

International Technology Licensing Agreements

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The following is intended for general information only, regarding some of the issues relating to businesses operating in Saskatchewan. We advise you to seek specific legal advice prior to making any of the arrangements outlined in this article, as the particular facts of each person's situation will vary, as will the advisability and effectiveness of any particular strategy.

Table of Contents

1. Introduction
2. Leaping into the Unknown
3. Regulatory Restrictions
4. Export and Import Restrictions
5. Regulatory Approvals
6. Competition or Anti-Trust Laws
7. Currency Exchange Regulations
8. Choice of Law
9. Choice of Language
10. Currency Conversion
11. Goods and Services Tax or VAT
12. Alternate Dispute Resolution
13. Force Majeure
14. Conclusion
15. Contacting a Lawyer on this Subject

1. Introduction

The purpose of this paper is to provide a broad overview of the issues which may arise in the process of negotiating and drafting an international technology licensing agreement. As the majority of the issues which arise relate to the inter-play of the laws of more than one country, it is not possible to discuss the specific laws of other jurisdictions in one short paper. Instead, the objective is to alert you to possible problem areas which will need careful thought and investigation before you or your client proceeds to ink the deal. For the most part, many of the issues remain the same as those raised in any other international transaction.

2. Leaping into the Unknown

Negotiating and preparing any international agreement requires discarding many preconceived notions as to what the law of the contract is, may be, or should be.

First, not all countries have the same (or even similar) underlying legal systems. Generally speaking, countries which were part of the English empire will have a legal system which has the same basic foundation as that of Canada. European countries (and countries originally colonized by European countries) have a very different legal foundation. Newly formed or developing countries may have only a very rudimentary legal system. What this means is that you may (or may not) be able to rely upon the terms of the contract. Your contract may be valid in Canada, but it might not be valid in another country.

The most fundamental piece of advice in negotiating and preparing an international transaction of any type is not to go leaping into the unknown without someone there to catch you. You should always consult with a local lawyer in the other jurisdiction to make certain that there are no laws or government regulations which are going to invalidate all or any of the terms of your contract. **Even if** your contract states that it is governed by the laws of the Province of Saskatchewan and Canada, there may still be foreign laws which will override this term of the contract.

3. Regulatory Restrictions

Every country will have different regulatory restrictions which may affect the transaction. Regulatory restrictions often have strong political overtones, and are generally designed to promote specific government agendas of the day. These regulatory restrictions can potentially have a significant impact on the transaction, and must be considered carefully before signing any agreement.

4. Export and Import Restrictions

Even though you cannot touch or see "intellectual property", the sale or licensing of that technology to someone in another country will be seen as an export of the technology. It is important to first check to make certain that the export of the technology from Canada is permitted by Canadian authorities, and the receipt of the technology (or import) is permitted by the authorities in the other country.

The export of goods from Canada is controlled primarily by the *Export and Import Permits Act* of Canada. The Act controls the export of products in primarily two different ways:

By prohibiting the export of goods to countries named in the Area Control List. As of April 15, 1997, the two countries listed on the Area Control List were Angola and Libya.

By making the export of certain prescribed goods as listed in the Export Control List to all other countries [footnote 1](#) conditional upon receiving an export permit from the Export Controls Division of the Export and Import Permits Bureau.

Matters relating to the Export Control List are outlined in the regulations to the *Export and Import Permits Act*. The list itself, however, is contained in a guide which is published from time to time by the Department of Foreign Affairs and International Trade. The Export Control List

divides itself into seven categories. Most of the technology-based goods or property which might require an export permit are found in Group 1, the Dual Use List [footnote 2](#). For example, encryption software appears on the list as requiring an export permit. Technology items are also referred to in Groups 3 and 4 of the List, as being nuclear-related technology.

The quickest way to determine whether any particular technology requires an export permit is to contact the Department of Foreign Affairs and International Trade, Export Controls Division, at 613-996-2387. You can also visit their web site at <http://www.dfait-maeci.gc.ca/~eicb/menu.htm>.

There is also other legislation which imposes export restrictions [footnote 3](#), but which is less likely to apply to technology, such as the *Cultural Property Export and Import Act*, the *Game Export Act*, the *National Energy Board Act*, the *Fisheries Act*, the *Inland Water Freight Rates Act*, and regulations under the *Canadian Environmental Protection Act*.

Similarly (although less likely), the country to which the technology is being exported may have import restrictions in place which may affect the import of the technology into that country.

In terms of drafting an agreement, you will want to make certain you deal with whose responsibility it is to obtain any export or import permits which might be required, and whose responsibility it is to pay any costs or duties associated with the same.

5. Regulatory Approvals

Some countries, such as Central and South American countries, South Africa, and Japan, require government approval of the licence. The governmental agency may "...stipulate a maximum term for the licence, require the licensee to use local materials and employees, or impose various other restrictions." Failure to obtain the governmental approval may result in the entire licence being void or unenforceable, regardless of the stated law of the contract.

Sometimes governmental approval may take a very long time to obtain. For example, in South Africa, the Department of Industries and Commerce investigates the merits of each application for approval. It will reject any licence agreement which does not meet its standard established criteria. Once the Department is satisfied that an agreement is in order, it notifies the South African Reserve Bank, which then processes the agreement for statistical purposes. The Reserve Bank then notifies the licensee's local commercial bank of the approval. Because the Department's established criteria is not always applied consistently, there are often misunderstandings, and delay in getting the documents from one organization to another. For that reason, the parties often appoint a legal representative who is familiar with the licensing process to keep track of the progress of the approval, and to speak to the Department on behalf of both parties, if necessary. The Department may require changes to the agreement; for example, it may reject all minimum royalty payments, prefers to allow royalty rates of 4% to 5% on capital goods, tries to minimize any lump-sum payments, particularly

those which supplement running royalties, and requires re-submission of long-term at intervals of not more than five to eight years [footnote 4](#).

Your preliminary investigations should therefore include inquiries as to whether governmental approval is necessary, and how long it will take to obtain. You should also enquire as to the nature of any restrictions the government may be likely to impose, so that you can deal with these issues in your agreement from the start. As with export and import permits, your agreement should deal with whose responsibility it is to obtain the approval, and what will be happening (if anything) until the approval is obtained.

6. Competition or Anti-Trust Laws

A number of countries have competition or anti-trust laws which will affect or override the terms of a licensing agreement [footnote 5](#). For example, the European Union, in Article 85 of the EC Treaty [footnote 6](#) prohibits all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market. Article 85(2) provides that any agreement prohibited under Article 85 is automatically void.

Exclusive licensing agreements, by their very nature, have the potential to restrict competition with respect to the technology. Article 85(3), however, states that the provisions of 85(1) may be declared inapplicable in the case of agreements which contribute to improving the production or distribution of technical or economic progress, while allowing consumers a fair share of the resulting benefit. The agreement must not, however, impose restrictions which are not indispensable to the attainment of these objectives, and must not afford the possibility of eliminating competition in respect of a substantial portion of the technology in question.

The Commission of the European Communities has additionally issued certain block exemptions with respect to certain types of agreements. The attached Appendix 2 sets out Commission Regulation 240/96 with respect to technology agreements. As you will see from browsing this regulation, the Commission has extensive and detailed requirements as to what will and will not be covered by the block exemption for technology agreements.

Similarly, other countries will have competition or anti-trust laws in place that may affect portions of your agreement. The United States Department of Justice has published *Antitrust Guidelines for International Operations*, which include a description of the application of U.S. antitrust laws to technology licensing. Licensing arrangements which may raise anti-trust concerns are those which, for example, include restrictions on goods or technologies other than the licensed technology, contractual provisions that penalize licensees for dealing with suppliers of substitute technologies, and acquisitions of intellectual property that lessen competition in the relevant anti-trust market [footnote 7](#). Further, "intellectual property licensing between actual or proposed competitors may raise antitrust concerns by reducing or eliminating competition in the market(s) in which they actually - or are likely to - compete [footnote 8](#)." Breach of anti-trust provisions can be enforced by private parties,

with the potential that treble damages may be awarded. The Department of Justice may also enforce anti-trust rules, with the ability to impose criminal sanctions and fines [footnote 9](#).

Again, given the potential downside, it is important to have local counsel review licensing agreements to ensure compliance with the local competition or anti-trust legislation.

7. Currency Exchange Regulations

Not all countries permit the foreign exchange of currencies. Many countries restrict the exit of both foreign and local currencies from their countries, or restrict access to foreign currencies. It may be that the local country will require an application to the country's central bank to convert the currency, or may not even allow any such conversion. It may even be that local currency cannot be removed from the country, but must stay on deposit and be used in the local country. If the local currency cannot be converted in the local country but can be removed from the country, you will want to consider your ability to then convert such currency in the free market. Currency exchange controls can be volatile, and subject to change at any time.

It is important to be familiar with local exchange controls, and to anticipate a change in those controls in your agreement. You may want to consider whether there are goods you can receive in trade if the currency should become blocked, or whether you simply wish to build in certain termination rights in the event conversion becomes difficult or impossible. For example:

A. If the transmission of any royalties derived from any countries or territories to the Licensor is prevented by embargo, blocked currency regulations or other restrictions, before the Licensee manufactures, distributes or sells the licensed product in such country or territory, Licensor and Licensee shall agree on the manner and method of the payment of royalties before any such manufacture, distribution or sale commences.

B. If after the commencement of sale in any country or territory, the laws of such country or territory are changed so that the transmission of any royalty derived from sales in such country or territory into the Canada is prevented by embargo, blocked current regulations or other restrictions, then if the Licensor so elects (by giving notice to the Licensee) Licensee shall, to the extent permitted under the laws of such country or territory, deposit the royalties in local currency in any bank or depository designated by Licensor in such country or territory. Such deposit will be deemed payment to Licensor in the amount so deposited and Licensee shall have no further liability to Licensor in connection with any monies so deposited.

C. Notwithstanding the provisions of paragraphs A and B herein, if the laws of any country or territory are changed so that the transmission of any royalty derived from sales in such country or territory into the Canada is prevented by embargo, blocked currency regulations or other restrictions, the Licensor may terminate the rights granted herein in so far as such country or territory is concerned by giving Licensee 30 days written notice [footnote 10](#).

8. Choice of Law

It is normal practice to set out the law of the jurisdiction which will govern the contract. For example, a standard clause might be:

This Agreement is governed by the laws of the Province of Saskatchewan and the laws of Canada applicable therein.

This establishes, for the court's purposes, that in dealing with any issues which are in dispute, it will consider and apply (in this case), the laws of Saskatchewan and Canada. As stated above, though, this type of clause is not a "magic bullet". It will not, in all cases, prevent the laws of another country from applying.

It is also not always advisable to require that the law of the contract be that of Saskatchewan and Canada. If a dispute develops, you may need to use the local courts of the country in which the licensee is carrying on business in order to obtain quick relief, or the type of relief you require. If, for example, the contract is stated to be governed by Saskatchewan law, and you want to receive an injunction from the South African courts based upon a term of the contract, then the South African courts may have to use Saskatchewan law to reach their decision. This will result in you having to prove Saskatchewan law before the South African courts, which will generally mean having to pay a Saskatchewan lawyer to testify in South Africa.

Your choice of law, therefore, should be made in consultation with local counsel, who should advise you as to whether local commercial law is relatively simple and flexible, and whether it will support the kind of relationship you are trying to build with the licensee. If you should decide to continue to require that Saskatchewan law will apply, then you will want to check with local counsel that the local courts will recognize the application of Saskatchewan law, or, if you receive a judgment in Saskatchewan, that local courts will register and enforce such judgment.

9. Choice of Language

If you are negotiating an agreement which will require translation in order to be understood by either you or the licensee, then you will want to agree in your contract as to which version will be the official binding version. There can be small, subtle changes in a translation which can have a legal impact on the interpretation of the agreement. The choice of language should probably be the language of the country where any dispute is most likely to be litigated or arbitrated, so that the court or arbitrator will be able to deal with the official binding version. If this will be a language other than English, then it is important that any English translation be prepared by a qualified translator who is familiar with legal terminology.

10. Currency Conversion

The license agreement often provides for some form of ongoing payment, such as a royalty. Royalties based, for example, on gross sales give rise to issues as to how and when the payment is to be calculated and converted into the currency of the licensor (or alternatively, into U.S. dollars.) Issues of conversion become particularly important in countries where the value of the currency may fluctuate greatly. A sample currency conversion clause might be as follows:

Except as otherwise specified in this agreement, all payments required to be made by or on behalf of the Licensee under this agreement shall be converted to and paid in Canadian dollars, based upon the prevailing "buying" foreign exchange rate for Canadian dollars at the *[bank]* on the date any such payment is due, and shall be paid to the Grantor or to such account or accounts at such bank or banks as the Grantor may in its sole discretion designate from time to time and the Grantor shall give the Licensee thirty day's written notice of any such change in place of payment [footnote 11](#).

11. Goods and Services Tax or VAT

Certain grants of licences may be considered to be a supply of property within the meaning of the GST portions of the *Excise Tax Act*. Other countries with which you are dealing may have similar taxes; for example, Great Britain has the value added tax (VAT). You will want to investigate all tax consequences arising from the proposed license, and structure your agreement accordingly.

Under s. 165(1) of the *Excise Tax Act*, every recipient of a taxable supply **made in Canada** is required to pay GST, unless some other exemption within the Act can be found. Under s. 142(2)(c) of the Act, in the case of intangible personal property, a supply is deemed to be made outside Canada where the property may not be used in Canada. If, therefore, you are granting a licence to use the technology in, for example, North America, it may be useful to separate this into two separate licences for two separate markets (that is, Canada and the U.S.A.), so that the licensee will not be required to pay GST for the use of the technology in markets outside Canada. You will then want to make certain that in the Canadian license you provide for the payment of an additional amount for GST.

Similar concerns will likely apply in all countries having a goods and services or value added tax.

12. Alternate Dispute Resolution

It is important to consider how you will resolve any disputes which may arise with the licensee. Such disputes will have to be dealt with at a distance, with someone in another country. The court system may or may not be reliable in that country, and may or may not accept for registration judgments from other jurisdictions.

Alternate dispute mechanisms are of increasing popularity, and consist most often of either mediation or arbitration. A recent article from *The Financial Post* [footnote 12](#) stated that a recent survey of 528 major U.S. corporations shows that most are already using ADR in preference to litigation. One of

those uses is for transborder commercial disputes, because solving the dispute in the public court system can be jurisdictionally complex or uncertain.

Mediation is viewed as a consensual process, where both of the parties are seeking a "win-win" solution to the problem. The parties appear before a trained mediator, who will typically first meet with each side separately, to discuss the respective alternate viewpoints. The mediator tries to determine whether there are any underlying grievances, apart from the immediate problem, which are standing in the way of the parties reaching an agreement. The parties and the mediator will then typically meet together, where it is the role of the mediator to draw out both sides of the story, so that each party will come to appreciate the alternate viewpoint. The mediator and the parties then seek a solution which will meet the underlying needs of both of the parties.

Arbitration is more of a private adversarial system, where the parties agree on an arbitrator or a panel of arbitrators to hear the dispute. The parties present their evidence to the arbitrator, who then makes a decision. The rules of the arbitration can either be set out in the contract, or the parties can agree to use the set of rules which have already been established by some other organization; for example, the parties commonly agree to use the UNCITRAL Arbitration Rules [footnote 13](#) for international transactions. If the parties have failed to agree to a common set of rules, there is usually legislation which will govern the process [footnote 14](#).

The advantage to arbitration is that allows the parties to select an arbitrator who is trained, for example, to deal with highly technical information and who is familiar with the industry. Arbitration is widely used in the construction industry for this reason. It may also be faster, depending upon how slowly the courts operate in the relevant jurisdictions. It may not, however, be substantially cheaper, since the parties typically have to pay the costs of the arbitrator, the lawyers, and the place where the arbitration is held.

What you need to consider before agreeing to alternate dispute mechanisms is the result you wish to achieve. Mediation is best for preserving a working relationship between the parties; the result of mediation, however, is not binding upon the parties in the same way a court order is binding. Arbitration is generally considered to be more binding; you will want to make certain, however, that the other country has laws in place which will allow the order of the arbitrator to be binding and treated as having similar effect to a court order. With arbitration, you usually have to agree to the place of the arbitration in advance. Often the parties select a neutral, central location in a third country (for example, London.) This in itself can then cause later difficulties, because of the costs associated in arbitrating a matter in another country.

Finally, if you are the person giving the licence, it may be that you do not want to involve yourself in lengthy mediation sessions or arbitration. If, for example, the licensee has stopped making royalty payments, you may simply wish to terminate the licence. In that case, it is a disadvantage to agree to mediation or arbitration.

13. Force Majeure

Force majeure clauses are those which deal with some event which will prevent one of the parties from being able to perform the agreement for reasons completely out of their control. While initially these clauses typically dealt with "acts of God" such as floods, tornadoes, earthquakes, and other cataclysmic events, such clauses now also deal with acts of political unrest and instability. For that reason, force majeure clauses now are more typically used in international trade agreements than they are in domestic contracts.

You will want to consider both the events that will release the other side from performing, and what will be the consequences for such non-performance. Will the contract be suspended for a period of time, or will it be terminated? Would some form of partial performance be satisfactory for a period of time? These are all matters which you will want to work out in advance in your contract, particularly where you are dealing with someone in a country which is subject to political unrest and instability.

14. Conclusion

The global market has enormous potential for Canadian businesses. International trade agreements such as GATT and NAFTA indicate an increasing desire on the part of many countries to lower trade barriers. As with all business matters, information and knowledge are important to operating successfully in another country. Make certain you have the knowledge of what you need to protect your interests, and that you have the agreement in place to see that your business relationship is successfully cemented.

15. Contacting a Lawyer on This Subject

For more information on this subject or specific legal advice, contact Robertson Stromberg Pedersen LLP in Saskatoon at (306) 652-7575 or in Regina at (306) 569-9000.

Footnotes:

Many of the goods listed on the Export Control List may be exported without a permit to the U.S.A., as a result of trade agreements with the U.S.A. In some other cases, the country may be covered by a General Export Permit, which will allow export without any further permit.

See attached Appendix 1

Nenniger, James, International Technology Licensing Agreements, The Canadian Institute Seminar on International Commercial Contracts: Developments, Issues and Techniques, November 26, 1992, Toronto, Ontario.

Based upon 1992 information.

For general information regarding competition or anti-trust law, see the Heiros Gamos web site at <http://www.hg.org/antitrust.html>

See Appendix 2. The information found at Appendix 2 was downloaded from the server of the European Union, found at <http://europa.eu.int>

Hunter, Lawson. Patent Pending: A Modest Proposal for Achieving the Optimal Interface Between Intellectual Property Rights and Competition Law in Canada, The Canadian Institute Seminar on Intellectual Property in Business Transactions, September 26, 1994, Toronto, Ontario.

Hunter, Lawson. *ibid*, p. 32.

Hunter, Lawson. *Ibid*.

Carson, James, International Technology Agreements, Canadian Bar Association Seminar on Technology Agreements: Acquiring, Managing and Exploiting Technology, March 7, 1991, Ottawa, Ontario, p. 22; see also O'Brien's Form 32:21 (see footnote 11), at p. 32-199 for examples of other forms of restricted currency clauses.

O'Brien's Encyclopaedia of Forms, Commercial and General, Volume 3, Form 32:21.

The Financial Post, Tuesday, July 15, 1997, Corporate America Embraces ADR., p. 10.

UNCITRAL is the United Nations Commission on International Trade. The UNCITRAL Arbitration Rules were adopted in 1976, and provide a comprehensive set of procedural rules upon which parties may agree for the conduct of arbitral proceedings arising out of their commercial proceedings. For the full text of the Rules, together with recommendations as to their use, see the UNCITRAL Official Web Page at <http://www.un.or.at/uncitral>

For example, in Saskatchewan, the legislation to be used in international commercial arbitration is The International Commercial Arbitration Act.