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19445

Consultant Agency MARCOS
Executive Office, 100
Cable News
20-1-1945

Licence Agreements

The most common forms of transfer of technology agreements are the licence agreements with the following main types:

- Patent licence agreements
- Know-how licence agreements
- Trade-mark licence agreements
- Copyright licence agreements /for software in the industry/
- Franchise /licence/ agreements.

Other types of contracts involved in transfer of technology transactions are:

- Sales contracts
- Contracts for work and labour
- Leasing agreements /among them also usufructuary leasing agreements/.

Main differences between licence agreements and the other types:

- No change in title /unlike in sales contracts/
- Usually longer in time
- Joint interest
- No special contract laws.

Similarities:

- Similarity to usufructuary lease
/fruits, proceeds are collected by the licensee/
- Similarity to work and labour
/engineering usually involved - at least a basic engineering -
and usually a result is promised /not always//
- Similarity to sale /copies of documentation change title but
only as to their physical bodies, not to their intellectual
contents remaining with the licensor/.

Differences between patent and know-how licence agreements:

- In the definition of the technical subject of the licence.
In the case of a patented invention, it is sufficiently defined by referring to the patent specification and claims by its number, whilst in the case of an unpatented know-how it has to be defined by a more detailed description.

- In the way of protection of the technical subject of the licence.

A patented invention enjoys the statutory protection of the patent, whilst an unpatented know-how can only be protected by secrecy.

- In sanctions and defense against infringement.

In the case of a patented invention the statutory protection comes into motion, while in the case of an unpatented invention or know-how wither laws protecting trade or business secrets or laws against unfair competition can be used, or - if no unfair act has been involved /a competitor has developed it independently - nothing can be done.

Otherwise, there is no difference between the two types of licence agreements.

REMARKS to be made:

- In the strict legal sense, a "licence" applies only to "property" that has statutory protection, which the "know-how" does not enjoy. Nevertheless, the share of the know-how licence agreements shows a continuous increase and is quite considerable in international trade.
- The line between "patent licence" and "know-how licence" is not really a marked one, since a licence agreement between two companies from two different countries may have a technical subject matter which is patented in the licensor's country, but is not ^{always} patented in the licensee's country. In such a case and from the view of the licensee, the licence is a know-how licence agreement.
- "Know-how" will be and is used here as a technical solution, but it should be clear that there is ~~non~~-technical know-how too, like commercial know-how or management know-how etc. In this paper we will consider only technical know-how.

WHAT SHOULD BE IN A LICENCE AGREEMENT ?

There is no fixed, prescribed layout. Also practice varies from country to country and person to person. Similarly, the main features are dictated by the subject of the licence and subjects of the contract.

In general, main heads of a licence agreement are as follows:

- Identification of the parties
- Antecedents, including most favourably the economic aim and purpose of the project and of the licence
- Definitions
- Grants - type of licence and subject of the licence with limits
- Considerations
- Obligations of the licensor - Channels for the transfer of know-how
- Obligations of the licensee
- Possible failures /warranties/ - Consequences
- Intellectual property - Secrecy - Further developments
- Provisions for variation in terms of contract under certain circumstances
- Term /duration/ of contract - Expiry - Surviving rights and obligations
- Effective date
- Premature termination and rights of the parties upon such occurrence
- Applicable law
- Forum for settling disputes
- Miscellaneous.

Some comments and suggestions to these main heads:

Identification of the parties

Requires the utmost exactity and care to state the exact names and addresses with nationalities, headquarters, abbreviated names, if any. It is advised to take it seriously, it is NO FORMALITY.

Antecedents

This part should always be tailored to the case.

State capacity of the licensor /owner, entitled under a licence etc.

State prior events preceeding the conclusion of the contract.

State status of the invention or technology and its phase.

State how and on what basis the licensee selected the technology.

State the economic aim and purpose of the contract and of the project.

The purpose of the above is to indicate previous experience of the licensor in the field and that he acknowledged and accepted the economic aim and purpose of the contract. Needless to say, no licensor will undertake any responsibility for the economic results of a licence or a project which will necessarily be beyond his control, but the technical features, serving for the basis of the economic results, will be - if the contract is correctly worded, and if the technology and its supplier has been correctly selected and the contract is fair and correct in every respect.

Please, remember that if such antecedents are under the title of "introduction" or "preamble" or are in the form of "whereas clauses" such part does not belong to the main body of the contract which will start only after the words "have agreed as follows" or "Now therefore the parties agree". Many authors suggest now not to use such clauses but include such antecedents as clauses of the contract. Should anyone still wish to follow this customary style, this preamble part could be brought into the body of the agreement by making proper reference to it.

Definitions

State and define the invention or the technology, whether patented or not and where, define it by patent number/s/ or in the case of know-how, by some other technical description or specification. If there are many patents, refer to an annex.

Define the technical subject matter of the licence: "Licensed Product", "Licensed Process", "Licensed Technology", "Licensed Trade-Mark", "Licensed Programme".

DEFINE ALL NOTIONS IMPORTANT IN THE CONTRACT!

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Grants

Define ^{and state} the professional licence rights with their limits /manufacture, use /process/, application, sale.

Define and state the territory /geographical/ of the licence.

It must be precise without giving possibilities for interpretation perhaps on the basis of changes. E.g. NO "British Commonwealth" or "EEC-member states" or "Group of 7", since they may undergo change. It is advised to state the exact territory.

Define and state the type of the licence: exclusive, sole or non-exclusive. /Under an exclusive licence, the entitled person is the licensee alone, even the licensor is excluded. Under a sole licence both the licensee and the licensor are entitled, everyone else excluded. Under a non-exclusive licence, the licensor reserves the right to grant similar licences to others/.

Remember: Here again, the lines of the notions must be clear. E.g. A licence may be non-exclusive for the entire world, but exclusive within the given country. Or: The manufacturing licence may be exclusive within the country with no permission to manufacture the licensed product abroad plus a licence for marketing the product with an exclusive right within the country and a non-exclusivity outside of the country with restricted countries, where other licensees have exclusive licences.

Considerations

Licence fees may be: a lump-sum, running royalties or mixed /a so called entry fee plus running royalties/.

Factors usually considered by selecting one of the above licence fee forms:

Lump-sum: Advantageous for the licensee if it can be added to the investment and so financed, whilst royalties are not financed.

Advantageous for the licensor, because he gets the total of the licence fees immediately.

Setback for the licensee: it makes the licensor uninterested in the success after he collected the licence fees.

Royalties: Advantages for the licensee are that he can pay the licence fees always after sales. No setbacks for him, ex

cept for the financing problem mentioned above.

Setback for the licensor: his initial expenses occurred in connection with the transfer of know-how are not covered.

Mixed : Advantageous for both parties and is therefore the most commonly used one.

It is prudent to bind certain parts of the "entry fee" to certain acts /receipt of the documentation, of the engineering, successful guaranty test run/.

It may be prudent to divide royalties between various licence parts /patent, know-how, trade-mark/.

It is important to state method for calculating royalties and their bases /e.g. net sales price, how to obtain such net price with what deductions/.

State if there is an annual minimum royalty.

It is advisable to remember that there are tax aspects and to consult a tax expert.

State methods for payments and possible financial securities on both sides, also the documents for payments, copies etc. with prescriptions for book-keeping or extracts.

It may be useful to remember that there might be two notions covered by the term "lump-sum". Should it mean that the licensee has to pay only one single amount /indifferently from the fact that this amount may be payable in instalments linked to some acts/ and nothing more - the right name is "lump-sum fix". But it could mean that the lump-sum to be paid refers only to a given amount of production and should more than that be produced, royalties are due for the excess production - the name is "lump-sum royalty paid-up".

Obligations of the licensor

- As to patent rights /if any/
 - To follow-up applications in the territory of the licence and try to get the patents granted.
 - To maintain patents in validity.
 - Stipulate who pays the annual renewal fees.
 - If so required, to register the licence with the Patent Office.
 - To inform the licensee on changes.

- To act in the case of an infringement

Possibilities: - Assistance to the licensee

- Representation

- Inemmification

- Hold-harmless

- As to know-how

To transfer it by means of the following channels:

- Documentation needed for realisation of the technology

- To provide the basic engineering if so required -Specify

- To provide training

Specify details: program, number and qualification of trainees, program and place of theoretical and of practical training, period of it, fees and costs

- Consultations in each phase - expenses involved

- Other involvements of the licensor

It is advisable to get him involved in all phases

Warranties

This is an intricate matter.

Resulting from the nature of the licence, in the concept of most national laws, and mainly in the common law countries, responsibilities of a licensor are not dealt with. In their concept, the risks should mainly be borne by the licensee. For quite a long time in the history of licensing, it was the principle of "caveat emptor" /the buyer should be careful/ that prevailed and in some countries - at least partly - it continues to prevail. For quite a long period no warranty was given by the licensor at all and as Melville cited it, a typical clause in licence agreements read as follows:

"Licensor believes that know-how supplied or to be supplied hereunder will be of commercial value to licensee, but does not warrant or represent that any of it is fully comprehensive in its fields, that it is suitable to licensee's purposes, that it is or is not capable of being patented, that it does not infringe the rights of third parties and will not cause any damage or harm..."

Nowadays licensors are already inclined to offer some warranties.

In the concept of most national laws, the licensor should warrant that the use of the licensed technology would not infringe the

rights of third parties, and also that it would be suitable for the purpose acquired.

- Warranty against legal defects has been mentioned already. It is a matter of negotiating skills and of the nature of the licensed technology which of the possibilities mentioned will apply. Obligations of the parties in the case of a claim for infringement should be stipulated. It is advisable to include a statement, that the licensor is entitled to grant the rights /on the basis of ownership or licence/.

Care is the best warranty: a proper patent search in the territory of the licence prior to concluding the contract will reduce the risk of both parties.

It is also advisable to think of the possibility for a third party infringing the licence rights of the licensee.

- Technical "value warranties" or "technical guaranties"

It is advisable to fix critical values for critical parameters responsible for the commercial success and get them warranted

Details of a Performance Guaranty Test Run should be negotiated and fixed in the contract with possible consequences for not reaching them.

Since the licensee is interested in the success and not in collecting penalties or more correctly a reduction of the "price", it is advisable to make provisions for corrections and repetition/s/ of the Test Run.

It is similarly advisable to have weightings for the various value warranties, since their role and impact on the economic result may be very different.

It is also advisable to fix limits under or above which the technology could be refused.

Obligations of the licensee

Payments

- To make them at times and currencies as agreed
- To keep books of account and records needed to determine royalties and any other payments as agreed.

- To pay per diem and other fees agreed.
- To comply with tax provisions.

Absorption of the technology

- To select proper staff
- To make them study the pertinent parts of the documentation
- To finalize the training program with the licensor
- To replace unsuitable staff members.

Organize and manage investment

Though it does not need explanation and does not even belong to the scope of the licence agreement, it may be useful to call the attention to its importance. The project will need investment and acquisition of equipment, possibly from different sources and under different contracts. It is important to have warranties for all equipment fixed in a way - together with dates for delivery - that the plant could be erected in good quality at the time foreseen. Otherwise, warranties for various items of equipment could get lost because the warranty periods could get consumed by improper timing of deliveries, delayed erection and commissioning on the one hand, and on the other, delay may either get warranties for values lost, because the Performance Guaranty Test Run could not have been held at the time set for it, in which case values should have been considered as met with, or, due to excess specific consumption figures of such equipment, disputes may arise with the licensor. Consequently, the matter of design, procurement, erection, contracting, in brief, the organization must be considered as an important part of the obligation of the licensee.

Production

- To use the licence according to the conditions of the contract
- To maintain quality of the products.
- To accept liability for the performance of the products /product liability/.

Reliability and freedom from defects in a product depends as much on the correctness of the technology as on the way in which it is used.

A safety critical part in a motor vehicle e.g. can be rendered faulty and dangerous by a small mistake in heat treatment. Unless the licensor is to impose a local inspection of the pro-

ducts and of the entire production /which would be impractical and also very costly/, he cannot be hold responsible for consequences of a defective part.

It is the licensee who has to accept full responsibility, and he has to indemnify the licensor against any claims other than those directly caused by incorrect technology which must be proved.

Insurance could help.

Consequences of possible failures

Legal defects

- Third party claim for infringement

In the case of a valid patent in the territory of the licence such claim would have a minimum possibility and risk. The defence of the patent is usually and reasonably the job of the patent owner, i.e. the licensor.

If no patent protection exists in the territory of the licence and as already indicated, the first precaution is care: a patent search performed in the territory of the licence to find patents that could possibly disturb the use of the licence. Such search should be done prior to the conclusion of the contract.

Should against all precaution such claim be presented, the parties may agree in the contract as indicated already under the heading "Obligations of the licensor".

If the claim cannot be fought off, it would either be required to take a licence from the claimer, or the technology must be modified to make it non-infringing.

It is advisable to provide for such possibilities in the contract with a possibility to revise certain conditions of the contract, first of all the licence fees.

- Third party infringement

When provisions are being made in the contract, the following aspects should be given consideration:

If there is a valid patent in the territory:

- Evaluate damage done, loss suffered
- Evaluate chances for success of a law suit

- Measure costs against possible gains

One may find that efforts are not comparable to results, and especially, when the damage is not too severe. In such a case it may be more prudent and more economical to tolerate infringement. Consequently:

It is advisable to provide for a joint evaluation of the situation with a joint decision from case to case.

A limited compensation to licensee could be foreseen for the case when licensor has refused to take action even after chances have been found positive and loss was considerable, or, the licensee should be permitted to sue the infringer and the licensor should be obliged to assist him.

It may similarly be provided for in the contract, that should the licensor refuse to use his patents against an infringer, or uses them but fails in court to win the case and damage is considerable, that element of the consideration which is for such patent protection, should cease to be subject for further royalty payments. Or: The licensee should be entitled to terminate the contract.

It should be remembered, however, that to prove infringement is not always simple and might even be rather difficult.

If there are no patents in the territory:

If the measures mentioned under "Differences between patent and know-how licence agreements" cannot be taken or fail, the infringer of the licence rights may get into a favourable competitive position, since he is not obliged to pay royalties. It is suggested therefore, that the contract should have a provision which either releases the licensee from the obligation to pay royalties, or oblige the parties to review the situation and adapt the contract to the new situation - may be by a joint decision to dissolve the contract.

Physical failure

As mentioned already, a failure to achieve minimum warranted value in critical factors should be sanctioned by a reduction of the "price" i.e. of the licence fees. It is advisable to agree to a scale in the contract for all critical factors with tolerances and

limits below or above which the technology should be termed as unsuitable for the purpose.

Remark: It is cautioned against placing limits too eagerly and to make consequences too hard, because it either causes the licensor to refrain from signing such a contract at all, or to increase his "prices".

Commercial failure - failure of the licensee

It may happen that preparation of the project was not proper for any reason /market was wrongly evaluated, size of the plant incorrectly selected etc./. It is advisable therefore to make a provision in the contract, according to which, should the licensee pay only the minimum annual royalty over a longer period - say 3-5 years - the parties will jointly review the situation, analyse causes and decide what measures to take, including the possibility to resolve the contract in agreement.

This also covers the point mentioned under "Provisions for changes in terms".

Intellectual property - Secrecy - Further developments

Intellectual property stays with the licensor.

This increases the importance of secrecy. It is advised to take this matter very seriously, all the more so, as it is in the interest of both parties. It is particularly important if the subject matter is an unpatented know-how. It is also advisable to make secrecy a joint obligation.

As a consequence of such intellectual property, it is also advisable that changes in the technology should be made only after an approval of the licensor - particularly, if a trade-mark is also involved.

Further developments

If the licensee wants to stay competitive, further developments of the technology in all its elements/process, equipment, product and product application/ is simply a must.

If the licensor has a strong development-research section and it can be expected to continue to bring new results, it is in the interest of the licensee to obtain them as long as possible, even, if this means a prolongation of the obligation for royalty payment. Authorities limiting such periods commit serious errors and place

short term financial interests before longterm technical and financial interests.

It is an advantageous solution to provide for in the contract the so called "pool or club of licensees" named sometimes - not quite correctly - "cross-licensing". This means that over a period fixed in the contract, the licensee agrees to submit, free of charge to the licensor any and all improvements made by him, which the licensor can freely pass over to those other licensees of him, who have agreed to a similar obligation. Thereby, the licensee not only gets the improvements of the licensor, but also of other licensees. Such "pool" or "club" usually also includes annual meetings held at the works of members, where all other members have the possibility to see results in practice and exchange information by direct contact.

Other possibilities for exchange: Innovations or improvements that are considered non-patentable are exchanged free of charge, while those considered patentable, only against payment on both sides. Or: all improvements are exchanged free of charge. A one-sided obligation, where only the licensee is obliged to supply improvements is considered under most regulations against unfair competition as being illegal /so called "black clause"/.

Duration of contract - Surviving rights and obligations

The time or period of validity strongly varies with the subject of the contract. In the case of a simple show-how, it may be only a few weeks. In the case of production of capital equipment, it may be as long as 20 years. For other subjects it may be anything in between, The longterm interests should be considered.

Expiry

A licence agreement almost never expires on one particular day. There are almost always rights and obligations that survive, such as: secrecy, further developments, settling of disputes. This must be remembered when drafting.

Premature termination /termination for cause/

As in all contracts, the right for termination for cause being a breach of obligation uncured or unrepaired within the time set in the admonition should be provided for in the contract, however, this should only be a final resource.

Applicable law

Practice shows that licensors or transferors of technology /and also of other commodities/ feel themselves more exposed to risks under a governing law they are not familiar with, which greater risk usually results in higher prices. It is therefore suggested, not to insist on the law of the country of the recipient to govern the contract, but instead, to select a neutral law known to both parties.

It may similarly prove to be of advantage to select a fully codified law, e.g. the Swiss law of contract /Schweizerisches Obligationenrecht/.

Since neither of the laws used in international practice have special rules for immaterial commodities, here again it should be called to attention, how important it is to make a clear, correctly worded, fair, balanced and correct contract.

Forum for settling disputes

Experience shows that priority should be given to arbitration and among the possibilities for arbitration to one with institutional process rules. Whilst such an arbitration is not inexpensive, the suggested forum /e.g. that of the International Chamber of Commerce Paris/ saves time and money.

It is suggested to stipulate the language of the procedure to be the language of the contract.

Some remarks concerning other licence agreements

Model licence agreements

They are similar in contents, but due to the shorter period of protection, they usually run for a shorter period.

Trade-mark licence agreements

Since the technologies are usually less intricate, technical conditions and those connected with them, like warranties, are usually much simpler.

A stricter control over the production of the licensee by the licensor is usually stipulated.

Software licence agreements

The licence is usually perpetual.

The licence fee is usually a lump-sum fix, with no royalties involved.

Since the software is a peculiar commodity which is usually never free of defects, which defects, or a considerable part of them can only be detected after a longer period of operation, parallel with the licence agreement, usually a Software Maintenance Agreement is also concluded, under which defects detected after the warranty period is over, are corrected against payment.

Franchising agreements do not really belong to the industrial sphere since their subjects are usually service operations, are not dealt with here.

Some general remarks

- Quite frequently, licence agreements have more licences as subjects belonging to other types of licence agreements as mentioned here. E.g.: a patent licence agreement may also contain a trade-mark licence, or a trade-mark licence could be granted for a patented product etc. All said above would apply to such cases, too.
- Quite frequently, transfer of technology agreements also include supplies of certain key equipment. It is advised to remember and apply all said above with the additional feature that warranties for the equipment can be more easily tackled with.
- The same applies to the supply of complete plants, in which case the supplier undertakes an integrated responsibility and undertakes to produce a result. In such a case the licence would be a secondary subject. Nevertheless, it is suggested to remember those said about the licence agreements and apply them in an adapted way.