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# LICENSING IN THE EASTERN BLOC

*Lajos Schmidt**

This article will discuss the legal problems faced by American enterprises desiring to license industrial property rights—principally patents, trademarks and know-how—in Eastern Europe. Licensing in seven countries—the Soviet Union, Poland, Czechoslovakia, Hungary, Romania, the German Democratic Republic (East Germany) and Bulgaria—will be examined.[1] Of course, these countries form separate and independent legal and political jurisdictions; and even their cultural backgrounds differ. Any generalization about them must be taken in that context. Nonetheless, each of these countries is governed by similar political and economic principles—in particular, the principle of centralized economic planning. These common factors are reflected in common problems faced by Western licensors, and their attorneys, in dealing with their counterparts in each of the countries in the Eastern bloc.

The legal problems of industrial property licensing must be viewed in the proper socio-economic context as well as within the context of the legal system of each Eastern European nation. Therefore, a brief discussion of the current Eastern European "context" may be useful to the reader before an analysis of the

* Partner, Baker and McKenzie, Chicago. LL.B., 1941, Peter Pazmany University, Budapest; Ph.D., 1942, University of Munich; D.J., 1943, St. Elizabeth University, Pecs, Hungary; J.D., 1954, Chicago-Kent College of Law.

1. These countries are the "active" members of the Council for Mutual Economic Assistance, sometimes referred to as COMECON or COMECON member countries. Although Albania is generally counted among the Eastern bloc countries, it is not an active member of COMECON and has no present economic significance to United States licensors. The author is unaware of any license agreements existing between any Western enterprises and Albania.

legal problems of licensing, as reflected in the drafting of licensing agreements, is considered.

## I. The Climate for Licensing in Eastern Europe

### A. *Interest in Western Technology*

The technical achievements of Russian scientists in space exploration and other areas might indicate that there are few fields in which Western European and United States technology is more advanced than the state of art in the socialist countries. Nonetheless, in spite of these advances, Eastern European nations need and seek Western technology; and the United States, with its research and development ability, manufacturing know-how and abundance and quality of manufactured goods, is considered the leader in most fields of technology and industry. Even in fields of industry that might be considered rather mundane in the West, an eagerness exists on the part of Eastern enterprises to obtain licenses. For example, Swiss Vogelsang A.G. recently licensed the Czech Barvy a Laky Company to manufacture automobile lacquers.[2]

The reason for these demands for Western licenses despite Eastern European technological advances is complex, but a major factor seems to be the Eastern European tendency to segregate research and development from industry. Until recently, research and development efforts were carried on in "think tanks" that were under the control of different ministries than were production enterprises, and that were segregated physically from the factories. Much basic research was carried on by scientists concentrated in these institutions and there is a great wealth of basic discoveries made in the Eastern European nations. According to a 1965 Organization for Economic Cooperation and Development study, Russia employed more graduate engineers in research and development than did the United States. This great research effort may be attributable to the Marxist-Leninist tenet that economic improvement follows the development of science and technology. The successful selling of goods supposedly commences with fundamental research through development followed by marketing and therefore increases the standard of living of the masses. There exists, however, a wide gap between research and development carried out in the abstract and its translation into day-to-day use through

2. 1 E. Europe Rep. 52 (1972).

manufacturing.

The 1970 statistics published by the Soviet Chamber of Commerce on Czechoslovakia's balance of license proceeds and expenditures further indicate this concentration on basic research and development. Thirty-three per cent of Czechoslovakia's receipts from Western licensees were generated by basic research carried on by the Czechoslovak Academy of Sciences and Technical Universities; thirty-four per cent were attributable to chemical and pharmaceutical licenses and twenty-seven per cent to the textile, machinery and leather working industry. This Czech technology flows principally to West German, United States and Japanese licensees.

On the other hand, Czechoslovakia pays four times more license fees to the West than it receives, principally, in descending order of importance, to France, West Germany and the United Kingdom. Forty-eight per cent of all fees paid originate from the engineering industry; twenty per cent from the chemical industry; thirteen per cent from consumer goods; nine per cent from the mining, iron and steel industry; and six per cent are attributable to the construction industry. Recently published figures indicate that Western licensors are extending licenses to Eastern licensees at an accelerating pace.[3]

There is evidence that several Eastern European countries are gradually eliminating the segregation between research and development and the manufacturing enterprises. In 1970, Izvestia mentioned the establishment of Pozitron of Leningrad as the first link between research and industry. This organization comprises a leading research laboratory, a machine tool development and design bureau and two substantial manufacturing enterprises. In Romania, Centrala Industriala (Industry Centers) were formed by 180 individual associations. The purpose of the Industry Centers is to coordinate entire fields of industry starting with research, through development, to manufacturing. These Industry Centers represent a self-contained unit, similar to large United States corporations. However, until these concepts are widely adopted, and probably even thereafter, the need for practical Western technology in Eastern Europe will continue to be enormous.

3. BUSINESS INTERNATIONAL S.A., EUROPEAN RESEARCH REPORT 72-3: DOING BUSINESS WITH EASTERN EUROPE 131 (1972).

## B. *COMECON*

In addition to centralized planning at the national level, there have been repeated attempts, primarily at the instigation of the Soviet Union, to institute centralized economic planning at the Eastern European level within the Council for Mutual Economic Assistance (COMECON). At the July 1971 COMECON meeting in Bucharest the following goals were established: (1) to increase labor productivity; (2) to secure to the member states a more competitive position in world markets; and (3) to pool work in advancing science and technology. Even though we read of attempts to increase cooperation among COMECON member nations, as in the field of computer development (and this was clearly the intention of the third goal), several Eastern European nations have endeavored to implement the foregoing resolutions by seeking access to the most advanced technology and production methods, which, in their opinion, are available in the West, principally in the United States. This has meant that enterprises in different COMECON countries have competed with each other to obtain licenses, a very favorable development from the Western point of view. There are indications that this situation may change, however. For the last few years, the leaders of the Soviet Union have endeavored to coordinate more closely the economic activities of the COMECON member countries. At a recent informal discussion held by Party Chief Leonid Brezhnev, the leaders of the COMECON member countries decided to inaugurate immediately the coordination of each country's 1976-1980 five-year plan and to have those plans available for review at the beginning of 1974. This early review of the five-year plans will facilitate the allocation of production goals and resources among the member countries thereby eliminating the parallel manufacturing of the same or similar products.

There remains some doubt whether all COMECON members will be willing to accept the economic role assigned to them and to specialize thereafter in the designated fields of economic endeavor. During the last decade, Romania has refused to be relegated to the position of an agricultural producer and raw material supplier and, since that time, has achieved great progress toward industrialization. The benefits that Romania derived from the independent attitude of its leaders will not be lost on the other COMECON countries.

The Soviets reportedly may be able to achieve the allocation of primary production responsibilities among the COMECON mem-

ber countries indirectly even if its current attempt to do so directly should fail. The 27th COMECON Council meeting held in Prague in June 1973 called for the "further development of mutually advantageous economic, scientific and technical relations between states with different social and economic systems, especially in Europe." Should a strong working relationship develop between the COMECON and the European Economic Community, a means of channeling Western technology to the country designated by the COMECON as the primary producer of particular goods or machinery may develop. Should the COMECON, directly or indirectly, succeed in allocating responsibility for the development of certain industries among its member states, Western licensors would find themselves with but a single potential licensee.

### C. *Nature of the Licensees*

1. *Foreign Trade Organizations.*—As noted above, common characteristics of the countries in Eastern Europe are their centrally planned economies and their nationally monopolized foreign trade. Typically, obtaining licenses from abroad or extending licenses to foreign parties falls within the competence of a foreign trade organization established by the state. For example, a Western licensor wishing to extend a license or to obtain a license in Eastern Europe would enter into a contract with the foreign trade office of the appropriate country—in the case of the Soviet Union, with V/O Licensintorg; in Poland, with Polservice; in Czechoslovakia, with Polytechna; in Hungary, with Licencia; and in Bulgaria, with Technika. In Romania, the authority of the previous central licensing organization, Industrialimport, has been decentralized recently as described below.

2. *Individual Enterprises.*—In January 1968, Hungary introduced an experimental program labeled the "New Economic Mechanism." This program gave individual enterprises a greater independent responsibility in complying with the overall production goals established by the central planning authorities. In order to enable enterprises to comply with these production goals, some were given the right to enter into transactions with foreigners, including the right to purchase and sell machinery and equipment. Since technology most often enters the Eastern bloc countries as an essential part of a transaction for the purchase of machinery, equipment and even entire plants, the New Economic Mechanism gave a substantially larger number of Hungarian enterprises access to Western technology than the strict central planning previously utilized had provided; the New Economic Mechanism also afforded foreign companies relatively free access to potential Hun-

garian licensees. On the other hand, freer access to Western machinery, equipment and technology carried with it a correspondingly greater responsibility on the part of the individual enterprises to generate convertible currency to fund the purchase of goods and technology. If an enterprise exceeds its export goals, then, as a further inducement, a portion of the excess earnings can be retained for additional purchases in the West.

In Romania, a similar decentralization program accompanied the establishment of Centrala Industriala. Instead of Industrialimport, the previous single foreign trade organization responsible for purchase of foreign licenses, the newly established Industry Centers have been authorized to acquire licenses from abroad or extend them to the foreign enterprises. Each Industry Center may have its own foreign trade department, responsible solely to that Industry Center, allowing the Center to contract directly with foreigners for the purchase and sale of goods and technology. The Industry Center's foreign trade department obviously can discuss license arrangements with a foreign licensor in a different manner and with a different understanding of the technical and commercial problems involved than a state foreign trade organization. Foreign trade organizations are not only likely to be less knowledgeable about the particular art in question, but they also are normally responsible to a different ministry than the enterprise for which they are presumably acting—a source of innumerable delays and difficulties. The establishment of the Centrala Industriala therefore secures a more direct approach to potential licensees. Poland has brought, or is in the process of bringing, all enterprises into closely knit industry groups. The legal existence of the group members will be preserved, but their research and development, purchasing, sales and international trading activities will be closely coordinated, resulting in increased efficiency.

3. *Limitations on the Independence of Enterprises.*—In rigidly planned economies like the Soviet Union, the status of the foreign trade office as intermediary between licensor and licensee will be unavoidable since that status preserves the dominant, monopolistic role of the office. Even in Hungary and Romania, there are limitations on the ability of individual enterprises to negotiate on their own behalf. For example, in the case of a pure license, a Western licensor, despite the creation of the New Economic Mechanism, must negotiate with a special licensing foreign trade organization. More importantly, all Eastern European countries experience a shortage of convertible currency and, therefore, must carefully consider the wisdom of expending the limited amount of available foreign currency on licenses. Even if an enterprise and its

relevant ministry conclude that this expenditure would be desirable, supervisory authorities will determine whether the payment of license fees in convertible currency should be allowed. This is the reason for the recurring effort on the part of Eastern European licensees to generate, in one way or another, convertible currency or to pay license fees in kind, a point to which we shall return in the second part of this article.

### D. *The Negotiating Process*

The shortage of convertible currency means that a foreign license is of fundamental importance to an Eastern European licensee. A Western team negotiating a contract typically will encounter substantial delays in finalizing the agreement. Very often, members of the Western team are at a loss to understand the reason for the delay, since everything that could be explained has already been explained, the terms reasonably well worked out and the technology understood by the technical representatives of the Eastern team. One reason for these delays, if not the principal one, is the desire of the Eastern team to know more intimately the licensing entity, its status in the particular field of technology, its likely future progress, and the compatibility of the persons and personalities involved on the Western side with those of the future licensee. In addition, Eastern Europeans demonstrate a great propensity to collect data and information only *per tangentem* related to the proposed license but which will prove the diligence and care with which such an important endeavor is handled on the part of the Eastern team.

It is the author's impression that the conclusion of a license agreement between a Western licensor and an Eastern European licensee depends to a greater extent on the subjective judgment formed by the Eastern European team about the Western company and its representatives, and their understanding and flexibility, than would be the case with a license agreement between two Western parties. It is therefore of great importance that the Western team have a thorough understanding of the Eastern European mentality, the economic system and the limitations on the contracting enterprise within that economic system. The Western team must also display considerable flexibility and inventiveness in solving problems as they arise.

### E. *Eastern European Legal Systems*

1. *In General.*—The 1957 *Declaration of Twelve Communist Parties in Power*[4] emphasized the substance rather than the form of the law and described the goals to be achieved by the law:

> Guidance of the working masses by the working class, the core of which is the Marxist-Leninist party, in effecting a proletarian revolution in one form or another and establishing one form or another of the dictatorship of the working class; the abolition of capitalist ownership and the establishment of public ownership of the basic means of production; gradual Socialist reconstruction of agriculture; planned development of the national economy aimed at building socialism and communism, at raising the standards of living of the working people; the carrying out of the Socialist revolution in the sphere of ideology and culture and the creation of numerous intelligentsia devoted to the working class, the working people and the cause of socialism; the abolition of national oppression and the establishment of equality and fraternal friendship between the peoples; defense of the achievements of socialism against attacks by external and internal enemies; solidarity of the working class of the country in question with the working class of other countries; that is, proletarian internationalism.[5]

Such attempts to tie law to ideology have had a greater impact in the theoretical than in the practical sphere and attorneys representing Western licensors in negotiating industrial property licenses in Eastern Europe will find themselves in reasonably familiar territory, at least if they have some prior experience with Continental legal systems.

The 1922 Russian Civil Code was based on a marketplace economic model, and the Code retained many pre-Revolution provisions regulating contracts and their enforcement; most of these provisions were derived from Roman law.[6] Later legislation in the area of contract law reflects the 1922 Civil Code but efforts were made to distinguish between contracts between individuals in their restricted sphere of action, between state enterprises and individuals, and between state enterprises. The question of whether different rules and concepts should govern legal transactions between individuals, between state enterprises and individuals, and between state enterprises was resolved by Alexei N. Kosygin in 1961[7] in favor of the uniform handling of all legal transac-

4. Declaration of the Twelve Communist Parties in Power, in THE NEW COMMUNIST MANIFESTO 169, 176 (D. Jacobs 3d rev. ed. 1961).

5. *See* J. HAZARD, COMMUNISTS AND THEIR LAW 6 (1969).

6. *Id.* at 313.

7. *Id.* At the time, Kosygin was a colleague of Chairman Khruschev. Kosygin became chairman of the Council of Ministers of the Soviet Union in 1964.

tions regardless of the identity of the contracting parties.[8] The civil codes of the other Eastern European countries also reflect their Roman law backgrounds. All follow the Russian lead in subjecting contracts and other commercial transactions between individuals and state enterprises to a uniform set of legal rules.

2. *Patent and Trademark Laws.*—Each country belonging to the Eastern bloc has its own patent and trademark laws. Some of the following comments are based on the development of the patent and trademark laws of Hungary since the author is more familiar with that jurisdiction, and since the Hungarian legal developments appear somewhat representative of the legal developments in other Eastern European countries. The first Hungarian Patent Law was enacted in 1895[9] and remained in force, with various amendments, until 1969. The new Hungarian Patent Law became effective on January 1, 1970.[10]

Indicative of the number of patent applications filed in an Eastern European jurisdiction is the Hungarian experience; in 1969, approximately 3,500 patents were applied for in Hungary—fifty-five per cent by foreign applicants.[11] The percentage of foreign applications increased to sixty-three per cent in 1971, while the total number of applications decreased by about six per cent.[12] The United States was the source of thirteen per cent of the applications, trailing the German Democratic Republic, the Federal Republic of Germany and Switzerland.[13] Forty-two percent of all patents granted in 1969 and 1971 were chemical or metallurgical in character;[14] the greatest number of patents were filed in the pharmaceutical-chemical field. Principal companies filing patent applications in this field included Hoffman-LaRoche, Geigy and CIBA (Switzerland), Hoechst (West Germany), Sumitomo (Japan), ICI (United Kingdom) and Bayer (West Germany). The COMECON member nations have designated Hungary as the primary developer and manufacturer of certain chemical compounds, drugs and pharmaceuticals. This is the primary reason for the very substantial number of patent applications filed in Hungary in the pharmaceutical-chemical field.

8. *Id.* at 313-14.
9. Law No. XXXVII/1895.
10. Patent Law of April 26, 1969, 30 MAGYAR KOZLONY (official Hungarian Gazette) 279 *et seq.*
11. *See* 9 INDUS. PROP. 1, 2 (Annex to No. 12, Dec. 1970).
12. *See* 11 INDUS. PROP. 1, 2 (Annex to No. 12, Dec. 1972).
13. *See* 9 INDUS. PROP. 1, 4-5 (Annex to No. 12, Dec. 1970).
14. *Id.* at 11. *See also* 11 INDUS. PROP. 1, 14-15 (Annex to No. 12, Dec. 1972).

A legal device widely employed in certain Eastern European countries for the protection of inventions is the Certificate of Inventorship (also referred to as Inventor's Certificate or Certificate of Authorship). This device originated in the Soviet Union in 1959 within the Statute on Discoveries, Inventions and Innovation Proposals.[15] Under this statutory system, an inventor employed by a state enterprise refers his "innovation" to the innovation officer or factory patent engineer who, in turn, assists the inventor in filing an application for a Certificate of Inventorship.[16] In return for certain royalties determined according to a schedule established by law, the state becomes the owner of the invention.[17] In theory, a free inventor who develops his invention without use of state-owned facilities applies for patent rights in his own name and for his own benefit, but in practice, this occurs only in the rarest of instances since all or nearly all productive-age persons are employed by the state, and all laboratories and other research institutions are owned by the state.

A foreign inventor may enjoy the same rights granted to Soviet citizens by applying for an Inventor's Certificate, thereby seeking only recognition of his authorship and granting to the state the exclusive exploitation of the invention.[18] He would then be entitled to the economic benefits accruing to Soviet inventors but, however valuable these may seem to be, they are likely to be of little practical value to a foreigner.[19] Therefore, a foreign inventor is likely to prefer to apply for a patent recognizing his exclusive rights to exploit the invention in addition to a certification confirming his authorship; a foreign inventor thus maintains a relatively free hand in negotiating licensing agreements. Furthermore, a patent establishes a legal base for the protection of licensed products against imports. Available comparative statistics on applications

15. Law of April 24, 1959, Statute on Discoveries, Inventions and Innovation Proposals § 6 (Decree of Council of Ministers No. 435, U.S.S.R.), in [1959] COLLECTED ENACTMENTS OF THE USSR, No. 9. *See also* Law of Dec. 8, 1961, Principles of Civil Legislation of the USSR and the Union Republics arts. 110-16, [1961] 50 Ved. Verkh. Sov. S.S.S.R. (Supreme Soviet U.S.S.R.).

16. *See* J. HAZARD, *supra* note 5, at 248.

17. Soviet Patent Law ¶ 49, in I. GRAVE, SOVJETISCHES PATENTRECHT 11 (1966) and Rodite, *Patent Protection in the U.S.S.R. and Eastern Europe*, 1 THE AMERICAN REVIEW OF EAST-WEST TRADE 12 (1968).

18. Law of April 24, 1959, Statute on Discoveries, Inventions and Innovation Proposals § 6 (Decree of Council of Ministers No. 435, U.S.S.R.), in [1959] COLLECTED ENACTMENTS OF THE USSR, No. 9.

19. Beier, *Traditional and Socialist Concepts of Protecting Inventions*, 1 INT'L REV. INDUS. PROP. & COPYRIGHT L. 328, 335 (1970).

for inventor's certificates and patents filed in the Soviet Union bear out this contention.[20]

All Eastern bloc countries are members of the Paris Convention of March 20, 1883, which secures to all subjects of each Convention country in all other Convention countries the same patent protection and advantages granted to nationals of these countries. The last of the COMECON member countries to become a Convention member was the Soviet Union, with membership commencing on July 1, 1965. The other Eastern European countries had acceded to the Paris Convention several decades earlier.[21] Interestingly enough, all countries except Poland adhere to the Amendment of Stockholm of 1967, granting to applications for Certificates of Inventorship (or "Authorship") the same claim of priority that is accorded to patent applications.[22] Poland is bound by the 1925 Hague Revision.[23]

As renewed efforts are made on the part of the Soviet Union and some other Eastern European countries to extend licenses, it is of increasing importance for a prospective Western licensee to determine whether the filing date for a Certificate of Inventorship in the Eastern country will be recognized for priority purposes in the jurisdictions where the licensee wishes to obtain a patent grant for the Eastern invention. In countries that are parties to the Stockholm Agreement of 1967, applications for Certificates of Inventorship receive priority status equal to patent applications. In states not adhering to the Stockholm Agreement (like the United States), the priority of the certificate is undetermined.

In the last few years, more emphasis has been placed in Eastern Europe on consumer goods, and a freer flow of ideas and consumer goods from the West to the East exists. Also, a substantial number of Eastern visitors are traveling to the West and *vice versa*. Therefore, trademarks have gained increasing importance in Eastern

20. *See* Blair, *Inventions in the Soviet Union*, 7 INT'L LAW. 485, 487 (1973).

21. For the text of the Paris Convention see WORLD INTELLECTUAL PROPERTY ORGANIZATION AND UNITED INTERNATIONAL BUREAU FOR THE PROTECTION OF INTELLECTUAL PROPERTY, 1 MANUAL OF INDUSTRIAL PROPERTY RIGHTS (Paris Union) § Z, at 1-3 (1971) [hereinafter cited as INDUSTRIAL PROPERTY RIGHTS]. Bulgaria acceded to the Convention on June 13, 1921; Czechoslovakia, on October 5, 1919; the German Democratic Republic, on May 1, 1903; Hungary, on January 1, 1909; Poland, on November 10, 1919; and Romania, on October 6, 1920.

22. For the text of the Amendment of Stockholm see INDUSTRIAL PROPERTY RIGHTS, *supra* note 21, § A2, at 1 (1971).

23. For the text of the 1925 Hague Revision see INDUSTRIAL PROPERTY RIGHTS, *supra* note 21, § D3, at 1-2 (1965).

Europe. Several Eastern European countries, among them the Soviet Union, now recognize the value of advertising—a development that is likely to increase further the importance of Western trademarks and trade names. The author's colleagues in the trademark area have recently noted a substantial increase in new trademark applications in several Eastern jurisdictions. In that connection, and interestingly, in 1968, 232[24] and in 1969, 161[25] United States-owned trademarks were registered or renewed in Hungary. Four Eastern European countries (Czechoslovakia, German Democratic Republic, Hungary and Romania) are members of the Madrid Arrangement of April 14, 1891, for the International Registration of Marks.[26] All four countries are bound by the Act of Stockholm.[27]

## II. Particular Provisions of a License Agreement

### A. *Parties—Legal Capacity to Act*

As noted above, the nature and number of potential licensees have been broadened in several Eastern European countries because of the greater autonomy enjoyed by individual industrial enterprises in entering into contracts (including technology agreements) with foreigners. It is recommended that in each case the Western licensor verify the legal capacity of the Eastern party to enter into the particular transaction. In addition, one must also ascertain whether the person or persons executing the agreement are entitled to bind the enterprise. In the case of contracts of major importance, the licensor can discover the identity of the persons who can contractually bind the enterprise either by obtaining an excerpt from the Companies Register where the name and title of the persons entitled to bind the entity are recorded or by securing a certificate from the appropriate Industrial Center or Ministry.

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24. 8 Indus. Prop. 18-19 (Annex to No. 12, Dec. 1969).

25. 9 Indus. Prop. 18-19 (Annex to No. 12, Dec. 1970).

26. For the text of the Madrid Arrangement see Industrial Property Rights, *supra* note 21, § Z [Marks], at 1 (1971). Czechoslovakia acceded to the Arrangement on October 5, 1919; the German Democratic Republic, on December 1, 1922; Hungary, on January 1, 1909; and Romania, on October 6, 1920. Certain states disagree on the membership of the German Democratic Republic, but the recent diplomatic recognition and United Nations membership of this country will remove the obstacles for full membership recognition.

27. The Act of Stockholm was promulgated July 14, 1967. *See generally* J. Lightman, Eastern European Trademark Systems and East-West Trade 455 (1967).

### B. *Patent and Know-How to be Licensed—Aversion to Pure Patent Licenses*

At the present time, few Western inventions are protected by patents in Eastern Europe, although this is likely to change as the economic importance of Eastern Europe increases. In the case of a registered patent, there is no impediment to the patent owner's extending a naked patent license, but the author has no personal knowledge of a grant of a patent license without the concomitant know-how; usually the manufacturing technology also accompanies the license. Many Eastern European companies harbor the suspicion that the right to a patent license, which is the equivalent of a covenant not to sue, is a capitalist invention and should not command a high price. On the other hand, they are eager to obtain a patent license coupled with know-how and manufacturing technique, but the real interest is in the know-how and manufacturing technique. The patent license is considered only incidental.

### C. *Exclusive versus Nonexclusive Licensing*

1. *In Licensee's Jurisdiction.*—In the author's experience, Eastern European licensees seek an exclusive license to manufacture, use and sell in their own jurisdiction. Considering the economic system prevailing in Eastern Europe, a Western licensor will lose nothing by going along with the requested exclusivity, especially since this may also enable the licensor to obtain capital gains treatment for the consideration paid under the license agreement.

2. *The Right to Export Licensed Products.*—Western licensors must exercise caution when granting exclusive licenses covering the entire Eastern European bloc since, in many instances, the proposed licensee may not be the ideal vehicle through which to reach a potential market of 350 million persons. A hasty decision may prevent the licensing of another Eastern European company that may prove necessary in order to satisfy completely the demand for the licensed products. On the other hand, when the licensed product has only a limited application, and if the potential licensee is located in a jurisdiction designated by COMECON to develop the particular branch of industry, if the licensee has a demonstrated manufacturing ability, and if the payment provisions are sufficiently attractive, a licensor should consider extending exclusive manufacturing and, possibly, sales rights covering all Eastern European countries.

Generally, Western licensors will endeavor to limit the sales ter-

ritory of the Eastern European licensee to the other COMECON member states. As mentioned above, Eastern European licensees are short of the convertible currency necessary for the payment of royalties. More often than not, licensees in Eastern bloc nations will also have a limited amount of convertible currency for the acquisition of the modern machinery and equipment necessary for the efficient exploitation of the licensed technology. Under these circumstances, enterprises will often seek, sometimes quite forcefully, the right to export directly, or indirectly through the licensor, to jurisdictions where they can earn sufficient convertible currency to fund license fees and the cost of machinery, equipment and replacement parts.

In the author's experience, all export rights and limitations granted to Eastern European licensees are respected by the licensees regardless whether direct sales rights or indirect sales rights are provided for in the particular contract. When the license includes highly technical products requiring substantial service and spare parts support, Eastern European licensees are likely to prefer to use the marketing and service channels of the licensor for the sale of the licensed products in designated jurisdictions or a specified part of the world, retaining to themselves only the sales and service rights in the COMECON countries.

A word of caution is justified about certain restrictions appearing in many East-West licensing agreements. The Antitrust Division of the United States Department of Justice recently indicated its intention to scrutinize East-West licensing agreements to ascertain whether they contain restrictions that cause a loss of export opportunities to American firms or impede American importers from securing products.[28]

### D. *Inclusion of Trademark Licenses*

Although trademarks have not yet been important in East-West licensing, it is the author's opinion that the increasing importance of consumer demand and consumer products in Eastern Europe, as discussed above, will mean that Western trademarks and trade names will attain an increased importance in Eastern European countries and will become sought-after industrial property rights.

28. *See* Letter from Keith I. Clearwaters, Special Assistant to the Attorney General, Antitrust Division, Department of Justice, to Dr. T. Keith Glennan, Department of State, in BNA PATENT, TRADEM'K & COPYR'T J., No. 149 at A-17 (Oct. 18, 1973).

Accompanied by know-how and manufacturing technology, trademarks are likely to form an attractive licensing package. To appreciate the trend toward the inclusion of trademark rights in licensing agreements one need only look at the great popularity of Coca-Cola and Pepsi Cola in Eastern Europe, increasing the number of countries where the thirst of the masses is quenched by an American cola.

### E. *Provisions for Protection of Secrecy*

Since Eastern European licensees are primarily interested in know-how and manufacturing technology, a license agreement must explicitly provide, in the clearest possible language, for the confidential treatment of that technology. By allowing Eastern European technicians and engineers to visit Western plants and by revealing to Eastern European licensees the lifeblood of the Western licensor—its sought-after know-how and manufacturing technology—the circle of persons having this previously confidential information will undoubtedly be enlarged. This is, of course, also true with licensing agreements between Western licensors and licensees, and, judging from the proliferation of these agreements, not much harm has ensued from this exchange of ideas. In the author's opinion, the risk of a breach of confidentiality by an Eastern European licensee is substantially less than a breach by a Western licensee. This apparent anomaly may be explained in part by the existence of legislation in most if not all socialist countries prohibiting the revelation of technical knowledge acquired by a person in the course of his employment, a prohibition sanctioned by imprisonment. If the agreement so provides, a Hungarian licensee, for example, will obtain from each employee having access to the licensor's technology a written confirmation that he will not reveal the technology to any unauthorized person and that he is cognizant of the legal provisions punishing infringement by imprisonment. (The written confirmation represents a stronger undertaking than written statements of nondisclosure made by employees of Western licensees).

An additional problem for Western licensors is confining confidential information to the licensed company in an economic system in which all enterprises are owned by the state. Notwithstanding this common ownership, enterprises maintain independence and guard their manufacturing secrets more stringently than do firms in the West. Access to factories is far more restricted in the East than it is in the West. If a Western licensor feels that excluding unauthorized persons from the licensee's premises will help

preserve the confidentiality of his technology, the licensee will likely be prepared to limit access to its operations. Again, the wording and the enforcement of the undertaking can and will be more forceful in the Eastern European countries than they would be in the West.

A related question involves the possible delivery of the Western know-how and manufacturing secrets to other COMECON member countries by the licensee state itself. Experience indicates that this has not yet occurred and is even less likely to occur in the future. The 1964 agreement between the United States and Romania is noteworthy; in that agreement Romania undertook not to reveal American technology to any other country. Of course, in the event that a United States export license is needed for the exportation of certain technology, then the export license will provide that the technology may be exported only to a particular Eastern European licensee and may not be passed on without United States Government authorization. Since the prospective licensee must state officially to the Office of Export Control of the United States Department of Commerce the use and the user of the technology the licensor will be additionally safeguarded. Past experience indicates (and the author believes) that Eastern European licensees and their governments will abide by a properly phrased contractual provision requiring secrecy of the know-how and technology and will not reveal that information to another COMECON member country. In addition to the business (*i.e.* competitive) importance of such a provision, the existence of sufficient legal safeguards maintaining trade secrets and confidential treatment of know-how is a key element in determining that an exclusive license covering an entire country involves the grant of a "property" right, thereby entitling the grantor to capital gains tax treatment of the proceeds obtained from an Eastern European licensee.[29]

### F. *Consideration Payable*

1. *Amount.*—The license fee to be paid is, of course, one of the most important points to be determined in the negotiations and it is of great importance to both parties that a proper consideration be agreed on. There are several ways in which license fees may be determined.

(a) *Fixed.*—In the past, Eastern European companies as-

29. *See* Rev. Rul. 64-56, 1964-1 CUM. BULL. 133-34. *See also* Rev. Proc. 69-19 § 3.02(a), 1969-2 CUM. BULL. 301, 302.

serted that it would be impossible under their economic system to reveal production figures, and wished, therefore to stipulate the license payment as a fixed sum rather than paying percentages of production totals. This fixed payment might be paid either in one lump sum or in several installments. Of late, Eastern European licensees have been less likely to make this assertion since the disclosure of the units produced by the licensee has been seen less and less as a state secret. From the point of view of the licensor, provisions for payment of a fixed amount eliminates some of the vagaries of planned economies. On the negative side, the potentially greater rewards to the licensor, in case of a greater-than-projected success by the venture, is also eliminated.

(b) *Percentage.*—Under the New Economic Mechanism, introduced by Hungary and now practiced in other COMECON countries as well, enterprises are increasingly forced to price their goods based on economic factors. Nonetheless, true market pricing may not be achieved in the near future and, therefore, if it is the Western licensor's desire to obtain a percentage license fee based on the sales price, an "objective" basis on which to calculate the percentage fee should be chosen. For example, the sales price charged by the Western licensor, reflected in its published list price, less its customary discount (or a similar formula) should be adopted rather than a percentage of the sales price actually set by the Eastern licensee. It seems to be increasingly feasible to provide in license agreements for a neutral review of the accounts of the licensee to control proper payment of the stipulated license fee.

(c) *Maximum-Minimum.*—In the course of negotiations, there can be wide differences of opinion between licensor and licensee about the quantity likely to be produced and the term during which the particular technology may be exploited. Providing for minimum payments with a limitation of the total amount to be paid may be an expedient solution to this difficult question.

2. *Payments in Kind.*—The convertible currency shortage discussed above will encourage Eastern European licensees to request that payment of license fees be made in kind. It is understandable that a Western licensor would prefer to obtain United States dollars, or another convertible currency, instead of the licensed products or parts thereof in consideration for the licensed technology. However, many Western European licensors, especially West Germans, derive an increased return from their Eastern European licenses by accepting, at favorable prices, delivery of parts or subassemblies of the licensed products. This arrangement, in turn, allows the Eastern licensee to manufacture the licensed items in

greater amounts with modern production methods. The license may acquire thereby sufficient foreign exchange to buy from the licensor parts or subassemblies, resulting in greater benefits of scale to both parties. One American licensor of diesel engines has undertaken to purchase parts from the licensee in the amount of the license fees paid plus the finished parts purchased from the licensor, provided the quality and the terms of sale offered by the licensee are as favorable as those offered by the licensor's other suppliers.

### G. *Duration and Termination*

1. *Preference for Relatively Short Term.*—As indicated previously, there are few Western patents registered in Eastern European countries. Therefore, the term of a license agreement does not necessarily extend through the life of the patent, and is more likely to be arbitrarily set at a term of five to ten years, coinciding with the expected life of the secret technology. Since the amount of foreign currency needed for the payment of license fees over the entire life of the contract is of pressing importance to the Eastern licensee, it is understandable that an Eastern licensee generally wishes to limit the term for which payment for the Western technology is due. Skeptics in the licensee's organization may think it is unlikely that the licensor can come up with new technology and thereby deserve continued payment of license fees. This is not as serious a conflict as it might first appear if the licensor, in turn, is confident and can convince the licensee that it can keep up its pace of development and will thereby be able to supply new or improved technology to the licensee.

2. *Right of Licensee to Extend Know-How Term.*—In order to solve the sometimes difficult impasse arising during contract negotiations about the duration of the license agreement, it may be advisable to resort to the expedient of somewhat lower license fees and a shorter term during which the licensor will promise to maintain the level of technology available to the licensee or to allow the licensee access to its manufacturing facilities. At the same time, a licensee may be given an option to extend the license for an additional term (*e.g.*, five years). To date, there is insufficient experience to indicate whether socialist licensees will indeed renew the term of a know-how and manufacturing technology agreement. Considering, however, the great advances made in the last few years by Western companies that are leaders in their field of industry and active in East-West licensing, we may assume that Eastern European interest in Western, mainly American, know-how and

technology will continue and that Eastern licensees will opt for the extension of license terms.

### H. *Applicable Law*

Until a few years ago Eastern European licensees refused to agree on an applicable law provision; the refusal stemmed from a reluctance on the part of the licensees to recognize the applicability of the licensor's law and a similar reluctance on the part of the licensor to subject the license agreement to an Eastern European legal system. As a compromise, agreements generally provided that in case of arbitration, the arbitrators would apply equitable principles, *i.e.* render their award *ex aequo et bono*.

In the last few years, however, the attitude of Eastern European licensees has changed, and they are now prepared to stipulate that a neutral country's law will govern the construction and interpretation of the license agreement. The Soviet Union, for example, prefers to provide for the application of Swedish law[30] (The Soviets frequently provide also for arbitration in Sweden). This choice appears to be motivated more by ideology than a real preference for the substantive provisions of Swedish law. Few if any of the contracts containing choice-of-law provisions are negotiated by attorneys familiar with Swedish law. Other Eastern European countries are amenable to accept the application of the law of the Swiss Confederation, with concurrent arbitration in Zurich or Geneva.

Until recently, American licensors were uncertain whether a contractual provision for Swedish or Swiss law, for example, would be upheld in case of controversy since there is no nexus of any kind between the designated countries and either the parties or the license agreement itself. The United States Supreme Court's judgment in *The Bremen v. Zapata Off-Shore Co.*[31] seems to have removed this uncertainty. Although *Zapata* involved a stipulation of a neutral (English) forum in a contract between German and American parties, the Court's strong preference for giving full recognition to the preference of contracting parties in the absence of a clear violation of public policy would seem to be equally applicable to an agreement containing a choice-of-law clause. Thus, parties to a license contract may be reasonably certain that a contrac-

30. *See* J. GIFFEN, THE LEGAL AND PRACTICAL ASPECTS OF TRADE WITH THE SOVIET UNION 191 (1969).

31. 407 U.S. 1 (1972).

tual provision opting for a neutral governing law will be upheld by American courts.

## I. *Arbitration*

Arbitration has long been accepted as the preferred means of settling disputes arising from international commercial contracts. Such contracts are typically concluded among parties accustomed to different legal systems and concepts, different languages and commercial customs and indeed, even different societies. In our context, the parties may even be unequal; a private individual or corporation may be dealing with a state trading agency, a formidable opponent indeed in the courts of its own country. On the other hand, socialist enterprises are not eager to accept the jurisdiction of a capitalist court. Although objections to the status of arbitral proceedings in East-West trade are voiced occasionally,[32] arbitration offers the most efficient way to resolve disputes arising in the course of East-West commercial relations. This efficiency has been recognized not only in international conventions (discussed below) but also in municipal legislation.[33] The necessity and convenience of arbitration in potential East-West trade disputes is well documented in legal literature.[34] It is thus not surprising that arbitration clauses are found in practically all license agreements in East-West trade.

The importance of arbitration has been stressed by the recent Trade Agreement concluded between the United States and the Soviet Union.[35] Article 7 of the Trade Agreement encourages both

32. *See* Tangley, *International Arbitration Today*, 15 INT'L COMP. L.Q. 719, 723 (1966).

33. *See* INTERNATIONAL CHAMBER OF COMMERCE, COMMERCIAL ARBITRATION AND LAW THROUGHOUT THE WORLD (Supp. 1964) (loose leaf); 3 P. SANDERS, INTERNATIONAL COMMERCIAL ARBITRATION 1965-1969. *See also* Act of Dec. 4, 1963, No. 98, Concerning Arbitration in International Trade and Enforcement of Awards (Czech.).

34. *See, e.g.*, L. KOS-RABCEWICZ-ZUBKOWSKI, EAST-EUROPEAN RULES ON THE VALIDITY OF INTERNATIONAL COMMERCIAL ARBITRATION AGREEMENTS 317 (1970); Dietz, *Foreign Trade in Hungary*, 5 N.Y.U.J. INT'L L. & POLITICS 251 (1972); Domke, *Arbitration Between Government Controlled Bodies and Foreign Business Firms*, 53 REPORT OF INT'L L. ASS'N 645 (1968); Domke, *Recent Developments in International Commercial Arbitration*, 2 N.Y.U.J. INT'L L. & POLITICS 267 (1969); King-Smith, *Communist Foreign-Trade Arbitration*, 10 HARV. INT'L L.J. 34 (1969); Kleckner, *Foreign Trade Arbitration in Romania*, 5 N.Y.U.J. INT'L L. & POLITICS 233 (1972); Szaszy, *Arbitration of Foreign Trade Transactions in the Popular Democracies*, 13 AM. J. COMP. L. 441 (1964).

35. *See* 67 DEP'T STATE BULL. 595 (1972). For an excellent discussion of the

the inclusion of arbitration clauses in United States-Soviet commercial agreements and the submission of disputes to arbitral tribunals in neutral countries. The Soviet Government can obviously guarantee that their state trading agencies will comply with this treaty provision by accepting the suggested arbitration procedure; American corporations are free to reject the arbitration procedure suggested by the Agreement[36] unless the parties fail to specify a different procedure in their contract.

The Trade Agreement also calls for the application of the Arbitration Rules of the United Nations Economic Commission for Europe,[37] in spite of the fact that the United States was not a signatory party and has not acceded to this Convention. These rules should prove to be acceptable to American licensors. The rules allow the parties freedom to appoint arbitrators, and only in the event they fail to do so may a designated body or person appoint arbitrator(s) on their behalf or designate the presiding arbitrator. Contracting parties are also at liberty to designate a body or person who is to appoint an arbitrator or the president of the arbitral tribunal. Only if the parties fail to adopt the appropriate appointive provisions will the "Appointing Authority" designated in the Annex to the Rules make such an appointment.

A similar tendency toward the use of conciliatory arbitration procedures in international commercial transactions may be seen in all other socialist states. Arbitration clauses are almost always included in contracts. Moreover, the Eastern bloc nations are members of several existing international conventions dealing with arbitration and the enforcement of arbitration awards. For example, Bulgaria, Czechoslovakia, Hungary, Poland, Romania and the Soviet Union are members of the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Awards.[38] All of

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Agreement see Starr, *A New Legal Framework for Trade Between the United States and the Soviet Union: The 1972 U.S.-U.S.S.R. Trade Agreement*, 67 AM. J. INT'L L. 63 (1973).

36. Trade Agreement art. 7(a).

37. Arbitration Rules of the United Nations Economic Commission for Europe, Jan. 20, 1966, U.N. Doc. E/ECE/625/Rev. 1, E/ECE/TRADE/81/Rev. (1966). The Arbitration Rules were adopted pursuant to the European Convention on International Commercial Arbitration, April 21, 1961, 484 U.N.T.S. 364.

38. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, Sept. 1, 1970, [1970] 3 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 3. The Convention was signed (and ratified) by Bulgaria on December 17, 1958 (October 10, 1961); by Czechoslovakia on October 3, 1958 (July 10, 1959); by

these countries are also members of the European Convention on International Commercial Arbitration signed in Geneva on April 21, 1961.[39] The tradition of adherence to such conventions has deep roots: Czechoslovakia, Poland and Romania were among the members of the Geneva Convention and Protocol on Arbitration Clauses of 1923;[40] Czechoslovakia and Romania were among the original signatories of the Geneva Convention on the Execution of Foreign Arbitral Awards of 1927.[41] Thus, there should no longer be any question of the enforceability of a properly rendered arbitration award in any of the countries in Eastern Europe. The United States has acceded to and has implemented the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958,[42] and all Eastern European countries are signatories of, or have acceded to, the same Convention.

## III. CONCLUSION

In conclusion, one might note that, to date, American companies have relatively little experience in licensing in Eastern Europe, a fact attributable in large measure to American preoccupation with strategic considerations during the Cold War era. With the arrival of detente, American companies can be expected to catch up with their Western European counterparts. Nonetheless, some Western companies, especially American companies, still hesitate to explore fully a licensing arrangement with potential licensees in Eastern Europe. One reason for this reluctance is that American firms question whether divulging United States technology to Eastern Europe will increase the Communists' ability to "bury" the capitalist countries, à la Khruschev. In answer to these fears, Kenneth Rush, Deputy Secretary of State, speaking at the United States Naval Academy in Annapolis, recently commented:

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Poland on June 10, 1958 (October 3, 1961); by the U.S.S.R. on December 29, 1958 (August 24, 1960); and acceded to by Hungary on March 5, 1962, and Romania on September 13, 1961.

39. *See* note 37 *supra*. The socialist countries were among the original signatories and they ratified the Convention as follows: Bulgaria, May 13, 1964; Czechoslovakia, November 13, 1963; Hungary, October 9, 1963; Poland, September 15, 1964; Romania, August 16, 1963; and the U.S.S.R., June 27, 1962.

40. Geneva Convention and Protocol on Arbitration Clauses, Sept. 24, 1923, 27 L.N.T.S. 157.

41. Geneva Convention on the Execution of Foreign Arbitral Awards, Sept. 26, 1927, 92 L.N.T.S. 301.

42. Act to Implement the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 9 U.S.C. §§ 201-08 (1970).

> We would like to see more American businessmen begin to pursue profitable business deals in Hungary as in Belgium; in Bulgaria as in Norway; in Poland as in Uruguay. We encourage them to sell, invest, and buy in these countries as opportunity permits and in confidence that doing business in Eastern Europe is fully consonant with the U.S. national interest.[43]

Reluctant potential licensors should also consider the views expressed in November 1970 by Professor Ota Sik, Deputy Premier and economic reformer under former Czech Premier Dubcek, before the Subcommittee on Foreign Economic Policy of the Joint Economic Committee of the United States Congress. After describing the drawbacks of the communist system, he noted that he was still "an advocate for broadening and intensifying East-West relations to the greatest possible extent." He further stated that the development of economic relations with Western countries will "take the wind out of the sails of reactionaries and strengthen the position and arguments of the liberal forces" in Eastern Europe. He felt that East-West trade serves only to dramatize the inefficiencies of the economic systems in the Eastern European countries and the competitive limitations of their products in world markets.[44]

43. Dep't State Press Release, April 4, 1973.

44. *Hearings Before the Subcomm. on Foreign Economic Policy of the Joint Economic Comm.*, 91st Cong., 2d Sess., at 1182 (1970).