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Industrial Property Rights - Licensing and Joint Ventures Abroad

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INDUSTRIAL PROPERTY RIGHTS— LICENSING AND JOINT VENTURES ABROAD*

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Every firm engaged in international trade has occasion at some time to consider overseas licensing of industrial property rights and joint ventures with foreign partners. A frequent pattern of market penetration has been for companies to begin by exporting and go on to licensing and joint venture arrangements. Both are excellent channels for the exercise of what Secretary of Commerce Maurice H. Stans has called the fourth Economic Freedom—the Freedom to Exchange Technology.

LICENSING AGREEMENTS

The rights granted in foreign licensing agreements are of three distinct types; patent rights, trademark rights, and knowhow rights. The combination of these rights licensed in any particular agreement will depend on the respective resources and needs of the contracting parties, and on the products or technology involved.

Patents are limited monopoly rights conferred by the government of a country within its own area, and in accordance with its own laws and regulations. Ownership or control of a U.S. patent does not automatically give protection in other parts of the world or provide the basis for a license grant to a foreign concern.

To obtain foreign patent rights the company must file a separate application in each country in which it desires protection. Under the International Convention for the Protection of Industrial Property, the person or concern filing an original patent claim in one member country has a priority right of application for the corresponding patent right in other member countries for a period of one year following the original filing. The number of countries which belong to the Convention has been rising steadily and now stands at about 80, including all of the industrialized nations; the Soviet Union joined in 1965 and most of the other European communist countries are also members.

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Therefore the U.S. company interested in securing foreign patent rights for licensing purposes should apply for these rights within one year after applying for the U.S. patent. The laws and regulations governing the registration, use and protection of patents, trademarks and other industrial property rights are many and complicated. Any company interested in obtaining and exploiting foreign patent rights, either directly or through licensing arrangments should have the help of a competent patent attorney.

Like patents, *trademarks* are a limited monopoly right granted by a government within its own geographic area. A U.S. company acquires its foreign rights by use and/or registration in each country in which it desires protection, and retains these rights by observing the local laws and regulations with respect to renewals, fees, supervision and use of the registered marks.

Unlike patents, which have a limited life of 15, 17, 20 or other fixed term of years, depending on the country, trademark registrations can be renewed. In this respect, therefore, a trademark can be a more lasting right than a patent. They are most valuable of course, in connection with consumer goods and other products which retain their identity at the stage they are merchandised and sold to the ultimate consumer.

FAST ACTION REQUIRED

Trademark registration abroad is facilitated and protected by the International Convention in much the same manner as patent applications, but the priority right of registration is limited to six months. Only by timely and widespread registration can a company be sure of having the right to use, and to keep others from using, its domestic trademark in foreign markets. Registration fees vary in amount but the cost per country is relatively small.

As in the case of patents, the owner can assign or sell his trademark in a given area, or can license its use to others. However, in the case of licensing he must in most countries undertake a supervisory responsibility beyond that required in patent licensing.

While *knowhow* is gaining recognition as a legal property right, it does not have statutory protection like that for patents and trademarks. So in granting a foreign company the right to use is unpatented knowhow, the licensing company is quite dependent on good faith and contractual safeguards for the protection of its ownership rights.

While knowhow rights can be licensed alone, and are frequently the

most valuable consideration included in a licensing agreement, it is common practice to link them with a patent or trademark right when this is at all feasible. The knowhow enhances the value of the other licensed rights, while the inclusion of a patent or trademark license gives the licensor a statutory basis for more control over the use of the licensed knowhow.

EIGHT LICENSING ADVANTAGES

Not many companies confine their foreign operations to licensing alone. Most firms view licensing as a supplement to exporting, manufacturing, or both rather than as a sole means of entering overseas markets. However, particularly for those who for financial or staff limitations are limited in the resources they can devote to foreign business, this may be the most feasible method of penetrating an overseas market. Here are some of the reasons companies have given for getting into foreign licensing.

- Licensing opens the way to getting a foothold in foreign markets without large capital outlays. It is therefore a favorite device for small and medium sized companies.

- Returns are apt to be quicker in coming than in the case of manufacturing ventures.

- The income from foreign licensing helps to underwrite costly research programs.

- Licensing enables a firm to retain markets otherwise lost by import restrictions or because it is being outpriced.

- Licensing can be used to test a foreign market and then to service it without costly additions to production or detracting from the supply available for local customers.

- To develop outlets for components or other products and to build goodwill for other company products.

- To protect patents and trademarks (e.g. against cancellation for nonuse).

- To establish a company in countries which are sensitive to foreign ownership.

In hazardous situations licensing can provide a local base without the risk of investment. For example, some of the risks of marketing in the countries of Eastern Europe can be avoided through licensing arrange-

ments. Similarly, in the developing countries emergent industry often provides the basis for technical assistance in a gradually developing market that could not justify a major investment and that may be closed to imports by tariffs or other barriers.

RECIPROCAL BENEFITS

Some licensors consider the acquisition of foreign license rights one of the major benefits to be gained from licensing operations. For this reason reciprocal license grants are frequently made in a manufacturing or patent licensing agreement as partial compensation for the rights and knowhow made available by the licensor. Where a foreign licensee has no reciprocal rights or knowhow to offer the licensor at the time a licensing agreement is concluded, it is often customary to include in the licensing contract a grant-back or feed-back commitment with respect to the rights and knowhow supplied by the licensor.

All should be aware of the principal hazards and disadvantages of licensing as a marketing technique.

- Every licensee is a potential competitor. However, if the arrangement is truly of mutual benefit, both parties will want to perpetuate it and continue to exchange knowhow and product improvements.

- Licensor control over the licensee's manufacturing and marketing operations is rarely completely satisfactory. This can result in damage to your trademarks and company reputation. The technique for averting this problem lies in careful investigation before selecting a licensee, and maintaining quality control whenever a trademark or trade name is licensed.

- Licensing is probably the least profitable way of exploiting a foreign market. On the other hand the risks and headaches are usually less than investing, although perhaps more than exporting. Moreover, licensing may represent the only way to enter certain markets and the return, although small, is better than losing out altogether.

Before turning to the Government services which can help you in licensing operations, it is revealing to note briefly the part it plays in our international balance of payments.

LICENSING EARNINGS

It is very difficult to measure the actual money payments on licensing account to and from all U.S. firms. However, fairly reliable estimates

have been developed which at least give an idea of their general size and the trends. These figures cover payments for the licensing of patents, trademarks, and knowhow, and include income from copyrights and management fees directly connected with the transfer of intangible property.

In 1967 payments to Americans from foreigners in connection with the licensing of intangible property were estimated at $786 million, divided $438 million in payments from direct investment sources abroad and $348 million from nonrelated foreign firms. This represented an increase of about 10% over the 1966 total of $709 million. Estimates for 1968 are not complete but the indications are that these payments again increased to over $800 million.

Over the years income from direct investment licensing has increased more than income from licenses with nonrelated firms abroad. Much larger figures than these are sometimes cited as attributable to licensing; however, they include management and service fees unconnected with licensing (1967 total $702 million).

On the other side of the ledger, payments from the U.S. to foreign recipients have also risen steadily from year to year. In 1967, these outpayments amounted to around $138 million.

Thus, the U.S. had a favorable balance as far as licensing is concerned of some $662 million in 1967 and $571 million in 1966. These figures, it should be noted, reflect only pure royalty and fee payments. If one takes into account the merchandise shipments which frequently accompany licensing arrangements, the earnings attributable to licensing would be much larger.

What help does the Government provide to firms that want to engage in licensing transactions? There are a number of pertinent programs, most of which have been emphasized and expanded in recent years as an important part of the national effort to combat the balance of payments deficit.

GOVERNMENT AIDS AND SERVICES

The U.S. Department of Commerce can provide economic, marketing and financial information, some of it free, and some at a very low cost where special services are required.

It can provide trade lists to help in finding customers, distributors, agents and licensees abroad; world trade directory reports containing

basic commercial and financial information on specific foreign firms and individuals; and all kinds of customs, tax, and legal information, including patent and trademark regulations abroad.

For $50, a special survey will be made on a firm's behalf by the U.S. Foreign Service to help find a qualified licensee in a specified country. This service is available from any Commerce Field Office by submitting Form FC-965—Application for Assistance in Selecting a Firm to Manufacture under License. The $50 cost is a bargain in terms of what you get—a canvass of the local business community for the licensees, identification of the most promising prospects, and an evaluation of their suitability.

The Bureau of International Commerce (BIC) periodically sponsors trade missions to potential foreign markets. The missions are basically selling teams sent out to develop business opportunities. The mission members talk in person with foreign businessmen. They take with them specific business proposals submitted by American firms. The teams include experts in various lines of business and industry, often including persons experienced in licensing techniques. They return with proposals and offers submitted by foreign firms and these are made freely available to the business community.

BIC also reviews reports submitted by U.S. Commercial Officers abroad for trade, investment and licensing opportunities. Most of them are published in INTERNATIONAL COMMERCE, and receive further dissemination as well. A goodly proportion of these opportunities report on the interest of foreign companies in U.S. patent, trademark or other property rights.

Information on these and other Commerce services is available from the Department's Field Offices throughout the country.

The Agency for International Development seeks to increase investment by U.S. private enterprise in the economies of free less developed countries by guaranteeing investors against certain political and business risks. Specific risk guaranties are available in most less developed countries against any or all of the following risks: inability to convert earnings or return of the original investment into dollars, loss due to expropriation; and damage to property resulting from war, revolution, or insurrection.

Guaranties are issued to cover an investment in the form of a licensing agreement for the use of patents, processes and techniques in exchange for royalty payments. Ordinarily, however, an agreement calling

for payments of royalties or fees will not be eligible for guaranties unless the investment is intended to extend for at least five years.

Congress specifically included these intangible assets in the investment guaranty program to encourage the spread of advanced technological methods. Trade names, trademarks and goodwill, while often closely associated with the license of patents, processes and techniques, are not eligible for guaranties. The maximum convertibility coverage obtainable under a licensing agreement is the sum of the royalty payments over the life of the contract. The investor must furnish AID with a copy of the licensing contract and substantiate both the reasonableness of the royalty rate and the estimate of royalty payments.

Attitudes abroad are favorable to both licensing and joint ventures. Some 60 Governments have adopted special legislation or policy statements relating to the conditions for the investment of private capital. Some of these laws apply to the licensing of industrial property and their provisions should be checked to see if the benefits provided are available to licensing agreements. The laws usually cover such matters as provisions relating to entry and approval procedures, assurance against expropriation, right to transfer profits and capital, limited exemptions from income and property taxes, and exemption from payment of certain import duties.

Most Governments are positively favorable to both licensing and joint ventures because of three principal factors: (1) import substitution with cost savings; (2) export possibilities; (3) training of local management and technicians in modern business and industrial methods. They are cautious, however, because of the foreign exchange costs and because of the possible impact on domestic competitors.

TAX CONSIDERATIONS

The enactment of the Tax Revision Act of 1962 interrupted the growing use of U.S.-controlled foreign subsidiaries to carry on licensing operations. However, one of the prime incentives for licensing continues to be the much lower royalty tax on patents, trade marks and other services over corporate rates. Under double taxation treaties, royalties received for copyrights, patents, trademarks, etc., are either exempt from tax or taxed at a reduced rate. The U.S. has tax treaties in force in all of the Common Market countries and in all European Free Trade Area countries except Portugal.

The United States has also engaged in discussions with a number

of less developed countries on the basis of a new approach to income tax treaties with them. One new feature is an incentive to licensing and joint ventures. It would provide deferral of current taxation by both the U.S. and the foreign country of compensation received in the form of stock in a foreign corporation in return for transferred technical knowhow, patents, technical service and the like. This is intended to enable U.S. investors to furnish property, services, or knowhow to a foreign corporation without being required to pay tax at time of transfer in either of the two countries. The tax thus deferred may be imposed when the stock which is received tax free is eventually disposed of. Also, these treaties provide, subject to prescribed conditions, that the rate of tax imposed by one country on royalties received by a resident or corporation of the other country not having a permanent establishment in the country imposing the tax shall not exceed 15% of the gross amount thereof. "Royalties" for this purpose include (a) copyrights, artistic or scientific works, patents, designs, plans, secret processes or formulae, trademarks . . . or (b) information concerning industrial, commercial or scientific knowledge, experience or skill.

Tax treaties of this type have already been signed with Brazil, Israel and Thailand. The Brazilian Treaty has been approved by the U.S. Senate, but not by Brazil.

SOME CURRENT DEVELOPMENTS

There are some other developments and projects of general interest which will have the effect of assisting the prospective international licensor.

• One problem area is patents. The very large increase in applications is taxing existing facilities and causing what has been called an "international patent crisis." As a result, countries having an examination system have been confronted with large backlogs of patent applications. Duplication of effort contributes heavily to these backlogs since about half of all applications filed are duplicates of applications filed elsewhere. This situation is one of real gravity because U.S. persons and firms file more patent applications abroad than nationals of any other country. The problem is further aggravated by differing national laws and procedures.

To meet this problem the U.S. Patent Office is working with other countries to simplify and unify the patent application formalities prescribed by national patent laws, to achieve a uniform system of patent classification, and to agree on certain basic principles of patent laws.

A diplomatic conference to negotiate a proposed Patent Cooperation Treaty is scheduled to take place in 1970. Recently the idea of a "European Patent," first raised in 1962, was revived in a new plan with assurances that non-European countries would be permitted access on a reciprocal basis.

• Consideration is also being given to U.S. participation in an international trademark convention. This would make it possible to centralize protection of trademarks in an international registration. One registration would suffice for all the member countries. The considerable saving in time and money is indicated by the fact that there are 150 independent trademark jurisdictions throughout the world, according to the tabulation of the U.S. Trademark Association.

• On Dec. 3, 1968 the United States deposited instruments of accession to five international customs conventions. These conventions to which the Senate gave its advice and consent to U.S. accession on March 1, 1967, are as follows: 1) Customs Convention regarding ECS Carnets for Commercial Samples; 2) Customs Convention on the ATA Carnet for the Temporary Admission of Goods; 3) Customs Convention on the International Transport of Goods under Cover of TIR Carnets; 4) Customs Convention on Containers; and 5) Customs Convention on the Temporary Importation of Professional Equipment.

Together, these conventions will facilitate the temporary, duty-free entry into member countries of a wide variety of articles, and will ease the customs clearance procedure for goods in transit. Some of these facilities should be available to U.S. business soon. Each of the conventions is in force with respect to all of the major trading countries of Europe as well as several other countries. U. S. adherence to the international carnet system will be helpful to firms which need temporary duty-free entry privileges in connection with their licensing activities.

• Another measure that should be helpful to licensing is the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. This convention is designed to facilitate the recognition and enforcement by foreign courts of arbitral awards granted in the U.S., as well as similar action by our courts with respect to foreign arbitral awards. U.S. adherence could become effective this year, assuming implementing legislation is enacted. It should encourage further use of arbitration by American firms in their foreign sales, investment and licensing activities.

• Export licensing controls apply to the export of technical data.

As simplified earlier this year (Current Export Bulletin No. 980, January 28, 1969) there are now two general licenses. General license GTDA authorizes the export to all destinations of 1) data that have been made generally available to the public in any form; 2) scientific or educational data not directly and significantly related to design or production; 3) data contained in an application for the foreign filing of a patent, provided that the patent application has been filed abroad in an "earlier publication country." A second general license designated GTDR authorizes the export of technical data not exportable under the provisions of general license GTDA subject to specific restrictions depending on the destination. Exports that do not meet the conditions of either general license GTDA or GTDR, require a validated license.

Licensing relationships often involve or lead to joint business ventures. Such ventures include any business activity where management is shared by two or more collaborating firms.

During the past ten years the number of joint ventures has sharply accelerated and they have become an important part of the international business scene. Federal Trade Commission Chairman Paul Rand Dixon has stated that between 1960 and 1966 the 50 largest U.S. industrial corporations entered into 92 overseas joint ventures with both American and foreign firms. Joint ventures are to be found in the oil consortia, construction projects, companies exploiting basic metals and in manufacturing.

As in the case of licensing one of the strongest appeals of joint ventures is that they substantially reduce, by the amount of the partners' contributions to the venture, the political and economic risks that are the principal obstacles to direct foreign investment. The presence of a local partner not only guards against government encroachment or outright expropriation but also helps to protect the venture against the nationalistic feelings existing in many countries, which often lead to restrictions and discrimination against foreign investors.

According to a survey made by the National Industrial Conference Board there are several psychological and technical advantages to an international joint venture. There is a valuable pooling of resources, ability, and experience between local and foreign partners. Together the partners supply capital that either one alone would not want to risk or could not raise. Local partners contribute knowledge of local management methods, customs, laws and business practices, and provide access to customers and labor markets in the area.

Joint business ventures are the preferred form of doing business in the eyes of many less developed countries. They look to the foreign partner to bring needed technology and capital to build basic industry and supply needed services, as well as to expand exports. At the same time joint ventures give local businessmen the opportunity to maintain some share in the profits and in the management of enterprises established locally.

The primary objection to joint ventures raised by executives who prefer wholly owned enterprises is that it involves loss of freedom of action in production and marketing operations. Shared ownership means shared management and profit. Partners must be convinced that a change is necessary before it can be done.

Difficult decisions confront corporate managers in considering joint venture opportunities. The main issue largely centers on the matter of control. If assured control is desired it can be achieved only through ownership of a majority of the voting stock of the joint enterprise. Control is particularly important in the cases of dividend policy, recapitalization, major expansion, borrowing money, selection of management, acquisitions and dissolution. Degree of control needed for a given action varies, of course, among jurisdictions.

Dividend policy in particular is a matter on which joint-venturers can easily get at loggerheads. This is particularly true if one party is a corporation and its partners are individual investors. The corporation would probably favor a policy of building the business from retained earnings. The partners, on the other hand, would frequently have as their chief interest maximum, immediate dividends.

American companies also have to consider nowadays the possibilities of joint ventures with a foreign government as a partner. This sort of relationship imposes an entirely new set of conditions with which most U.S. industry is unfamiliar. Generally speaking it is not an arrangement which companies would select if they had any other choice. The increased use of state-trading entities in certain countries, however, probably indicates that this type of joint venture will be the prevailing vehicle for some countries and that failure to accommodate to it may involve losing the market. This type of venture will be found in some Soviet bloc countries, less developed countries, and in even a few countries of Western Europe. The natural hesitancy of U.S. firms to become involved in this type of arrangement is not fully shared by Western European firms, which have branched out into bloc countries via the joint venture route.

Acquisition is probably favored by most companies as a better means of obtaining a fair share of a market. The acquired company probably has a distribution network in the country and in export markets. Here some caution is indicated since in many countries difficulties and expenses may be met if it becomes necessary to terminate distributorships.

One U.S. manufacturer with abundant experience on the question says there are basically three instances where joint ventures seem appropriate:

- When the company lacks capital or personnel capabilities to expand its international activities otherwise.
- When the company seeks to enter a market where wholly-owned activities are prohibited, and
- Where it may enable the company to utilize skills of a local partner.

Some United States enterprises have adopted a policy of operating in foreign countries only on a joint venture basis. They have found that for them the best method of operation is to share equity ownership and control with nationals of the country. Generally speaking the trend toward joint ventures is desirable as long as it reflects the voluntary decision of the business enterprise concerned. However, the subject of joint ventures is so complex and the problems are so variable that generalized opinions are very risky. The decision depends on the facts of each case and is up to the individual firm to decide one way or the other.

U.S. firms considering the possibility of licensing or joint ventures abroad may find a variety of reference works of interest. Among such publications are:

Appraising Foreign Licensing Performance, by Enid Baird Lovell, Studies in Business Policy No. 128, National Industrial Conference Board, New York, 1969. 106 pp. $3.50 to NICB members.

Practical Patent Licensing, by Albert S. Davis, Jr. Practising Law Institute, New York, 1966. 311 pp. $15.00.

International Licensing Agreements, by Gotz M. Pollzien and George B. Bronfen. Bobbs-Merrill, Indianapolis, 1965. 426 pp., $22.50.

Industrial Property Rights Overseas, American Management Association, New York, 1964. 40 pp. $1.50 to AMA members.

Trademark Licensing: Domestic-Foreign. The United States Trademark Association, New York, 1962. 90 pp. $2.

Licensing in Foreign and Domestic Operations, by Lawrence J. Eckstrom, Foreign Operations Service, Inc., Essex, Conn., 1964. 1059 pp. $32.50.

International Trademark Protection, by Eric D. Offner. Fieldston Press, New York, 1965. 285 pp. $20.

Foreign Licensing Agreements: I. Evaluation and Planning, Studies in Business Policy No. 86, National Industrial Conference Board, New York, 1958. 88 pp. $3 to NICB members.

Foreign Licensing Agreements: II. Contract Negotiation and Administration, Studies in Business Policy No. 91, National Industrial Conference Board, New York, 1959. 96 pp. $4 to NICB members.

Joint Ventures with Foreign Partners, National Industrial Conference Board, New York, 1966. 92 pp. $3 to NICB members.

Joint International Business Ventures, by W. G. Friedman and George Kalmanoff, Columbia University Press, New York, 1961.