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RESTRICTIVE BUSINESS PRACTICES IN LICENSING AGREEMENTS 1/

by

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INTRODUCTION

This paper focuses attention on the legal and economic implications that derive from international technology transfer agreements with special emphasis to restrictive business practices in licensing transactions.

It heavily relies on the experience of Mexico and the efforts of the National Registry of Technology Transfer to deal with the complex matter of eliminating undue restrictions that emanate from the contracting process.

BACKGROUND

As world economic and development structures are changing, technical knowledge has become an increasingly significant factor in the development process of nations. This question becomes particularly important for the developing countries that most heavily rely on the acquisition of proprietary know-how from foreign sources.

In recent years the developing countries have become better prepared to deal with the complexities of international licensing and have developed - with the assistance of International Organizations - UNIDO in particular - a system, and a co-ordinated approach to orient and regulate the acquisition of foreign know-how.

For this purpose national agencies have been created with the necessary authority and governmental support to rationalise licensing procedures, and to acquire technology in terms and conditions satisfactory to the recipient country's economy.

The Mexican experience can help to illustrate the difficulties and achievements obtained in this area and to ascertain future actions for increasing the technological base of the country, in order to meet the socio-economic objectives that lie ahead.

From the outset it should be stated, that developing countries would need to increasingly rely and spend more for the purchase of foreign technology, mainly because technological requirements increase - both, in cost and sophistication - in co-relation with the industrial development of a country. As a result, the transfer of technology from developed to developing nations is going to play an even major role in international economic relations.

Technology however, very often involves a high price, not only in terms of direct payments on royalties, but also as a result of contractual provisions that recipient companies in the developing countries are forced to accept in order to attain their main objectives.

Many licensors of "technological knowledge" - including patents, trade marks, process organization, trade secrets and the like - have managed to unduly use that knowledge as a lever to impose obligations, restrictions and controls over production in the recipient country, that otherwise would be quite impossible.

Many firms from industrialized countries that enjoyed technical advancement and expertise, have in the past been able to impose contractual provisions that not only perpetuate non-competitive market structures but which also - and more important - tend to harm the internal economy of the recipient country.

The conditions under which the commercialization of technology operates on a world scale, has posed multiple legal, economic and political questions; and the awareness of its implications by the recipient developing countries explains the active role that the United Nations through organizations like UNIDO is now playing.

Another area of concern about this situation, which can be seen as a new variation of potential market domination, is growing on the international level. Both developed and developing countries are seeking ways to limit the influences and controls of the business interest of other nations.

In order to deal with this problem the Mexican Government enacted a specific legislation in the early part of 1973: "The Law for the Registration of the Transfer of Technology and the Use and Exploitation of Patents and Trademarks ."

It should be mentioned that more than 80% of technological inflow (and corresponding payments) and direct foreign investment into Mexico, originates from the United States. The United States by and large has been one of the world leaders in technological developments, and likewise, U.S. enterprises have been prominent in licensing and controlling technology. Therefore the importance that the Registry of Technology attaches to legislative procedures and related developments in that country.

In this context the U.S. antitrust laws provide one source of control, to the type of restrictive trade practices contained in contracts with foreign companies. Antitrust principles have been applied to such agreements in the past, but the exact scope and limitations of these principles are not precisely clear.

Under U.S. law, technological knowledge is considered as intellectual property and has special status and protection. Certain forms, such as patents or trade marks, do provide "legal monopoly" to their holder. However, even this grant protection is strictly limited in terms of scope, field-of-use, duration, etc.

It emerges from these that a legal monopoly cannot be used to obtain larger control or to work against antitrust principles. From the point of view of government authorities it becomes essential to properly define the scope of legally protected monopolies with as much accuracy as possible, since restrictive terms outside the "protected area" may be construed as violation of antiturst laws.

The Mexican experience has shown that more than 75% of technological licensing agreements do not involve patents and that they fall within the category of know-how licensing contracts. Extensive research conducted at the international level demonstrates that in the future the trend will be to rely more on know-how licensing and to gradually reduce the use of patents as a main object in the contract. (With exceptions on certain fields, such as pharmaceuticals)

In this connection it is pertinent to point out that secrets and unpatented technological know-how cannot obtain a legal monopoly protection. In practice this becomes a fundamental issue and should carefully be studied by any developing country that wishes to regulate international licensing transactions.

The basic area of concern, is that the "non-protected category of technology" is only protectable by contractual provisions of nondisclosure and/or no use. Under a similar analysis, restrictions imposed in such contracts cannot be used to produce controls that go beyond the necessary scope of protection.

The basic relationship between technology licencing and antitrust regulations is that control of technology on the one hand and legal monopolies on the other, cannot be used to give the holder more rights that there are specifically defined in legal statutes. Likewise neither contracts for technology nor specific business arrangements, such as joint ventures or wholly-owned subsidiary arrangements, can be used to overcome these limitations and to create anticompetitive market structures that are otherwise illegal.

Although, this remains a highly technical and specialized field of activity, governments of developing countries must study carefully the implications that derive from contractual arrangements in the legal and economical areas.

To illustrate this point, we should refer to the Mexican experience in dealing with licensing of non-patented technology that quite frequently would call for an excessive nondisclosure period on the part of the recipient - either an indefinite period or an obligation for more than 20 years.

Considering that the Mexican patent law only grants a maximum of 15 years of protection, one can clearly see that, as a result of a contractual provision in this area, the licensor is seeking to acquire substantially more than what he could be granted by obtaining a patent. In other words, monopoly rights are sought through contractual arrangements, even though, as already indicated, nonpatented know-how does not acquire legal monopoly protection.

The Mexican law of technology calling for the compulsory registration of all existing agreements gives the Mexican authority a good opportunity to collect information for research and comparison in this field. Any efforts conducted in this area were to give due consideration to the provisions of article 13 of the law that requires to keep secret all technological information concerning the processes or products covered by registred agreements. This information constitutes a valuable source for understanding the nature and extent of restrictive business practices in the technology transfer process.

RESTRICTIVE PROVISIONS IN LICENSING AGREEMENTS

This paper aims at understanding restrictive licensing clauses viewed in light of the Mexican law of technology, and particularly of the provisions in article 7 of this statute.

Additionally an effort has been made to incorporate certain elements of economic nature in order to properly assess the implications of restrictive provisions in a practical and realistic manner. This might include:

(i) financial and technological capabilities of the recipient firm;

(ii) industry structure;

(iii) production sectors; and

(iv) export considerations.

In preparing this paper it was necessary to consider the types and frequency of restrictions contained in technology agreements vis-à-vis the structural variables mentioned above, and to ascertain particular trends within specific sectors of production.

Although antitrust criteria on the one hand and the provisions contained in the article 7 of the Mexican law on the other, go into considerable detail to enumerate the kinds of restrictive practices that must be eliminated from contracts in order to qualify them for registration, there are certain types of restrictions that are of greater importance than others and that should be analyzed in closer detail.

In order to elaborate on this, we will enumerate the kinds of restrictive practices that are contemplated in article 7 of the Mexican law.

In this context the registration of a contract may be denied if it contains provisions where:

1. - The technology to be transferred is freely available in Mexico (clause I, art. 7).
2. - Obliges the licensee to grant back to the licensor the patents, trademarks, innovations or improvements it makes (clause IV, art.7).
3. - Limits the licensee's research and development efforts (clause V, art. 7).
4. - Prohibits or restricts the export of goods or services by the licensee in a way contrary to Mexico's interest (clause VII, art. 7).
5. - Establishes excessively long terms of enforcement (clause XIII, art. 7).
6. - Calls for disputes, to be submitted to the jurisdiction of courts in a foreign country (clause XIV, art. 7).
7. - Sets a price out of proportion to the technology acquired or [illegible] Mexico's economy (clause II, art. 7).

8. - Permits the licensor to regulate or interfere with the management of the licensee (clause III, art. 7).

9. - Obliges the purchase of equipment, tools, parts or raw materials from a certain supplier, only (clause VI, art. 7).

10. - Prohibits the use of complementary technology (clause VIII, art. 7).

11.- Requires that goods produced by the licensee be sold to the licensor, only (clause IX, art. 7).

12. - Obliges upon licensee to permanently employ personnel appointed by licensor (clause X, art. 7).

13. - Limits production volumes or imposes sales prices on goods produced by the licensee (clause XI, art. 7).

14. - Obliges the licensee to sign exclusive sales or representation contracts with licensor in Mexico (clause XII, art. 7).

Except for the first six provisions, for which no exception can be made, the Mexican law establishes that contracts that do not meet one or more of these conditions may be registered; if the National Registry of Technology Transfer believes the contract is of special interest to the country.

Our analysis of the restrictive business clauses will concentrate on the following types of provisions which in one way or another hinder upon se. ral of the above mentioned clauses for article 7, these are:

1. various types of tying clauses;
2. excessive royalty payments;

3. field-of-use or cross-licensing restrictions;

4. territorial restrictions;

5. price fixing;

6. grantback provisions

The Mexican experience may serve as a reference to other developing countries for the purpose of understanding the types of restrictive practices and contract provisions currently used and the manner in which the National Registry of Technology has tried to overcome and eliminate such abuses. Although it would be impossible within the scope of this paper to discuss how useful antitrust principles are and to go too deep into the analysis of how restrictive provisions may effect the national and international legal statutes, this paper may be able to point out certain gaps in the present international legal system related to controls on patenting, licensing and business practices in general that should be brought into public review through information or legislation.

TYING CLAUSES AND PACKAGE LICENSING

Tying clauses imply the requirement on the part of the recipient who wants to acquire certain goods from a supplier (licensor) to also purchase other products from that supplier.

Such clauses are often considered a violation to various antitrust legislations, e.g. it should be noted that the Clayton Act, Section 3 focuses attention on sales of commodities "patented or unpatented for use, consumption or sale within the United States". On the other hand the Sherman Act is not as limited and can be applied to sales outside the United States when the United States' commerce might be affected.

The general criteria is that tie-in clauses are unreasonable whenever a party has sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product. The legality of this is usually established when the tying product is patented, however, when no patent is involved but only a trade secret or process know-how, this requirement may be harder to prove. Additionally, there are precedents for regarding a technology licence in itself as a "tying product" upon which the licensor has economic power. On the basis of the Mexican criteria tying clauses are per se not acceptable. But in practice there may be some exceptions to that rule, in cases where there is a need for the tie-in product if this is considered to be essential to the protection of the patentee, or for the functioning of the patent itself. The Mexican experience shows that in the majority of cases it is possible to eliminate tie-in provisions from the contract. However, the elimination of a contractual provision may in itself not be sufficient to prevent a wholly owned subsidiary or a licensee with a majority foreign participation to de-facto exercise this requirement.

In a recent paper prepared by the author concerning restrictive business practices in licensing contracts among multinational firms and their subsidiaries, it was reported that from the Mexican point of view restrictions that appear in contracts among parent and subsidiary were eliminated without great difficulties and it was recommended that additional measures had to be taken from the government in order to effectively regulate unreasonable practices in this field. A difficult case emerges when, for example, the licensor's equipment reputation in terms of efficiency and reliability is dependant on the use of other equipment or products and the licensor can prove that the original equipment does in fact perform better with the specified additions. In practice, the argument against allowing such a situation to pass legal scrutiny is that, if the assumption is correct, the licensor will be able to convince the recipient company to buy and obtain the sale of additional equipment or products without the incorporation of a tying clause.

PACKAGE LICENSING

A package licence is the type of a tying agreement where the patentee conditions the signing of a patent licence on the acceptance of licensing one ore more additional patents. Certain valid business reasons may be behind package licensing, since it can be used to avoid problems, such as determining which sales relate to a certain licence right or to apply differential royalty rates and eliminate extensive book keeping.

Several cases were brought to the attention of the Mexican Registry in which the licensee without prior knowledge as to the value of "all" patents involved was forced to incorporate these in the original agreement forcing the licensee to pay a higher royalty.

[illegible]

A [illegible] is one in which the licensor limits the licensee with respect to the scope of use of the licensed product.

By imposing such restrictions a licensor could block off various fields, either to charge different royalties in each field, or to avoid licensing a recipient company in certain areas in which the patentee (licenser) plans to utilize the patent. From the practical point of view, if a restriction does not effect the manufacturing plans of the recipient company this may be accepted, however, such an arrangement should be carfully negotiated under a lower royalty basis. Finally it should be said that field-of-use restrictions will vary considerably with the type of production technology involved. From the government's point of view what is important is to assess the economic effect of such provisions.

TERRITORIAL RESTRICTIONS

According to the Mexican law, territorial restrictions are considered illegal, unless limitations on exports of goods or services do not go against the country's interest. Flexibility is needed in this area in order to eliminate restrictive clauses only if they affect the possibilities of growth of the recipient enterprise and the overall external policy of the country. On the other hand, it should be noted that by simply eliminating contractual clauses that limit, condition or prohibit the export of licensed products, the recipient country not necessarily will be in a position to increase its exports, as this is basically governed by economic and commercial considerations that apply to the international market, i.e. cost, quality, delivery time, etc.

Under this type of analysis any developing country trying to regulate licensing arrangements should make an effort to ascertain what legitimate business justifications could exist for restrictions in this area and to determine as well what would be the effect in the economic sense. In this connection some relevant factors to consider will be:

(i) size of the licensor's and licensee's enterprise;

(ii) the extent to which they are able to participate in various markets;

(iii) the type of exclusivity involved;

(iv) the duration and scope of the agreement;

(v) the type of products, cost of them and whether or not a cross-licensing is involved.

The general criteria in Mexico is that the registration of a contract may be denied if:

(i) it contains a total prohibition for exports;

(ii) it obliges the licensee not to export to certain geographical areas where the licensor has not granted exclusive rights for manufacture or sales to third countries;

(iii) it establishes a ceiling concerning the volume of export sales;

(iv) it obliges the licensee to export only through the licensor to the detriment of licensee's successful market penetration in third countries;

(v) it obliges the licensee to pay a high royalty on export sales, etc.

In the same way, Mexico has accepted certain limitations for exports in cases where:

(a) the licensor has previously granted exclusive manufacturing rights under a patent in a particular country;

(b) the licensor is not authorized by legislation or decree in its own country to export directly or indirectly to certain geographic areas;

(c) a higher royalty on export sales is applied and this contributes to the balance of payments or the development of marketing abroad of products of high local content.

Many licensors have developed particular methods of imposing territorial restrictions without having expressed clauses in licensing contracts, for instance:

(i) by not granting patent rights in licensor countries and by the risk of infringement suits;

(ii) by imposing prohibited higher royalties that would make uneconomic any export possibility;

(iii) by restricting the field-of-use of a particular patent or know-how; thereby reducing the quality or specification of products.

PRICE FIXING

Under the Mexican regulatory policy a price fixing arrangement will be considered not acceptable. Similarly, on the Section 1 of the Sherman Act once a patented product has been sold, the producer cannot fix resale prices, nor can the sales price of a unpatented product resulting from a patented machine be fixed by the patent holder. United States Case History shows that certain restrictions of this kind might be valid if adopted in a reasonable manner and for the purpose of protecting the patent holder's profits that could rightfully be expected from the patent monopoly.

In connection with price fixing provisions, a developing country should carefully assess the economic implications to the local company and companies operating in the same sector. In this context it should be kept in mind that manufacturing costs in the developing countries are in general considerably higher than in the industrialised countries; additionally, there are many economic considerations that go beyond the control of the local company, such as higher cost of raw materials or equipment, market stability, inflationary trends, etc., etc. In such a situation a price fixing arrangement could negatively affect the profitability of the project and the growth of the recipient enterprise.

In recent times, international organizations have taken a leading [illegible] in the [illegible] of international guidelines of conduct that [illegible] developing countries in regulating restrictive business practices in licensing. Emphasis has been made on the inacceptability [illegible]

It is possible that by following very rigid recommendations that do not take into account the practical and economical realities, a developing country can be misguided. To illustrate this, we should refer to the serious efforts of many developing countries to promote and encourage the establishment of sub-contracting agreements; these are arrangements in which the export element is a central one, and where certain price arrangements would have to be made in order that the licensor or a third company may be in a position to enter into a long-term/high volume agreement for the supply of parts and intermediates.

This serves to demonstrate that much flexibility is needed as well as guidance and expert advice to ascertain the economic implications of price fixing arrangements.

The fact remains that from the point of view of the recipient company and host country it is always desirable to eliminate unreasonable price fixing provisions in contracts that may hinder the growth and financial stability of the recipient firm.

ROYALTY PAYMENTS:

Restrictive provisions in this area are some of the most important to consider, as they could have a negative impact on the development of the country and the recipient enterprise's economy. Under U.S. antitrust policy a misuse of a patent through an improper formulation or imposition of royalties could be considered a violation. Under the Mexican criteria the basic elements for judging on the validity of royalty provisions take into consideration the analysis of their economic effect at various levels.

This is an area in which the legal, technical and economic considerations should be brought together. Although this is basically an economic and technical problem, the legal aspects, particularly in patent agreements, should also be taken into account. For example, attempts might be made to avoid price fixing charges and to achieve price control through the amount of royalties. Similarly, a licensor may condition the grant of a patent licence upon payment of royalties on products which do not use the patent. Under the U.S. antitrust law,establishing different royalty rates for different licensees is considered acceptable, but it may not be used to effect certain competitors or prevent newcomers. Differential royalty rates may not be accepted under antitrust criteria in cases where this is used to achieve an unlawful allocation of markets. Developing countries should carfully consider the economic implications of this in various areas, for instance, an American firm imposes a reasonable royalty rate for domestic and export sales, but a prohibited higher rate for sales into the United States, thereby preventing access to the U.S. market. (- de facto introducing territorial restrictions). In principle, this will be considered illegal by the United States antitrust authorities.

Any developing country wishing to introduce policy guidelines on permissible royalty rates, should be prepared to carefully ascertain the degree of flexibility needed in view of: (i) foreign exchanges considerations; (ii) industrial sector priorities; (iii) external policy [illegible] and [illegible], on a sector by sector basis. [illegible]

Note: The Government of Mexico has been successful in maintaining a receptive climate for technology licensing and investment, and simultaneously exercising a careful control on technology payments. Two and a half years after the enactment of the Mexican legislation, it was possible to report savings in the order of two hundred million US Dollars by enabling foreign companies to directly participate in the renegotiation of contracts (this figure was computed taking into account the "modified royalty rates" through the life of the agreements). Mexico has been efficiently assisted by UNIDO in achieving this important goal. Also with the help of UNIDO the Mexican Registry has carefully monitored the reaction of foreign enterprises that were involved in the reduction of royalty payments and the overall effect of the Mexican legislation in the external market.

This helps to demonstrate that it is possible to engage in the renegotiation of existing agreements if flexibility is applied and if these renegotiations are conducted with the participation of all interested parties, including the foreign enterprises.

It is probably too early to ascertain what has been the effect of the Mexican law of technology, nevertheless, Mexico is continuously receiving an average of 50 new contracts a month.

It may be of interest to all developing countries to know of the general criteria for determining what in Mexico is considered to be an excessive payment or what constitutes an excessive burden to the country's economy.

For this purpose we will summarize the basic criteria for dealing with Clause II, Article 7 of the Mexican law:

Although it is not possible to establish general rules concerning the most adequate level of payments, what is important is to conduct a careful techno-economic evaluation on a case by case basis and to determine:

- If the payments involved, do in fact, relate to the services and knowledge that is to be provided.
- It is essential that either in the contract, or separately, the base and formula to calculate royalty payments is clearly specified.
- It is important that the contract clearly specifies that taxes due on royalties are the responsiblity of licensor.
- A differentiation is made between payments involving know-how fees and continuing royalties.
- Contrary to what is followed in other countries Mexico has not established royalty ceilings on various sectors.

In order to determine the total flow of payments involved the following is considered:

i) The manner in which payments are going to be effected.

ii) Projected volume of sales or production during the life of the agreement.

iii) The duration of the contract.

iv) The specific dates that payments should take place, given special attention to a [illegible] [illegible] for [illegible] of an industrial [illegible]

It was found that in practice, the various modalities for covering payments change considerably from case to case. In this context some reference points for comparison were established at the sectorial level.

In this connection, the following indexes are considered important:

a) $\dfrac{\text{Royalties related to products of the contract.}}{\text{Total sales of the recipient company.}}$

b) $\dfrac{\text{Royalties on products of the contract.}}{\text{Total sales of products of the contract.}}$

c) $\dfrac{\text{Royalties related to products of the contract.}}{\text{Net income based on products of the contract.}}$

d) $\dfrac{\text{Total payments involved.}}{\text{Total investment in machinery and equipment.}}$

The above reference indexes were found to be useful in determining to what extent the payments involved affect the manufacturing cost and the financial situation of the recipient company.

As a general rule minimum royalties are not accepted in Mexico. However, if the foreign licensor insists on a minimum royalty, the Mexican Registry would then request the incorporation of a maximum royalty fee.

<u>Note:</u> After a revision of many cases that contained minimum royalty provisions it was found that they operated only on few cases. The concept of a minimum royalty is not always acceptable because there are cases were, for reasons beyond the control of the recipient company, such as market demand, etc. the licensee may be put in an unfavourable position, particularly in cases were new products are involved, or were the sector of industry is highly dynamic and competitive.

In order to determine if the payments involved constitute an excessive burden on the economy, it was necessary to examine, to what extent the total flow of payments (both, explicit and implicit) may be detrimental to the country.

- By explicit payments we understand, those that pertain to royalties and fees specified in the contract.
- By implicit payments we understand those that result, among other things, from tie-in clauses which normally appeared in (i) overpricing of raw materials, parts, equipment, etc. obtained from licensor, (ii) underselling of products exported through licensor, etc., etc.

Although, the definition of what may be construed as a negative effect to the economy is a difficult question and requires the technical support from various agencies; the register of technology can at least examine some of the most obvious implications that result from contractual arrangements with foreign companies. In this context it was considered important to determine (i) what is the effect of payments on the recipient company; (ii) the industrial sector to which it belongs; (iii) and how it affects the country's balance of payments; additionally it should also be determined (iv) what can be the effect of said payments for technology in the cost of goods and services and how this may affect the consumer sector, etc.

There are other aspects that have to be studied at the sector by [illegible] level, in order to define appropriate [illegible] payments, that could have a negative [illegible]

It should be mentioned that clause II is closely interlinked with clauses: I, IV, VII and XII of article 7.

It is not possible, within the scope of this paper to discuss in full what is the internal criteria for the application of clause II of article 7; nevertheless, in addition to the general criteria mentioned above, each contract is evaluated from the legal, technical and economic point of view and specific guidelines have been developed for the application of clause II in the following areas:

1. <u>Use of trademarks</u>

   a) A deliberate effort had to be made to gradually reduce the use of foreign trademarks in the domestic market, particularly when:

      i) They are not yet established in Mexico.

      ii) Their impact in the sale of products is of minor significance due to the type of products or services involved.

   b) On a selective basis the use of new foreign trademarks should be encouraged and authorized:

      i) When they are considered important for the export of products manufactured under license.

      ii) When it brings alone a recognized technical prestige and is required in a particular market.

   c) It is important to promote the creation and development of Mexican owned trademarks.

      i) In order to gradually identify the products as Mexican both domestically and internationally.

d) When licensor does not participate in the capital of the recipient company, payments for the use of trademarks are maintained in the range of one percent on sales.

e) No payments for the use of a trademark are authorized when the licensee is a wholly-owned subsidiary of licensor, or when licensor has a majority equity participation in the recipient firm.

2. The right to use patented inventions

The law of industrial property of Mexico considers three kinds of patents that are subject of regulation by the registry:

a) Patents on inventions.

b) Patents on improvements.

c) Patents on industrial models or designs.

- The duration of patents on inventions and improvements is granted for 15 years.

- The duration of patents on models and industrial designs is granted for 10 years.

These provisions as well as others that relate to the validity, exploitation and termination of patents, are carefully appraised by the registry.

In connection with contracts that cover the use of patents the following is [illegible].

- When a patent has been requested but not yet granted by the industrial [illegible] will be conditioned to the [illegible]

- When the contract covers payments for the right to use several patents, it is important to determine the duration of all of them and to differentiate the "basic" or "secondary" patents.

- It is also important to determine whether or not the patented know-how is being used in the manufacturing process, and if so to what extent.

- It is important to determine the degree of exploitation of the patents involved in the "territory" of the contract.

- The Mexican Registry will insist that any possible infringement on licensor patent rights by a third party, shall be the sole responsibility of licensor.

- Any contractual provision limiting the "field-of-use of a patent" in an unjustified manner cannot be accepted.

- Licensor should be responsible to defray all expenses related to the registration and maintenance of its patents in Mexico.

3. The supply of technical assistance

Payments for technical assistance normally covered through "know-how fees" should be examined in close detail. In Mexico a differentiation is made between lump-sum payments and those that call for the continuous supply of technical assistance over the life of the agreement.

In connection with know-how payments, the following should be taken into consideration:

- When the object of the contract covers technical know-how that could be assimilated directly by licensee, i.e. formulations, drawings, specifications, etc. payments on a continuous basis are not accepted in principle.

- Concerning the know-how incorporated in drawing formulas and/or technical know-how, no limitations, other than those pertaining to a reasonable obligation on confidentiality, shall be accepted.

- The Registry will not accept any restriction at the end of the agreement concerning the use of nonpatented know-how.

4. Basic or detail engineering

The supply of engineering services will depend on the technical capability of licensor. In practice, basic and detail engineering are obtained from different sources, and it is therefore important to define the degree of responsibility of all parties involved.

An important aspect concerning the supply of engineering services relates to the type and scope of guaranties required by the recipient company.

- When licensor is responsible of supplying basic engineering together with process technology; licensee should obtain specific guaranties at least in the following areas:

   i) Volumes of production.

   ii) Yields.

   iii) Quality of products.

There are many considerations concerning the proper evaluation of engineering services, but it is important that the amount of payments of these services, should be evaluated, comparing them with alternative offers on substantially similar levels.

Finally it is essential that contracts covering the supply of basic and/or detail engineering should clearly specify the type and scope of these services as well as the manner in which the corresponding payments should be effected.

5. <u>Continuing technical assistance</u>

For the purpose of evaluation of payments concerning technical assistance the Mexican Registry uses the following criteria, and separates the following concepts:

a) <u>Pre-operational phase</u>

i) Pre-investment studies;

ii) Technical assistance for the purchase of equipment;

iii) Technical assistance in the erection and installation of plants;

iv) Plant start up;

v) Training of technical personnel in the above areas.

b) <u>Operational phase</u>

i) Assistance in the purchase of spares, raw materials, parts, etc.;

ii) Quality control;

iii) Assistance in plant operation including repairs and maintenance, production efficiency and others;

iv) Technical services to clients;

v) Technical improvements of processes, and products;

vi) Training of technicians in licensor's or licensee's plant.

The following considerations are taking into account:

- It is important that the contract specifies the various services involved and the corresponding payment for them; <u>in a separate manner.</u>
- It is important to ascertain the time required to cover the various services related to the pre-operational phase.
- A definition of the scope of technical assistance to be provided in the operational phase.
- Determine the relationship between the kind of assistance to be supplied by licensor and the complexity of the manufacturing process in its various phases.
- The degree of technical change in the sector of industry in question.
- The technical capability of licensee.

6. <u>Managerial assistance</u>

The cost and scope of these services will greatly depend on the functions to be covered. In general terms, these services are obtained over a limited period of time; covering among others, the following aspects:

i) Planning and programming;

ii) Research and development activities;

[illegible]

[illegible]

[illegible]

Managerial or administrative services have to be evaluated in consideration of the following:

i) The sector in which they are applied;

ii) The requirements of the recipient party;

iii) The type and scope of the same.

In this context the following is to be considered:

a) A definition of the different services involved.

b) The provision for training programmes in order that the various functions can gradually be covered by licensee's staff.

c) Payments for this concept shall be viewed in relation to the economic benefits of the recipient company.

d) The responsibility and functions of licensor should be clearly delineated.

e) Managerial assistance in the area of marketing is in principle not accepted when the recipient company has been established for the sole purpose of manufacturing and selling intermediate products.

GRANT-BACK PROVISIONS

A grantback provision in a technology agreement is the one that requires the licensee to assign-back to the licensor, any new patents, improvements or the result of technological developments, [illegible] conducted by the licensee during the life of the agreement.

Under this type of provision it might be convenient to consider the criteria of the Japanese Fair Trade Commission (FTC) which for all practical purpose may be considered appropriate.

__Note:__ Interested officials of developing countries wishing to look closer at restrictive business practices in licensing agreements will be advised to obtain copies of the __Japanese guidlines__ on the "recognition of standards concerning international contracts for technological introduction", published by the Fair Trade Commission on May 24, 1968.

The analysis of grantback provisions can be divided into three parts:

1. Provisions in which the licensee is obliged to inform licensor __of all the knowledge and experience__ which licensee has acquired in connection with the goods and services covered by the contract.

2. Provisions that oblige the licensee to assign the rights (patent rights or rights arising from application thereof) related to any improvement, invention or application of inventions which the licensee has made.

3. Provisions that oblige licensee to grant to licensor a licence on any improvement, invention, or application of invention which the licensee has made. The criteria of the FTC of Japan considers that these provisions may not [illegible] or unfair mode of trade, if the licensor is placed __under the same__ [illegible] __and if the obligations of the licensor and licensee are__ [illegible]

[illegible] obligations of both parties are considered to be [illegible] of both parties are the same [illegible] (1) [illegible]

(ii) duration of the obligation, (iii) the area in which the licence is granted, (iv) degree of exclusivity applied to either party.

If both parties are mutually obligated to inform each other as to the knowledge and experience acquired, in relation to the technology covered in the contract; and the obligation for the licensee remains during the whole duration of the agreement and the obligation of licensor is for a shorter period of time; or if the licensee is obligated to pay royalties for the information while licensor is not obligated; FTC considers that the obligations of both parties are not well balanced.

Furthermore, if a licence which the licensor grants, is effective only for the duration of the contract, while the licence which the licensee grants to licensor is effective during the time of validity of the patent - and this covers a longer period than the contract itself - then the obligations of both parties are not well balanced.

Finally to illustrate what would be the strictest form of grantback restrictions it could be useful to illustrate this with an example:

"In case the licensee has made an improvement, invention, application of new invention, related to the patented goods during the period of the contract, the licensee shall immediately inform the licensor and assign the right of such an invention to licensor without any compensation. The licensor shall have the right to apply for a patent in any country; the licensee shall be given a non-exclusive licence on the invention concerned (his own invention) only in the territory where the licensee has been authorised to manufacture or sell patented goods." In this example it is provided:

i) that in case that the licensee has made an improvement, invention, application of invention or new invention he must inform the licensor thereof immediately;

ii) that the licensee <u>must assign all rights</u> pertaining to such an invention to the licensor without compensation;

iii) that the licensee is granted a non-exclusive licence as a result of said assignment;

iv) that the granted licence is effective only in the territory of the original patent licence;

v) that the licensor without due compensation acquires <u>exclusive rights</u> to exploit a patent developed by licensee in all countries excluding the "licensed territory."

The criteria developed by Mexico concerning grantback restrictions was based on the analysis of more than 2500 agreements and falls closely to the FTC criteria.

In this area the Mexican Government feels that the registration of a contract <u>will be denied when:</u>

i) it establishes the obligation to assign the property of trademarks or patents that might be developed by the licensee;

ii) it obliges the licensee to assign to licensor licensee's own [illegible] upon the termination of the contract;

iii) [illegible] of inventions developed [illegible]

CONCLUDING REMARKS

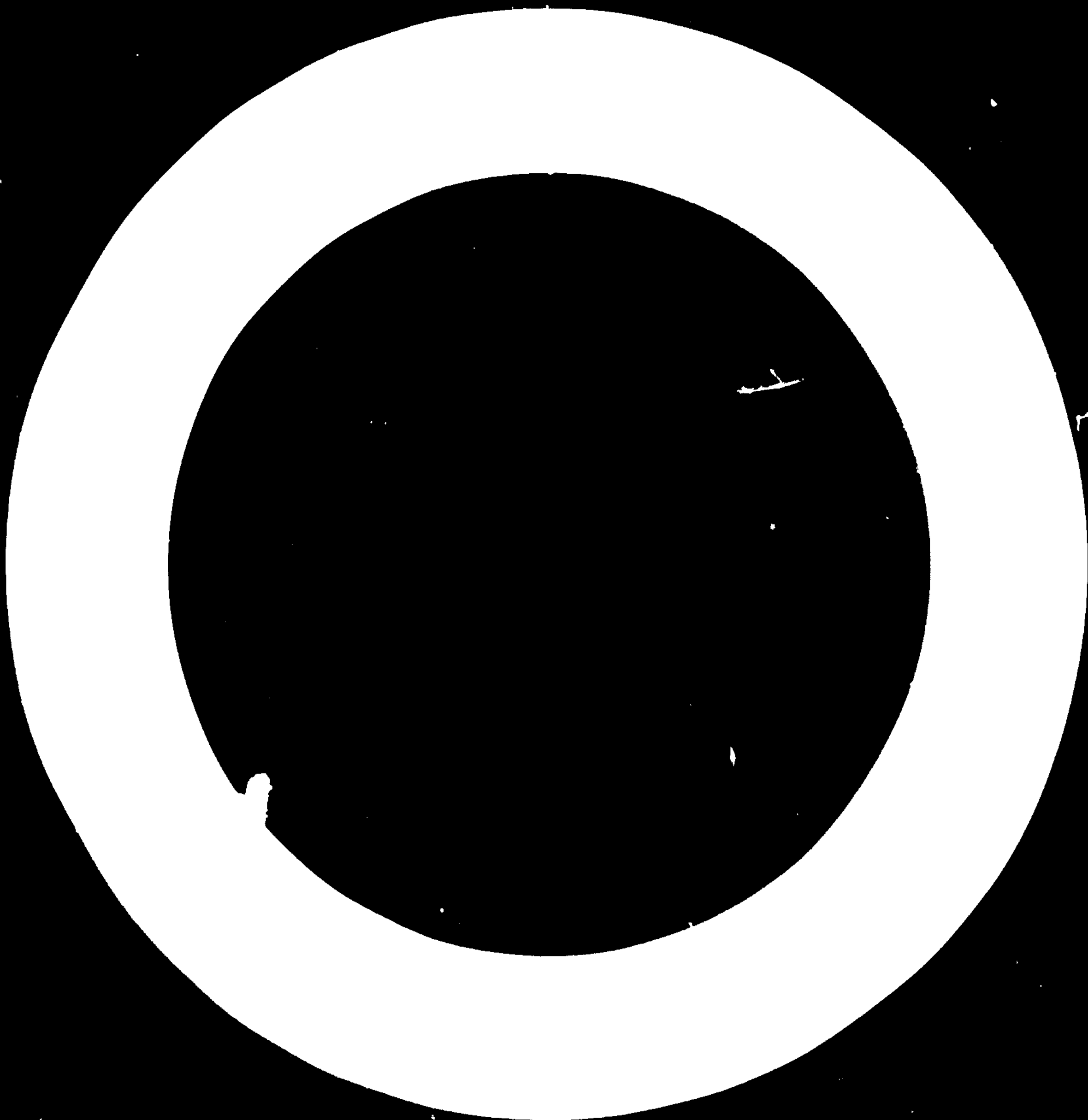
It is the hope of the author that this attempt to illustrate some of the basic criteria of the Mexican Government in the area of restrictive business practices in licensing contracts will serve to encourage additional research and analysis from the part of other developing countries. In preparing this paper an effort has been made to illustrate the complexities involved in dealing with this problem, and to highlight the need for joint efforts in this area among developing nations and to rely more on the assistance of the United Nations and particularly UNIDO for improving communication channels among each other.

It is quite obvious that the implications of restrictive business practices in licensing agreements are quite complex and that in order to deal with this problem and to effectively regulate these transactions the efforts of the developing countries should not be limited to legal scrutinity but rather to incorporate economic and technical considerations to properly assess the effect of these restrictions on the recipient enterprise and the economic and industrial development of the recipient country.

From the point of view of the developing countries the policy rationale in providing intellectual property protection and for the introduction of legislation to regulate in the field of technology transfer should not be viewed in isolation from the economical and technological policy of the country.

The presence of restrictive clauses in international licensing agreements could hamper the economic and technological development of the recipient nations. On the other hand there is a need to understand that technological contracts are excellent vehicles for strengthening the technological capabilities of the recipient country. Furthermore, these agreements are to be evaluated on the basis of economic and commercial criteria in order to properly ascertain the magnitude of problems and to create and maintain a receptive climate for technology and foreign investment into the developing countries.

The author wishes to give due recognition to UNIDO for providing a highly qualified expert assistance to the Mexican Government that made possible the establishment of an efficient system, and allowed important savings and benefits for the economy as a whole. And to encourage other developing nations to support the efforts of UNIDO in the field and to rely on technical assistance projects from UNIDO in the future.



A N N E X I

LAW FOR THE REGISTRATION OF THE TRANSFER OF TECHNOLOGY AND THE USE AND EXPLOITATION OF PATENTS AND TRADE-MARKS ADOPTED BY CONGRESS ON DECEMBER 28, 1972 AND PUBLISHED IN THE OFFICIAL BULLETIN ON THE 30Th. OF THAT MONTH.

LUIS ECHEVERRIA ALVAREZ, Constitutional President of the United States of Mexico, to its inhabitants, GREETINGS :

The Hon. Congress of the Union has sent to me the following

D E C R E E

The Congress of the United States of Mexico hereby decrees:

LAW FOR THE REGISTRATION OF THE TRANSFER OF TECHNOLOGY AND THE USE AND EXPLOITATION OF PATENTS AND TRADE-MARKS.

ARTICLE 1 . The National Register for the Transfer of Technology, in charge of the Ministry of Industry and Commerce, is hereby created.

The National Council of Science and Technology shall be a Consulting Body, as provided in the Law creating the Council.

ARTICLE 2 . The registration in the Register mentioned in the preceding article, is obligatory for all documents containing acts, contracts or agreements of every nature which are effective in the National Territory and which have been entered into for the following purposes :

a) The licensing of the use or exploitation of trade-marks.

b) The licensing of the use or exploitation of patents for inventions, improvements, industrial models and drawings.

c) The furnishing of technical information by plans, diagrams, models, [illegible], instructions, formulas, [illegible], [illegible] and training of personnel or [illegible]

d) The supplying of basic or detailed engineering plans for the building of facilities or manufacture of products.

e) Technical assistance in whatever form it may be fur - - nished.

f) Services for the administration and operation of business enterprises.

ARTICLE 3 . The following shall have the obligation to apply for the registration of the acts, agreements or contracts specified in the preceding article when they are parties to or beneficiaries thereof :

I . Individuals or companies of Mexican nationality.

II . Foreigners residing in Mexico and the foreign com - panies established in the country.

III . Agencies or branches of foreign companies established in the Republic.

The suppliers of Technology who reside in a foreign country may request the registration in the National Register for the Transfer of Technology of the acts, agreements or contracts to which they are parties.

ARTICLE 4 . The documents containing the acts, agree - ments or contracts referred to in Article 2, shall be filed with the Ministry of Industry and Commerce for registration in the National Register for the Transfer of Technology, within 60 days from the date of their execution. If filed within this period, the registration shall be effective from the date of their execution. Upon expiration of said period, the registration shall be effective only from the date of filing.

Further, any amendment of the acts, agreements or contracts referred in Article 2, must be filed for registration with the Ministry of Industry and Commerce, as provided in Article 2. When the parties termi- nate the contracts or agreements prior to the termination date stipulated therein, notice shall be given to the Ministry of Industry and Commerce . within 60 days from the date of termination.

ARTICLE 5 . Proof of registration shall be required in order to enjoy the benefits, incentives, aids or facilities provided by the Law of Promotion of New and Necessary Industries or other provisions or regulations governing the establishment or expansion of industrial business, or for the establishment of shopping centers along the border or in the free zones or areas, or for the approval of the manufacturing programs of persons who, being required to do so, have not registered the acts, agreements or contracts mentioned in Article 2 or the amendments thereof, in the National Register for the Transfer of Technology.

ARTICLE 6 . The acts, agreements or contracts mentioned in Article 2 and its amendments, which have not been registered in the National Register for the Transfer of Technology, shall not have any legal effect and therefore may not be enforced before any authority and compliance thereof may not be enforced before the National Courts.

Also, the above mentioned acts, agreements or contracts, the registration of which has been canceled by the Ministry of Industry and Commerce, shall have no legal effect and their compliance may not be enforced in the National Courts.

ARTICLE 7 . The Ministry of Industry and Commerce shall not register the acts, agreements or contracts mentioned in Article 2 in the following cases :

I . When their purpose is the transfer of Technology freely available in the country, provided this is the same Technology.

II . When the price or consideration does not represent the Technology acquired or constitutes an unjustified or excessive burden on National Economy.

III . When provisions are included which permit the supplier to regulate or intervene, directly or indirectly, in the administration of the transferee of the Technology.

IV . When there is an obligation to assign onerously or gratuitously to the supplier of the Technology, the patents, trade marks, innovations or improvements obtained by the transferee.

V . When limitations are imposed on technological research or development by the transferee.

VI . When there is an obligation to acquire equipment, tools, [illegible] exclusively from any given [illegible]

VII . When the exportation of the transferee's products or services is prohibited, against the best interests of the country.

VIII. When the use of complementary technologies is prohibited.

IX . When there is an obligation to sell the products manufactured by the transferee exclusively to the supplier of the Technology.

X . When the transferee is required to use permanently personnel designated by the supplier of the Technology.

XI . When the volume of production is limited or sale and resale prices are imposed for domestic consumption or for exportation.

XII . When the transferee is required to appoint the supplier of Technology as the exclusive sales agent or representative in Mexico.

XIII. When an unreasonable term of duration is established. Such term shall in no case exceed 10 years, obligatory for the transferee.

XIV. When the parties submit to foreign Courts for decision in any controversy in the interpretation or enforcement of the foregoing acts, agreements or contracts.

The acts, agreements or contracts referred to in Article 2, which are effective in Mexico shall be governed by the laws of Mexico.

ARTICLE 8 . The Ministry of Industry and Commerce may register in the National Register for the Transfer of Technology the acts, agreements or contracts which do not satisfy one or more of the requirements mentioned in the preceding article, when the Technology transferred is of special interest to the country. This exception shall not apply to the requirements cited in Sections I, IV, V, VII, XIII, and XIV of the preceding Article.

ARTICLE 9 . The acts, agreements or contracts required to be registered in the National Register for the Transfer of Technology do not include those relating to :

I . The immigration of foreign technicians for installation of factories and machinery or for making repairs.

II . The furnishing of designs, catalogues or advice, in general, which is acquired with the machinery or equipment and which may be necessary for the installation thereof, provided this does not include the making of subsequent payments.

III . The assistance in repairs or emergencies, provided these are part of any act, agreement or contract previously registered.

IV . The instructions or training furnished by institutions of learning, personnel training centers or by the Company to its workers.

V . The operation of "Assembly Plants" shall be governed by the legal provisions or regulations applicable thereto.

ARTICLE 10 . The Ministry of Industry and Commerce shall pass on the registration and non-registration in the National Register for the Transfer of Technology within a period of 90 days following the filing with it of the documents containing the acts, agreements or contracts referred to in Article 2. Upon the termination of this period without the Ministry having rendered its decision, the respective act, agreement or contract shall be registered in the National Register for the Transfer of Technology.

ARTICLE 11 . The Ministry of Industry and Commerce may cancel the registration in the National Register for the Transfer of Technology, of the acts, agreements or contracts when the terms under which they were registered are amended or modified contrary to the provisions of this Law.

ARTICLE 12 . The Ministry of Industry and Commerce is authorized to verify at any time the compliance of the provisions of this Law.

ARTICLE 13 . The official personnel who participates in the [illegible] of the National Register for the Transfer of Technology shall be required to keep secret all technological information concerning the processes or products covered by the acts, agreements or contracts being registered. This shall not include information which is in the public domain [illegible] other laws or regulations.

ARTICLE 14. The persons who consider themselves to be affected by the rulings of the Ministry of Industry and Commerce may, as provided in this Law, request within eight days from the effective date of notice thereof, the reconsideration of such rulings, submitting the evidence which they may deem appropriate.

The petition for reconsideration shall be filed in writing with the Ministry.

In the petition for reconsideration the petitioner shall offer proof and submit that in his possession. Oral and confessional evidence shall not be admitted. The Ministry may introduce the evidence it may deem pertinent in rendering its ruling.

When the period of proof has elapsed, the Ministry shall render its decision within a period not to exceed 45 days. Upon the expiration of this period without a decision being rendered, the reconsideration shall be deemed to be in favor of the petitioner.

TRANSITORY ARTICLES

FIRST This Law shall become effective 30days following its publication in the "Diario Oficial" of the Federation.

SECOND. The acts, agreements and contracts referred to in Article 2 which have been entered into prior to the effective date of this Law, shall be adjusted to conform to the provisions hereof and registered in the National Register for the Transfer of Technology within two years following the effective date thereof. The Ministry of Industry and Commerce may extend this period when special circumstances so justify.

The documents containing the acts, agreements or contracts shall be filed with the Ministry of Industry and Commerce for its information, without passing on their contents, within 90 days following the date the Law becomes effective.

THIRD . When the provisions of the previous article are complied with, within the periods therein established, the parties may continue to enjoy the benefits and incentives referred to in Article 5, which have been previously granted to them. Otherwise, such benefits and incentives shall be canceled.

FOURTH. Until the acts, agreements, or contracts referred to in Article 2 have been adjusted to the provisions of this Law and have been registered, the parties shall not have the right to enjoy the benefits, incentives, aids or facilities referred to in Article 5, nor shall their manufacturing programs be approved.

FIFTH . Upon the termination of the periods referred to in Transitory Article Second and the extensions thereof, the acts, agreements and contracts which have not been registered in the National Register for the Transfer of Technology, shall not be legally effective, as provided in Article 6.

SIXTH . In the case of acts, agreements or contracts which have been executed prior to the date of this Law, the ruling of the Ministry of Industry and Commerce on their registerability in the National Register for the Transfer of Technology, shall be issued within 120 days following the date of filing the documents.

Mexico, D. F., December 28, 1972. "YEAR OF JUAREZ".

In compliance with Section I of Article 89 of the Federal Constitution of the United States of Mexico and for its publication and observance, I hereby issue the Law in the residence of the Executive Power in the City of Mexico, Federal District, on December 28, 1972, "YEAR OF JUAREZ".

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