.

23. The licensor may agree to list as part of transferable assets the licensing contract for the remaining period of duration and under the same conditions. In many contracts, however, the licensor retains the right to cancel the contract at the time of the transfer. The problem can also arise in cases of partial transfer of licensee's enterprise. Furthermore, most of the licensing contracts contain a clause stating that the right to cancel the contract is granted to the licensor when changes in the structure of the licensee's enterprise have 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 the 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 discretion.

24. The personal character of licensing contracts, 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. If the licensing contract consists only in transfer of technical documents and information, having received initially these 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. If, however, technical assistance and improvements are also involved, the changes in the structures of the licensor's enterprise may be of importance to the licensee and the licensee should have the right to cancel the contract if he deems it advisable.

25. The problem of cancellation of the contract may also arise in respect of transfer of licence or subcontracting by the licensee without changes in the structure of his enterprise. 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 the express authorization of 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. The parties could also adopt the clause proposed in ORGALIFE's (Liaison Organisation of European Metalworking Industries) Model Form of Patent Licence Agreement (clause 1.III) according to which "the authorization of the licensor shall not be unreasonably withheld", in extending it to both patented and unpatented technology and to subcontracting. The question should be in any case clearly settled in the contract in order to avoid possible uncertainties as to the legal effect of an unauthorized transfer or subcontracting. A contractually



prohibited transfer of licence or sub-contracting would be considered 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 in paragraph 22 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. It should also be borne in mind that prohibited transfer of licences or sub-contracting may involve unauthorized disclosure by the licensee of confidential information to third parties and that the solutions envisaged in paragraphs 69 and 70 below with regard to the breach of the obligation to secrecy may also be applicable in the case of prohibited transfer of licences or subcontracting by the licensee.

#### VI. TERRITORIAL VALIDITY

26. A production licence is in most cases limited to the country where the licensee's plant is located. A formal 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. 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.

27. In licensing contracts, a production licence is usually issued in connexion with a sales licence, whereas a sales licence 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. When 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 may be to concentrate production in one country and to grant to the licensee in that country sales licences for as many developing neighbouring countries as would appear justified by the productivity or capacity and the licensee's plant facilities. Such a solution would be particularly commendable if a regional common market should be formed. 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 licenses previously granted by him to other licensees.

28. Both production and sales licences may or may not be exclusive. In conferring an exclusive licence, the licensor undertakes not to operate directly or indirectly in the reserved territory, not to grant in this territory a similar licence to anybody else and to instruct his licensees in other territories, if any, not to operate directly or indirectly in the territory reserved to the licensee. On the other hand, in certain cases the licensee agrees not to contract with other licensors for production and sales licences for competing products, although such a clause may not be valid under legislation relating to restrictive business practices. There may also be situations in which both parties may find it mutually beneficial to allow the licensee to add complementary techniques to the technology obtained under the exclusive licence 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, and that such limitations conform with the applicable laws on restrictive business practices.

29. As regards developing countries, it would seem advisable to grant exclusive production licences to enterprises of 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 a 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 be applied only in countries in which the licensor has not already granted to another licensee an exclusive sales licence. Furthermore, the non-exclusive sales licence granted for many countries, situated even outside the region, may 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 includes 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 can 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.

30. In introducing the idea of an exclusive licensee into their licensing contracts, the parties should pay the utmost attention to the legislation that

may exist in the countries concerned in respect of restrictive business practices. It is true that the industrialization process in 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 may operate in the opposite sense in prohibiting agreements that may hinder the free flow of goods between member countries of a common market. 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.

31. In view of the particular importance of the role that 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 operate in 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.

32. In cases of repeated violation by one of the parties of the 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. When the injured party is the licensee, the damages provoked by the cancellation of the contract may be particularly important, as the licensee can 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 that 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 of the total amount of unauthorized sales, no other indemnity or penalty will be due in case of non-observance of contractual clauses relating to the territorial validity of the licence and that the parties renounce in particular their right to cancel the contract.

#### V11. GUARANTEES TO BE GIVEN BY THE LICENSER

33. One of the main goals of the licensee in acquiring a given technology from the licensor is to obtain 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 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 infringement by third parties and possible actions in infringement brought against him. The analysis of present contract practices in commercial transfer of technology shows that the contractual guarantees which the licensee normally obtains under the contract are not always sufficient to ensure that he will actually achieve the results he had hoped to obtain in concluding a licensing agreement.

### Patented Technology

34. The protection a patent offers to its holder is not an absolute one. Even in countries where a patent is granted 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.

35. The licensors should bear all or part of the expenses involved in such an action as well as the costs of damages that 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, increases the technical value of the licence that would justify a special remuneration or rise in the global price of the contract. The licensees should bear this in mind when discussing the price of the licence, taking, however, also into account that a patent granted in the country of the licensee may strengthen his position on the market. If, in fixing the price of the licence, the value of the patent is taken into consideration, in case the patent is no longer valid, the price should be revised.

### Timely delivery of the licensed technology

36. The licensee's prime interest in contracting is the technical value of the licence. Thus he should obtain from the licensor a 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, advice 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 fail to deliver on time the promised information or services are charged a contractual penalty calculated on either a daily, weekly or 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, a contractual penalty is normally due without the licensee's 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.

37. The licensee may 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 the 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

38. 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 is capable of being obtained by

utilization of the licensed technology will actually be obtained in the 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. 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 specialists for a specified time to the licensee's plants, exchanging data between the research and technical departments of the licensor and the licensee, training of the licensee's personnel in the 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 operate. The licensors are therefore generally reluctant to extend their guarantees and their liabilities beyond the limits of their possibilities of exercising effective control.

39. This situation is reflected in various provisions of licensing contracts defining and limiting the 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 the 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 the licensee's personnel is not up to normal productivity standards, that the raw materials used do not conform with the contractual provisions on this point, that the general set-up of the 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 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 that may arise in the licensee's undertakings. A performance guarantee given under such conditions may be difficult to apply. It would therefore be in the interest of good relations between the parties to replace it by another formula that would not lend itself to disputes and litigation.

40. If the parties agree to limit the licensor's performance guarantees and liabilities deriving 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 in his factory to achieve contractual performances and parameters.

41. The reality of this guarantee can be controlled by the licensee in two ways: first, prior to signing the licensing contract, the parties can 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 that would be annexed to the contract and would thus constitute the criteria for the 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 procedure may at first sight appear preferable; it gives the licensee the possibility of acquainting himself with the details of the industrial process he intends to acquire, in an amicable atmosphere prior to the conclusion of the contract. Moreover, if in the course of the implementation of the 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.

42. In practice, however, the first procedure 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. To ensure secrecy during the negotiation of the licensing contract, the parties can conclude a type of preliminary agreement whereby the potential licensee would agree not to use himself nor to disclose to any one the confidential unpatented information obtained in the course of the examination of the licensor's industrial processes if the licensing contract is not concluded.

Proved violations of such agreements would result in the potential licensee's 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.

43. 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 the technology received. Only a few developing countries that have made significant progress in industrialization may be able to follow this practice. However, for enterprises in the other developing countries the risk to the licensee is believed to be too great. A licensee from these developing countries 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. These considerations lead to the conclusion that under present circumstances it would hardly be possible for a licensee from these developing countries to receive from a licensor from an industrialized country such an extended performance guarantee unless the licensor is associated in some 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 the 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 the licensee's production based on the imported

technology. It would therefore appear that separate licensing contracts, not inserted into a wider contractual framework, have little practical value in the relations between enterprises of developed and those of many developing countries, though the situation can be expected to change with the increasing industrialization of developing countries. Under these circumstances, 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 the 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 presently governing the licensing operations between enterprises of industrialized countries. It may be possible to find in this way the best compromise solution that would take into account equally the various interests, needs and possibilities of licensors from developed and licensees from developing countries.

#### Indemnification

44. 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. When the licensor's guarantee is limited to the supply of all technical data 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 that may have appeared in his original installation and organisation of production owing to the erroneous or incomplete technical documentation and information supplied by the licensor. The expenses and defaults in the licensee's production connected with such errors owing 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 the 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 up to the contractual standards.

45. In the case of a true performance guarantee, the problem of the verification of the results achieved in the licensee's factories is therefore of the utmost importance. It is normally stipulated in licensing contracts that at a given date the performances achieved in the licensee's factories are controlled in the presence of representatives of the licensor and the licensee. The results of such controls are recorded in a protocol signed by both parties. It could be suggested that the technical conditions of the controls and the consequences of a possible disagreement between the parties as to their actual results be clearly set out in the contract. The parties may also have an interest in a solution for the particular case where some parameters have not been reached without substantially diminishing the industrial and economic value of the licensed technology. They may, for instance, agree that the non-obtainment of certain parameters up to x percent will only result in an appropriate reduction of the contractual price.

46. 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 taken as 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 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 the 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.

47. In the relations between licensors from industrialized and licensees from developing countries, the technical equality that 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 the 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 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. If the parties do not agree in their contract on a reasonable limitation of indemnity, exceeding, however, the expected remuneration of the licensor, another method to reconcile the interests of the parties would be to connect the licensing contract with other agreements related to the construction and the operation of the licensee's industry, thus increasing the maximum amount of indemnity that would then be based on the over-all remuneration of the licensor. The licensor may also be given an interest in the financial results of the licensee's production in order to induce him to assume a more important share of the risk of the enterprise.

48. The limitation of the indemnity to be paid by the licensor in the case of non-fulfilment of his guarantee 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 guarantee 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 drastic action,

being aware of the sharply reduced amount of financial compensation he would be able to recover from the licensor.

#### VIII. REMUNERATION AND PAYMENT

49. It has been shown that the price of the licence may be strongly influenced by the guarantee given by the licensor. The territorial validity of the licence, its exclusive or non-exclusive nature, as well as other terms of the contract, have also a bearing on the contractual price of the licence, besides on the one hand the cost for the licensor of his research, development and other expenses linked with the licence and on the other hand the technical value of the licence for the licensee. At present, prices for licences 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.

50. If the transfer of technology is rewarded by a lump sum agreed upon by 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 that 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 considered to be mainly a compensation for the estimated cost and value of the transferred technology, whereas the royalties are a reward for 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 when the licence is remunerated by royalties alone.

#### Lump sum and/or royalty

51. From the point of view of the licensee, royalty payments may appear to be 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.

52. 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 the 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 for his production and 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, it will be necessary for the licensor in certain cases to supplement the verification of the licensee's books by inspections in the licensee's plants. The results of the 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. The duration of the contract as well as the solution to be adopted by the parties with regard to the problem of the utilisation of the technology after the termination of the contract should also be borne in mind in this respect (see para. 15 and 17 above).

53. 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 is not 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 expanded to include a minimum royalty that the licensee would have to pay even if his production or his sales does not reach the level that 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 by enterprises in 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. It may perhaps be possible to work out a compromise solution by fixing a minimum royalty that would start only after full production has been reached.

54. 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 from other suppliers and comparing the prices quoted in such offers with the prices given by the licensor. If after inquiry the licensee finds that the prices given by the licensor are similar to those the licensee can obtain from other suppliers or contain only a small additional profit margin that would have to be considered a very reduced remuneration for the licence, it would be to the interest of the licensee to accept this formula rather than 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 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 licensor separately for



the licence and purchase the equipment from the supplier who will grant him more attractive conditions with respect to 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.

55. Another way possibly to reduce the basic price of the licences granted to licensees from developing countries would be to give to the licensor, in the framework of an extended co-operation agreement, a financial interest in the results of the 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 the 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 the licensor's contribution to the marketing operations. These and other similar methods should be explored by those concerned with licensing arrangements.

56. 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 the licensor's personnel to the licensee's factories, training of the licensee's personnel in the 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. When the technical assistance services are included in the global price of the licence, this price will be higher than when prices are fixed individually for various services. The licensees may therefore prefer to have a breakdown of prices for items covered by the licence such as documentation, know-how, technical assistance in order to be in a better position to control and discuss the prices given by the licensor. For fiscal reasons the licensor may also be interested in a breakdown of prices.

57. 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 justified. This would entitle the licensee to insist that the licensor fulfil his obligations scrupulously 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 do so, the cancelling being supplemented by a special contractual penalty to be paid by the licensor.

58. The price of the licence may also be influenced by another element of licensing agreements, namely, the use of trade marks. The licensor's authorization to permit use of his well-known trade mark in the licensee's sale of products manufactured under the licensed technology would greatly strengthen the licensee's marketing position. When the licensee is authorized to use the licensor's trade mark 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 the trade mark. In many cases, however, the licensor would hesitate to allow his trade mark 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 the licensee's production derived from the technology supplied by the licensor is sufficiently close and extended, the parties may create a common trade mark distinct from licensor's own trade marks for similar products. In other cases the licensee, in using the licensor's trade mark, 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 trade marks seems less justified or justified at a reduced rate in the case of common trade marks or when the licensee's trade mark refers to the technology of the licensor.

#### Price revisions

59. 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 may be appropriate to base the remuneration for the licence on a declining scale, taking into account the 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. Alternatively, 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 that 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. This problem obviously does not arise when the licence fees are expressed as percentages of the sales prices of the licensed products.

60. 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 for protecting 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 event of a 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 declining scale.

#### Currency clauses

61. The problem of possible variations of the foreign exchange rate 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 wish to obtain payment in his own currency or in some other hard currency. The licensee from a developing country will probably find it difficult 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, such authorization is frequently refused. One possible solution may be to have the licensor and the licensee agree to the association of the licensor with the marketing of the licensee's products, the results of such an association being used to assure the payment for 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 for the licence in the currency earned on the third market concerned.

62. 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 to conditions pertaining to quality. 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 is 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. When payments are to 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 changes in the exchange rate of the contractual currency. As regards the currency of the country of the licensee, if the licensor agrees 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 nations of the country concerned, even on matters linked with international trade.

#### Payment

63. The licensee has to observe strictly the conditions set out in the contract as to the remuneration of the licensor. 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 obligations. After the expiry of this new time limit the licensor has the right to cancel the contract. The cancellation of the contract will not relieve the licensee from payment of sums due at the date of cancellation and of interest accumulated on these sums at a rate that may be fixed directly 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 that is the centre of the licensor's financial activities, including prima facie utilisation of sums earned abroad.

64. Payment by the licensee of sums due plus interest 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 interest 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 litigation. The solution to this problem will ultimately depend on the respective bargaining power of the parties concerned. It has, however, already been shown in paragraph 22 that the licensees may have good reasons for resisting the licensors' claims to further indemnification. Here again it may be recommended that this particular aspect of the problem be clearly and specifically settled in the contract.

#### IX. IMPROVEMENTS

65. The clause on improvements is among the most important in the contract. If drawn up in an appropriate manner, it may give to the licensees from developing countries access to more up-to-date techniques; it may also lead to technical co-operation between enterprises of developed and those of developing countries. The enterprises from developing countries should, however, resist the idea which, however, contrary to certain anti-trust laws, is found in some licensing agreements, that the licensor, in his capacity as author of the basic technology, has a right to all improvements made by the licensee, whereas the licensor should be obliged to communicate to the licensee improvements to the original technology made

subsequent to their agreement, may do so under certain conditions and against payment of an additional price. This general idea appears particularly in provisions related to patenting of improvements and to "improvements" radically altering the original technology.

66. 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 are 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 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 reserves sometimes to himself the option to patent the improvement or to leave to the licensee the right to patent it. If the licensor does not think it useful or necessary to patent an improvement then only the licensee is given contractually the right to patent the improvements he has made.

67. It appears that with such a provision 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 the improvements he has made and those his licensee has made; the licensee has the right only to patent all or part of his own improvements which the licensor does not think worthwhile patenting. 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 licensee, 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 all 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 he

has made 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.

68. Important for licensees from developing countries is the clarification of the boundary line separating the improvements of the licensed technology from different 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 that 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 improvements closely related to the original technology, they would probably not be prepared to disclose different 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 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. 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.

## X. SECURITY

69. 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 may, in the case of unpatented technology, be an important element of the operation (see paragraph 42). 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 be difficult to assess. In other contracts the licensors reserve also 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.

70. 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, if the licensed technology becomes publically known. In view of the difficulties that the licensor may have in proving that the licensee has violated his obligations and that the licensee may have in establishing that the licensed technology has been disclosed by the licensor or has become commonly known, it could be suggested that both parties do not put more emphasis on the character of secrecy of a licensed technology than is absolutely necessary. The cancellation of the contract may be 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 when 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. At the same time, the licensee should be given the right to claim a reduction of the contractual price for a licence for technology that has become commonly known and therefore the licensee has lost one of its original elements considered important by the licensee.

## XI. SETTLEMENT OF DISPUTES

71. 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 the licensee's accountancy, the technical value of the licensed technology, the quality of the licensee's products that 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, even if it does not correspond to current practices, 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 the 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 will be settled in a more rapid and suitable manner, provided the decisions of the experts on technical matters are considered final and binding.

72. For the settlement of other than purely technical disputes 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 jurisdiction 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 designating the arbitrators and 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.

## XII. APPLICABLE LAW

73. As in the case of all international contracts, the problem of what legislation should apply 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.

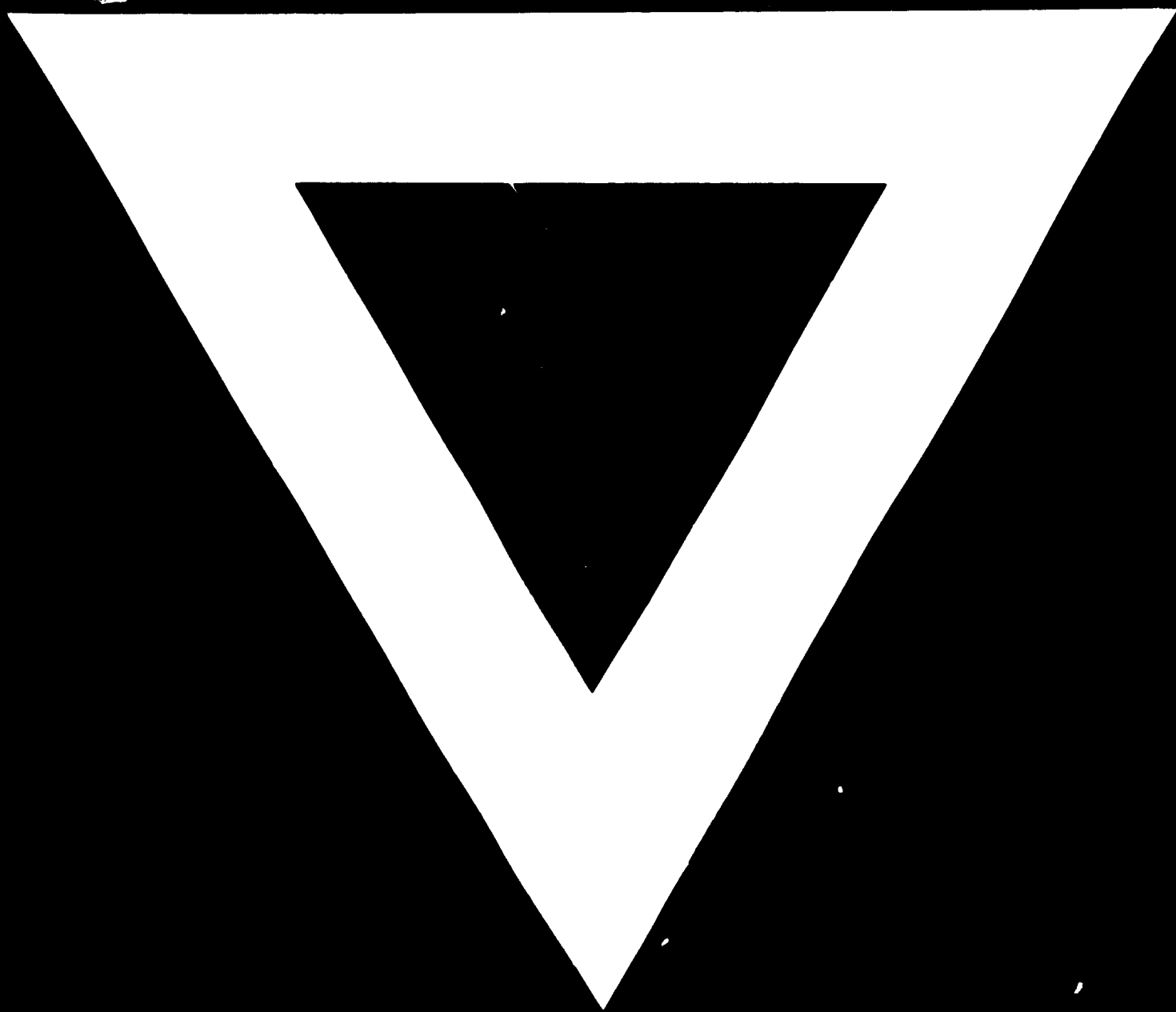
In this respect it may be suggested that, since the licensing contract produces its main effects in the country of the licensee, the law of this country be considered the "proper law" of the contract and that the application, the construction and, if necessary, the filling of the gaps of the licensing contract be subject to the law of the country of the licensee. It should, however, be recorded that in a number of international licensing contracts, as in other international contracts, the parties choose the law of a third country as the law applicable to the contract.

74. 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. The same applies to the protection of inventions by patent laws, which is strictly territorial.

75. It has already been shown that both parties are subject to regulations of their respective countries concerning restrictive business practices, transfer of currency, exchange guarantees and, in a more general way, authorization to conclude licensing contracts that 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 that may arise from conflicting fiscal requirements of the country of the licensor and of that of the licensee. In international relations the remuneration for 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 a 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 for licences i.e. to the country of the licensor. In most developing countries, however, the licensor is taxed even though 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 in their price or contractually shift to 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.

76. The excessive taxation that has a clearly negative effect on the cost of licences granted to enterprises of developing countries may 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 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. To permit the parties freely to choose the legal form that would best suit their contractual relations without their 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 for licences be taxed only in the country of the licensee. Even if such a solution is considered not to conform 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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