

TECHNOLOGY TRANSFER AGREEMENTS

The topic of technology transfer encompasses commercial aspects and a range of laws including intellectual property. No generalizations are possible regarding the terms of the contract and much would depend upon the facts and circumstances underlying a particular technology transfer. This Chapter is limited to providing a general overview of certain commercial and legal aspects that may be considered in a contract for technology transfer.

Nature of the contract

A contract for technology transfer can either be a licence agreement or a know-how agreement. The licence agreement normally refers to the licensing of intellectual property rights such as patents, trade marks, copyrights, etc. whereas a know-how agreement involves the transfer of information or skills which have not received statutory recognition. This distinction has an impact on the confidentiality and secrecy aspects of the contract. Any technology transfer contract broadly deals with the mode of transfer of technology, its use under certain terms and conditions. The mode of transfer can take place through documents or through the provision of technical services, assistance and training, software programs on diskettes or even through the sale of machinery, raw materials or components that embody technology.

Typical provisions of a licence or know-how agreement

An illustrative list of the provisions are briefly discussed below:

Product/ service definition

It is essential to provide an exact description of the product or service for which technology is being transferred. A very wide definition can bind the transferor from parting with technology that he had no intention of transferring. It must be determined whether technology for future model updates and improvements are included within the definition, and whether the specified consideration would include improvements or whether payments would have to be made in future.

Licensed property

The precise categories and details of patents, copyrights, etc. that are licensed are enumerated.

Technical know-how

Any technology transfer involves many types of expertise and knowledge. Therefore, it is important that these are precisely defined. These may include:

- (i) latest and complete data on the functioning of the product;
- (ii) information and assistance on suppliers of raw material, machinery, spare parts, etc.;
- (iii) maintenance manuals and instructions;
- (iv) engineering drawings and designs;
- (v) test methods;
- (vi) response to specific queries from licensee;
- (vii) deputation of personnel for on-site supervision.

Territory and sub-licensing

The territory in which the product/ services to be sold/rendered is defined so that the market areas of the Licensor and the licensee are clearly demarcated. This prevents the licensee from becoming a competitor to the Licensor and also provides flexibility for the Licensor to provide technology to parties in other areas. The normal practice in many cases is to provide that the licensee has an exclusive licence as far as India is concerned and that other areas may be added by mutual agreement. Further, it must be specified whether the licensee has a right to sub-license the technology and the terms and conditions if such a right is granted.

Commercial production

The start of commercial production may take place after certain test runs are conducted. The timing of the commercial production is critical from the view-point of the payment of royalties based on sales.

Licenser's obligations

The Licenser's obligations may typically encompass;

- (i) guarantee that the product manufactured shall meet certain performance tests and standards;
- (ii) providing technical assistance either in India or abroad;
- (iii) providing minimum sample quantities of test product;
- (iv) procuring equipment for the licensee;
- (v) training employees of the licensee;
- (vi) assist in setting up of facilities for testing and quality control;
- (vii) allowing use of intellectual property rights;
- (viii) providing knowledge of improvements made to the product;
- (ix) buy-back of product, if any;
- (x) deputation of on-site personnel.

Licensee's obligations

The following are some of the obligations of any licensee:

- (i) to make payments to Licenser;
- (ii) treat the technology confidentially;
- (iii) to exploit the technology to the maximum extent;

- (iv) to reach a minimum quality standard as required by the Licensor;
- (v) reporting production details;
- (vi) in case of manufacturing concerns -providing factory site with adequate infrastructure.

Warranties, indemnity and infringement

The Licensor warrants and agrees to indemnify the licensee for infringement of any rights in respect of the following:

- (i) Licensor has full and absolute ownership or otherwise has fully and absolute right and authority to transfer and furnish the know-how;
- (ii) the technical know-how provided under the contract and the intellectual property licensed shall achieve the objective of producing a quality product;
- (iii) the technical know-how provided under the contract and the intellectual property licensed does not infringe the rights of any third party to the best of the Licensor's knowledge. In case of any third party infringement or proceeding, the contract normally provides that the Licensor and the licensee shall take joint action to defend the matter and the costs of such a defence shall be borne by the Licensor and not the licensee;
- (iv) indemnity from third party claims in respect of defective products (provided that the defect is shown to be due to a lapse on the part of the licensor's technology);
- (v) licensor is not aware of any actions, suits or proceedings at law or at equity, before any court or authority in relation to know-how;
- (vi) the execution and delivery of the contract or the performance by the Licensor of its duties and obligations conflicts with or is contrary to any law or any agreement or commitment to which the Licensor is a party to.

Product liability and indemnity

product liability is an area where there is increasing judicial activism. Determining the cause of product liability is obviously critical; i.e. whether it is a manufacturing defect or a technical defect. It is advisable that the licensee procures product liability insurance particularly when products are exported to the European Community and the United States.

Improvements and Inventions

It is possible that the Licensor or the licensee's employees may make improvements to the licensed product. In such an event, it is the duty to disclose such improvements to the other party. The clause should also provide the suitable action regarding the joint registration of the intellectual property right and the party that is entitled to use such a right. In certain cases, the improvement may belong to the licensee for exploitation in the defined territory but the Licensor may have right of first refusal in case the product is to be sold out of the territory.

Inspection and information

The licensee agrees to provide access to any information required by the Licensor in connection with production and sales records. This is useful in case there is any discrepancy in royalty calculations between the Licensor and the licensee. There may also be a provision for penalties in case of discrepancies. Further, the cost of the audit is borne by the licensee in case any discrepancy is found.

Payment of consideration

The consideration can be in the form of a lump sum payment and/or royalty payment based on sales. These payments are subject to RBI guidelines (please refer Chapter 3). The net selling price is defined taking into considering these guidelines.

Currency and taxes

The currency in which payments are to be made and the exchange rate to be used is expressly stated. Any payment made by an Indian company towards royalty or fees for technical services are taxable in India in the hands of the foreign collaborator. The tax rate is 20% on such payments under the Indian Income-tax Act (“ITA”). This can be reduced to a lower rate based on India’s tax treaties. The payment of these taxes either by the Licensor or the licensee is frequently a negotiating point. The following considerations are important in the negotiation:

- (i) Taxes paid in India by a foreign collaborator is normally available as a tax credit in the collaborator’s home country. If a tax credit is available, it may be preferable that the foreign collaborator bear the tax in India as it reduces the tax cost of the total transaction.
- (ii) In certain cases, the foreign collaborator may not be able to use the tax credits as the overseas company may have carried forward losses or is located in a low-tax country. In such a case, if the taxes are paid by the licensee, no tax credit would be available to the foreign collaborator. No gross-up is required to compute the tax payment made by the licensee under section 10(6A) of the ITA as long as the agreement relates to a matter included in the industrial policy in force or is an agreement that is approved by the Central Government.

Research and development Cess of 5% is payable by the licensee on all payments made in connection with the payment of royalty or fees for technical services. Further, drawings and designs are subject to customs duty, but as of now an exemption is in force, so effective rate of duty is nil. However, it is important to note that if capital goods and technology are being imported in a composite transaction, the cost of the technology may be added to the value of capital goods for purposes of custom duty.

Confidentiality

Secrecy is of utmost importance in any technology transfer agreement and particularly in cases where unpatented know-how is involved. The following issues need to be addressed:

- (i) a breach of confidentiality can occur either during the preliminary stage of negotiation or during the duration of the agreement;
- (ii) the breach could also occur after the expiry of the agreement. Therefore, the confidentiality provision must survive the termination of the agreement for any reason;
- (iii) the technology to be kept confidential must be clearly identified. For example, information already in possession of the licensee and information publicly know are not subject to confidentiality;
- (iv) extent of permissible disclosure. For example, it is necessary to disclose certain technical details to an employee or a sub-contractor manufacturing the product or a component;
- (v) the extent to which the Indian licensee can bind its employees in respect of confidentiality during and after the employment;
- (vi) the obligation to preserve confidentiality is also imposed on the Licensor in cases where the agreement is exclusive.

The remedy for breach of confidentiality can be either provided in the contract or in its absence, the law of contract relating to damages for breach would apply. Liquidated damages may also be provided.

Duration of the agreement

The duration of know-how agreements is restricted by the RBI norms in this regard. Royalty payments can be made only during a period of 10 years from the date of agreement or 7 years from commencement of commercial production, whichever is earlier. Thus, most agreements provide for an initial term based on the above norms with a clause enabling renewal of the agreement subject to Government regulations at the time of renewal.

Termination

Termination of the agreement must be distinguished from the expiry of the agreement due to efflux of time. A breach of warranty by the Licensor or the licensee can cause termination of the agreement for instance, due to:

- (i) continued non-payment of royalty;
- (ii) failure to achieve quality standards set by the Licensor;
- (iii) Material breach of key obligations (after providing time to remedy);
- (iv) insolvency or change in ownership of any of the parties. The identity of the parties is crucial in a technology transfer and the agreement may be terminated if the control over any one of the parties passes over to a competitor.

If a technology transfer agreement is part of a joint venture, it may be provided in certain cases that any termination of the technology transfer agreement can also trigger off a termination of the joint venture agreement or vice versa.

Consequences of termination

One consequence that is of utmost importance is that of continued use of technology by the licensee. The Licensor may insist that know-how in the form of documents, equipment, etc. revert back to the Licensor and that the Licensee is not permitted the use of know-how. The termination normally does not absolve the Licensee from its obligations regarding confidentiality or payment of royalty. The termination is to be contrasted against expiry of agreement wherein the licensee may be permitted to manufacture the product beyond the life of the agreement.

Applicable law

The parties to an agreement have a choice with regard to the substantive law that applies to a particular contract. Ordinarily, Indian Law will apply to the contract as the technology is absorbed and used in India.

Arbitration

It is open to the parties to select the procedure and venue of arbitration. Each party normally bids for the arbitration procedure and venue in their own country and the result is that the procedure in a neutral country is adopted. For example, the International Chamber of Commerce procedural rules can be adopted and the venue of such arbitration can be in Paris. If the venue is not in India, but in say Paris or London, the Indian licensee must consider the high costs of arbitration and examine the enforceability of the awards in the Licensers country. The high costs is itself a deterrent to arbitration in such cases and thus, a more acceptable solution from an Indian Licensee's standpoint may be that the International Chamber of Commerce rules of arbitration may be adopted and the venue may be Singapore, rather than London or Paris. It is also important to specify the number of arbitrators that each party will appoint and it must be an odd number.

Force Majeure

This clause provides protection to the party confronted with events beyond its control which disable the party from performing its obligations under this agreement.

Amendment

The parties have to agree that the agreement may be amended if considered necessary by putting it in writing and attaching the same to this agreement.

Assignment or other transfer

The parties have to decide whether this agreement can be assigned or transferred to any subsidiary or group company of any of the parties or any of its successors or assignees. A subsidiary may be defined as any company that is under the control and management of the parent.

Preconditions

The agreement is expressly subject to the approval of RBI or SIA and the terms and conditions stipulated by the RBI in their letter of approval are to be made part of this agreement.