

BY *LUIS C. SCHMIDT*

PARTNER

LES/AIPPLA MEETING, NOVEMBER 2005

1.0 THE ROLE OF LICENSING IN TODAY'S BUSINESS AND ECONOMY.

There is no question that intellectual property licensing has played a major role in today's business and economy. Nobody would disagree that companies in a modern world can only grow on the basis of technology or other intangible properties and that licensing is essential for achieving that goal.

1.1 INTELLECTUAL PROPERTY AS A VALUABLE ASSET.

Intellectual Property is the right that authors or inventors hold for having created something original or novel. The subject matter of intellectual property, that is, works of authorship, inventions and trademarks, has significant value. The value of intellectual property can be viewed from different angles. From the cultural side intellectual property is valuable as it represents an exceptional contribution to human progress and wealth. From an economic perspective intellectual property is valuable since it is a scarce intangible asset giving companies or individuals a key competitive advantage in trade. Under the law, intellectual properties are protected on an exclusive basis and accordingly, their use is restricted to eliminate all possible forms of competition. Governments have considered that by protecting intellectual property they will ultimately stimulate creativity and accordingly, raise the cultural or economic level of the country.

1.2 INTELLECTUAL PROPERTY RIGHTS CAN BE LICENSED.

Holders of intellectual property rights can authorize third parties to use their works, inventions or trademarks. From a formal standpoint the authorization is called a license, generally a contract and thereby subject to the principles and

provisions of contract law. Licensing has proved to be a very effective mechanism for trading goods that are made under technologies or other proprietary rights. Licensing contracts entitle third parties unrelated to the rights holder to make a patented product, to copy or publicly perform a copyrighted work of authorship or to use a trademark. In the end “authorizing” or “licensing” the use of technologies to other properties is what licensing is all about. Licensing helps to reduce the “monopoly” effects of intellectual property rights. Licensing is principally “voluntary” in the sense that rights holders are free to decide who they will designate as licensees and what rights they will grant to them. However, in certain cases and for determined purposes the law will impose compulsory licenses, without to give the licensor the chance to grant a voluntary authorization.

2.0 LICENSING FOSTERS THE GROWTH OF BUSINESS AND ECONOMY

Licensing is one of the principal mechanisms available for ensuring that a given technology, trademark or copyrighted work will contribute to the growth of a business. Companies get attracted to licensing as it offers the chance of making profits without having to invest much money or resources like labor or other kinds. Licensees generally participate in investments and take their own risks in that regard.

2.1 THE NEED OF TECHNOLOGIES OR OTHER PROPERTIES

In complex world like the one we live few companies are able to develop internally every technologies needed for the manufacture of their products. On a frequent basis companies require technology from outside providers and accordingly, rely on licensing as the vehicle for obtaining the same. On the other hand, companies that develop technologies have the chance of expanding their business by using licensing as a strategy to penetrate markets that are unknown to them. However, if managed efficiently, licensing can certainly be the source of important income for the licensor.

Licensing has typically attracted governments as well. For the past decades international trade operations have multiplied and nations have become more sensitive to that. In that context governments have used intellectual property to capture economic value, making international trade operations more profitable,

and ultimately contributing to the trade balance of countries. Economic values obtained from intellectual properties can take different forms, which include taxes, wages and salaries, among others. Governments have in fact been interested to protect and enforce intellectual property rights only to the extent that they represent a benefit for the country. Accordingly, the more benefit a country is expected to receive from the trading of intellectual property rights the stronger means of protection and enforcement it will utilize.

3.0 IS LICENSING MERELY A LOCAL PROBLEM?

Licensing is important in the local context of trade and business. However, it is equally important on a global level. Companies would likely survive without expanding their business to foreign lands, especially if their local markets are large enough and sufficiently wealthy to keep the company working. However, cross-border licensing of intellectual property rights can be an additional attraction for expanding a business. Likewise, cross border licensing can be the chance of technology receivers to produce a more competitive product.

3.1 LICENSING FROM THE US TO ABROAD

US Companies are in the up front of international licensing. As professor Karl Jorda has stated, US companies and the country as a result, have benefited from international licensing: “Between 1950 and 1980, US companies signed approximately 32,000 licensing agreements” and that amount “grew at an unprecedented pace with the advent of technological developments”. Examples of the foregoing can be found in nearly every field of culture and industry: U.S, pharmaceutical laboratories like Abbott, Eli Lilly and Pfizer celebrate international patent license operations on a frequent basis with a number of foreign parties. In a similar fashion, McDonald’s, Starbuck or Domino’s Pizza have embarked into hundreds of franchise deals practically in every corner of the world. And in the cultural industry U.S. film and TV producers distribute their movies around the globe for public exhibitions, broadcasting or rental and also for dubbing or sub-titling.

3.2 LICENSING FOR ABROAD TO THE US.

United States is a large market and a very competitive one as well. Notwithstanding that fact, companies from other countries have always been interested doing all forms of trade, licensing included naturally. A number of European and Asian corporations have been able to conquest the US consumer, in a direct fashion or in alliance with US business partners. Latin American companies have entered the US market in a lesser degree, but there have been some remarkably successful stories to tell.

4.0 WHAT WOULD A TYPICAL CROSS-BORDER LICENSING OPERATION REQUIRE?

4.1 DIFFERENCES

International licensing is not like licensing in a domestic setting. US licensors exploring new markets need to consider this:

- The level of economic developments of the receiving country.
- The particularities of the geography, history and culture, including the language and the economic, social and political systems.
- Differences in business practices and in the manner that negotiations are conducted in the receiving country. Cultures can vary a lot in this regard. Professor Jorda refers to syndromes like the Black Ship (exertion of pressure from outside), Totem Pole (value to authority, title and hierarchy), Black Hole (reception but not emission of signals).
- The legal system and the differences with the US own system.
- The intellectual property system of the country. That includes any considerations on the constitutional and legal regime as well as to the number of international treaties that the country has signed.
- In complex licensing like franchising, the characteristics of the local market and of the financial, real estate and labor systems.

4.2 ASPECTS TO CONSIDER IN THE DRAFTING OF AGREEMENTS.

In probably most respects international licensing agreements are the same that domestic licensing agreements. It is normally possible to see in both events a

grant clause defining the licensed subject matter as well as consideration and termination clauses. Licensors are interested to impose controls in the use of the work, invention or trademarks. Most legislation would allow licensors to do that without facing legal restrictions. However, the following needs to be taken into account:

- Not every contractual provision valid under US law would be necessarily recognized in foreign countries.
- The granting clause may require specificity to a more-or-less extent. In keeping with this, the scope of the agreement could be interpreted broadly in favor of licensees unless limitations are express.
- Representation and warranty clauses may be the subject to certain form of legal restrictions. The law may indeed impose obligations on the side of the licensor with the purpose to protect licensee.
- Notice or marking provisions may be requisite in certain jurisdictions.
- Jurisdictions and applicable law may also be restricted under local regimes. The foregoing limitations could include arbitration.
- The same could be true as to term and termination.
- Antitrust and competition rules sometimes vary from country to country.
- Confidentiality or non-disclosure clauses may not be an acceptable practice.
- Clauses not to compete may also not be valid.
- In franchising agreements the law may impose a burden on issues like the offering of the franchise.
- Typical international licenses would require to consider points like the place of payment, the rate of exchange, tax burdens, government approval (in some jurisdictions), recordation of the agreements, export and import considerations, and applicable language.

5.0 LICENSING IN LATIN AMERICAN COUNTRIES

5.1 *THE INTER AMERICAN PROJECT*

The increasing number of trade blocs in the region has characterized the picture of the American continent. At least four well defined areas can be identified

there: The North American Free Trade Agreement (“NAFTA”) region: The Central American Convention and the Central American Permanent Secretariat on Economic Integration (“SEICA”); the Andean Pact or “Andean Union”; and the South American Common Market (“MERCOSUR”). Nations in the Americas have entered into either bilateral or multilateral free trade agreements. As a matter of fact, there are ongoing discussions to adopt a model agreement for the whole continent that would be called the Free Trade Area of the Americas (“FTAA”).

5.2 COPYRIGHT LICENSING IN LATIN AMERICA

The number of copyright licensing operations in Latin America is quite significant. The major US cultural industries have a strong presence in the region. Examples are numerous:

- Music recording labels license reproduction rights to produce sound recordings. They also license public performance rights of sound recordings^[1]. In Mexico US labels lead in a market generating incomes of nearly 190 million of US Dollars, while in Brazil incomes are of 150 million, approximately^[2]. Mexico and Brazil are respectively considered number 12th and 13th music markets in the world.

- Business software publishers license reproduction rights, mainly for the end use of computer programs. In 2004 US software publishers sold in Mexico US \$718 million and expect to grow in 2005 in an average of 10%.

- Book publishers license reproduction, distribution and sometimes translation rights of literary works. In 2003 US publishers obtained incomes for the sale of books and publications in Mexico in the approximate amount of 8 million US Dollars.

- Film and TV producers license reproduction rights for video sale or rental. They also license public exhibition or broadcasting rights of movies or TV programs.

- Merchandising company’s license reproduction and distribution rights of characters and similar properties.

By contrast, not many Latin American companies owning intellectual property rights have licensed in the US or other foreign countries. However, there are the following examples:

- Latin American music has become a big success in the world and Mexico City the “Mecca” of the entertainment industry in the Hispanic world, together with Miami and Los Angeles. IFPI has reported increasing sales of Mexican sound

recordings in the US, during the first semester of 2005, in great part due to a rise of 17% of music coming from Mexico and other Latin American countries.

-Mexican publishers also license the printing of books or magazines in the US. In 2003 they obtained an income of 5 million US Dollars for sales in the US and 30 million US Dollars in the whole world.

-Mexico and Argentina have a rather strong cinematographic industry. As a matter of fact, Mexican films of the so-called "Golden Age" are very popular and thus demanded by the Hispanic population of the US and are regularly distributed for broadcasting and public exhibition.

-Mexico and Argentina in the Spanish market and Brazil in the Portuguese are countries that are very strong for TV program production. Procedures and broadcasters such as Televisa, Television Azteca, Television Argentina and O'Globo, export soap operas and other shows to the US and other countries of the world.

5.3 PATENT LICENSING IN LATIN AMERICA

Patent licensing has grown in Latin America, in particular the pharmaceutical field. Of course, the proportion of patent licensing in the sector is higher in Brazil and Mexico, countries granting protection to pharmaceutical products and that are a member of the Patent Cooperation Treaty. US Laboratories like Abbott, Eli Lilly, Pfizer and Wyeth, have established subsidiaries in many Latin American countries and make licensing operations on a frequent basis.

5.4 TRADEMARK LICENSING IS COMMON PRACTICE IN LATIN AMERICA.

US trademark owners grant licenses to Latin American companies on a daily basis. The other way around, that is, licensing that goes from Latin American countries to the US is certainly not so large, but has increased throughout the years. Licensing is made for the making and distribution of an array of products and services in practically every industry. Franchising bear special mention since it has developed significantly in Brazil and Mexico, but also in Argentina, Chile and other countries. The spirit of franchising has been adopted in the region and

has been well accepted. At the same time, US companies have learned that franchise requires that the parties undertake a joint effort to satisfy a need of the market.

-Franchise started in Mexico in 1985 with four companies pioneering in this field: Mc Donald's, KFC, Howard Johnson and Helados Brind (a Mexican company later acquired by Unilever). In 1993 the number of franchising companies expanded adding Alphagraphics, Arby's, Blockbuster, Domino's Pizza, Oxxo (a Mexican food retailer) and Subway³. In 2005 the number of companies in the franchising sector has multiplied to nearly 730⁴, placing Mexico among the ten countries having more franchise operations⁵.

-The Brazilian franchising industry is also quite large. By 1993 had already reached the number of 50 thousand franchised establishments and was the third place in terms of business size, just after USA and Japan. IVIX, CAN and other local corporations have joined the many US franchisers in the business.

-In Argentina and Chile franchising has also represented a factor of business expansion and growth.