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Caveat Emptor: Lessons from Volkswagen's Lemon Purchase

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Introduction

In the spring of 1998, German automobile manufacturer Volkswagen AG paid almost $1 billion for Rolls Royce but did not acquire the Rolls Royce trademark, which was ultimately sold to rival BMW for a mere $65 million. The story of Volkswagen's botched acquisition is a reminder of the importance of careful due diligence when engaged in international acquisitions. In Part I of this Article, Volkswagen's steps (and mis-steps) are retraced and solutions are offered for counsel engaged in international transactions with the hope that the practitioner with little experience in this area can avoid similarly embarrassing and costly errors.[1]

For many small to medium-sized companies, the task of expanding internationally is a daunting proposition. In addition to the business equation, the prospect of establishing a foreign subsidiary or forming a joint venture with a local partner is simply beyond the resource capabilities of many domestic enterprises. Licensing is therefore an affordable and efficient way for companies to expand overseas. Licensing comes in many permutations and sizes but is essentially a contract not to sue, by the licensor, as long as certain conditions are met. In addition to due diligence, therefore, international corporate counsel should be aware of unique contracting issues that arise in international intellectual property licenses. In Part II of this Article, recommendations are offered on how to draft contract clauses for international licensing use.

Finally, a discussion of licensing technology that is U.S. origin would not be complete without a brief discussion of the U.S. export control regime counsel should be aware of. Part III of this Article provides a brief introduction to that control regime. Penalties for violations are stiff and potentially ruinous, and enforcement is at an all-time high due to security concerns. This is information that all international counsel should be aware of, not just experts in the field.

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I. An Acquisition Goes Awry – Where Were the Trademark License Attorneys?

Within a month,
Ere the salt of most unrighteous tears
Had left the flushing in her galled eyes,
She married. O, most wicked speed, to post
With such dexterity to incestuous sheets!
-- Hamlet (1.2.153-157)[2]

When Will Shakespeare wrote Hamlet's first soliloquy, he could not have foreseen a world where his words would have significance for the breakup of one of the United Kingdom's most venerable companies, Rolls-Royce. Just as Hamlet despaired over his uncle's murder of his father and his mother Gertrude's subsequent marriage to the murderous Claudius, the news that Rolls-Royce (and its sister Bentley) was being sold to German automaker Volkswagen AG in 1998 and that arch-rival BMW would own the trademark to Rolls-Royce starting in 2003 was greeted with derision and despair in Great Britain. The end result, however, was far from pre-ordained. Sloppy negotiating, abysmal due diligence, and a rush to "get the deal done" led to the incestuous relationship between BMW and Volkswagen, and the "children" of that relationship: Rolls-Royce and Bentley.

To understand the convoluted history of the Rolls-Royce/Bentley saga, it is important to trace the historical route the entities involved took. Since 1904, when Henry Royce met Charles Rolls,[3] Rolls-Royce has represented the very best in British motoring and has set the world standard for vehicles that catered to the ultra-rich. In 1931, Rolls-Royce purchased Bentley,[4] and, thus, began a fruitful and prosperous relationship that saw Rolls-Royce cater to the ultra high-end luxury market while Bentley (which often were Rolls-Royce vehicles thinly disguised, i.e., no flying lady, formally known as the "Sprit of Ecstasy") catered to the "sporty" end of the same niche market. Meanwhile, during the Second World War, Rolls-Royce focused its attention on manufacturing aircraft engines, a venture that continued successfully after the war. In 1971, after financial difficulties with product development of a jet engine designed for use on commercial airliners, the entire company (then Rolls-Royce PLC) went into receivership, and the vehicle and aviation companies were separated.[5] Rolls-Royce Motor Cars Ltd., producing both Rolls-Royce and Bentley vehicles, was formed in 1973, and in 1980, was acquired by defense manufacturer Vickers PLC. During the 1971 receivership, however, Rolls-Royce PLC maintained ownership of the "Rolls-Royce" trademarks and licensed the use of the mark to Rolls-Royce Motor Cars Ltd. in a 1973 trademark license agreement. One of the clauses in that agreement provided that while Rolls-Royce Motor Cars Ltd. would have the rights to manufacture Rolls-Royce and Bentley motor vehicles, Rolls-Royce PLC would maintain exclusive control of the Rolls-Royce mark in the event Rolls-Royce Motor Cars Ltd. (the licensee) was sold to a foreign owner.[6]

By the late 1990's, Rolls-Royce Motor Cars Ltd. had run into financial difficulties and was having difficulty raising sufficient cash to invest in new product development. The auto industry is notoriously unforgiving in terms of capital expenditure and absent high volume or high margins (preferably both), cash to invest in future product programs can be scarce. Meanwhile, Vickers PLC, the motor company's parent, was interested in pursuing strategic growth in marine, propulsion equipment, and turbine components.[7] Vickers, therefore, announced the sale of Rolls-Royce Motor Cars Ltd. in 1997.

At first blush, it may seem reasonable to a buyer interested in the company to assume that the corporate entity held all the assets required to manufacture, distribute, and market Rolls-Royce and Bentley motor vehicles. On March 30, 1998, BMW announced a $560 million bid for Rolls-Royce Motor Cars Ltd.[8] BMW, then led by Bernd Pischetsrieder, had a long history with Rolls-Royce, both the aerospace engine company and the motor vehicle company. As far back as the early 1990's, BMW was supplying development services on engine chassis/body rigidity, paint technology, engine ancillaries, and air conditioning to Rolls-Royce Motor Cars Ltd.[9] In 1990, BMW and Rolls-Royce PLC (keep in mind, a completely separate and unrelated entity from the motor company) formed an aero engine joint venture in Germany.[10] At the time the sale was announced, BMW was supplying a V12 engine for Rolls-Royce's Silver Seraph model and a V8 engine for the Bentley Arnage.[11] An important detail in the 1994 engine supply agreement was BMW's right to cancel the supply of engines with twelve months notice if Rolls-Royce Motor Cars Ltd. was sold to another car company, or three years notice if it was sold to a non-motor vehicle manufacturer.[12]

A month later, led by Chairman Ferdinand Piech, Volkswagen AG made an offer for $720 million.[13] In early July the offer was increased to $795 million based on newer financial statements.[14] The offer also included an ancillary deal to purchase Vickers' Cosworth engines subsidiary for an additional $190 million.[15] On June 5, 1998, Vickers shareholders agreed to the VW offer.[16]

It seems axiomatic that in an acquisition worth many hundreds of millions of dollars, trademark attorneys would have been integrated into the due diligence process in order to identify the nature of the trademark property owned by the target company. Arguably, in a company with storied past and famous trademarks such as Rolls-Royce and Bentley, the trademark is worth more than the other assets purchased. It may also seem obvious that the transactional attorneys would review material supply agreements prior to closing to ensure the target company could continue operating its business as it normally would while the new owner integrated the target into its own processes, which for an automobile company can take several years. Alas, neither assumptions held true for Volkswagen's acquisition team.

The end result: Volkswagen had paid almost $800 million for a premium luxury car company but did not have the right to use its brand, had no engines, plunging sales, and inherited an ancient assembly plant and cranky British workers.

What followed next was a tripartite punch that surely takes the prize for spoiling an acquirer's post-transaction party. First, lawyers for Rolls-Royce PLC notified Volkswagen of the 1973 trademark license agreement and firmly asserted its rights under the foreign-ownership clause to retain exclusive control of the Rolls-Royce trademark.[17] Second, by July 9th, BMW delivered twelve-months notice that it would stop delivering engines to Rolls-Royce for the Silver Seraph and Bentley Arnage models.[18] Third, at around the same time, BMW announced it had purchased the Rolls-Royce trademark from its technology and manufacturing partner Rolls-Royce PLC for $65 million.[19] One can only speculate at the behind-the-scenes strategic meetings occurring at BMW at this time. Led by Pischetsrieder, the company had made a bid for Rolls-Royce to allow it to grow into ultra-premium market segments, been outbid by Volkswagen, realized (or knew all along) the trademark was worth more than the assets and was not part of what Vickers PLC was selling, negotiated purchase of the trademark from its rightful owner and longtime partner (one has to wonder if the sale of its aero engine joint venture to Rolls Royce PLC in 2000 was part of the negotiations), and then delivered the death blow to Volkswagen by cutting off supply of engines for critical products. The end result: Volkswagen had paid almost $800 million for a premium luxury car company but did not have the right to use its brand, had no engines, plunging sales, and inherited an ancient assembly plant and cranky British workers.

On July 28 that year, over a round of golf at the Neuburg country club, Pischetsrieder and Piech came to a compromise. Under the terms of a Memorandum of Understanding, Volkswagen would retain the Bentley trademark, the factory in Crewe, and its 2400 workers. BMW would own the Rolls-Royce brand, but did not acquire any factories, employees, or other assets.[20] While BMW designed a new product and built a factory in England (eventually built in Goodwood), it would license the Rolls-Royce brand to Volkswagen until January 1, 2003. It would also resume supply of engines to Volkswagen to keep the Rolls-Royce Silver Seraph in production. Starting in 2003 (when its new factory was finished, workers hired, and new product (the "Phantom") developed), BMW would regain ownership and control of the Rolls-Royce brand. Graham Morris, the chief executive at Rolls-Royce Motors, who had promised his staff that Bentley and Rolls-Royce would never be split apart, resigned as "a matter of honor."[21]

For Volkswagen's Piech, the settlement with BMW was acknowledgement of a costly and embarrassing error in business judgment.[22] During a press conference, he admitted that he would "have liked to have kept both brands" and that the purchase price would have been "much lower" if he had known it would not have included the Rolls-Royce trademark.[23]

We may never know what led Volkswagen to such a disastrous outcome. Any number of personal and business factors may have played a role, from Piech's ego to a lack of understanding of the nature of BMW's relationship with Rolls-Royce

Motor Cars Ltd.[24] On the legal team's part, the transactional attorneys who assisted in the deal must have been scratching their collective heads over what went wrong. Certainly, sloppy due diligence played a role. Whether as a result of not discovering the key trademark licensing agreement or simply not reading all the documents gathered during due diligence, a clearer understanding of the nature of the trademark license held by Rolls-Royce Motor Cars under the 1973 trademark license agreement with Rolls-Royce PLC and the 1994 engine supply agreement with BMW would almost certainly have saved Volkswagen hundreds of millions of dollars. Second, there is an important lesson here for transactional attorneys who rely too heavily on a seller's representations and warranties rather than on due diligence. While the purchase agreement (whether stock or asset) between Volkswagen AG and Vickers PLC no doubt contained customary representations and warranties on what Volkswagen was getting for its $790 million, a long and protracted court battle over Vickers PLC would almost certainly have meant an interruption in production of the Silver Seraph and Arnage since a court battle would not have resolved BMW's termination of the engine supply agreement. Rolls-Royce risked further alienation of its loyal customers if there was a further deterioration of its precious brand image. Once the extent of the damage was uncovered, therefore, Volkswagen had little choice but to compromise with BMW and salvage what it could from its $790 million purchase. A tough way to learn the lesson caveat emptor.[25]

There is an epilogue to the story between the two executives most involved with the acquisition, Pischetsrieder and Piech. Pischetsrieder, in spite of his victory in winning Rolls-Royce over Volkswagen, was fired a year later from BMW over his handling of another (not quite as successful) BMW acquisition, that of Rover (otherwise known in the industry as "The English Patient").[26] Piech (who took a liking upon Pischetsrieder's negotiation and strategic skills that faithful day in July on the golf course), upon hearing of Pischetsrieder's ouster, immediately offered Pischetsrieder a job at Seat, Volkswagen's Spanish subsidiary. Within two years, Pischetsrieder had taken over Piech's job as chief of Volkswagen, thus, inheriting the newly christened Bentley Motor Cars Ltd. (not to mention that old factory in Crewe and its cranky workers).[27] Looking back, he says, "The best stories are written by life. To a certain degree, I regret that I was so clever to get Rolls-Royce back from Volkswagen, but that's the way it works."[28] With such dexterity to incestuous sheets, indeed.

In spite of Volkswagen's tale of horror, many companies still find a tremendous amount of value in licensing their intellectual property across borders. For many U.S. companies, licensing a product or technology is the most cost efficient and quickest way to distribute a product into a foreign market where it does not have any experience in conducting business.[29] The most common concern these licensor companies face is how to prevent the licensee from using the intellectual property forever without paying anything either by law, refusal by local authorities to enforce the law, or just because. The following contract provisions may address some of these concerns, but ultimately the ability of a licensor to prevent the misappropriation or infringement of its intellectual property in a foreign jurisdiction is a vexing problem that may have no satisfactory solution.

II. Contract Provisions to Consider

Before considering licensing intellectual property to a licensee in another country, an initial question should be whether or not the laws of the licensee's jurisdiction provide the same level of protection for the intellectual property you are seeking to license as the United States. While licenses are essentially contracts, many jurisdictions lack the same common law jurisprudence on contracts that the United States enjoys, and thus, sanctity of contract and the parties' intent when contracting may be overlooked.[30] As a matter of public policy, a foreign jurisdiction may choose not to enforce a license agreement if the subject matter licensed is not protected under local law since in most jurisdictions contracts contrary to public policy are void ab initio.[31] If the level of protection for the subject intellectual property in the licensee's jurisdiction is nonexistent or insufficient, then contract drafting becomes even more critical, particularly choice of law and forum clauses in countries that recognize and enforce foreign arbitration awards.[32]

In addition, clients should be counseled the law (and lawyers) can only do so much to protect a company's invaluable intellectual property. No quantum of damages or relief, equitable or legal, could compensate the publication of the formula of Coca-Cola on the Internet. Clients who adopt too much of a "let the lawyers protect us" attitude will expose the company to unnecessary risk as they ignore non-legal solutions to any potential problems in protecting intellectual property. Often, a licensee of technical information has some other business relationship with the licensor, such as seller or buyer. Changes to the business relationship that would result from a breach of the license agreement will often have more persuasive effect on a licensee's compliance with the terms and conditions of a license agreement than the remedies provided therein, and your business client is a critical component in dimensioning that context to the licensee.

. . . [T]here is an important lesson here for transactional attorneys who rely too heavily on a seller's representations and warranties rather than on due diligence.

The following are contract provisions to consider while drafting a license agreement for licensing intellectual property across borders.

<u>Definitions</u>. Most license agreements rely on the use of capitalized defined terms, so the manner of definition is critical. The most critical definition in the license agreement is the definition of the item or technology to be licensed. The rights being licensed should also be defined in no uncertain terms.[33] Carve exclusions for derivatives, new designs, or improvements of the item or technology. On the other hand, if licensee improves upon the licensed technology or item, the agreement should address which party has ownership of such improvements (i.e., a grant-back clause).[34] When defining the technical information to be used by the licensee, an exception should be made to exclude technical information that if used by licensee would result in licensor incurring an obligation to a third party or

breaching a confidentiality obligation to a third party.

Contract territory. One of the principal worries in licensing intellectual property is if something were to occur that would cause a breach or leak of intellectual property within a particular jurisdiction, that breach or leak should be "contained" within the national borders of the licensee's jurisdiction. This is especially true if the licensee is near or contiguous to a major market for your client. If the leak spills over into a high volume market, the damage from the breach may be much higher than if it is contained. A strong definition of the contract territory is a good place to start in this containment strategy.[35] Within the scope of the license grant, language should make it clear the licensee has the right to use (and/or sell) the licensed technology within the contract territory only. Local counsel should be consulted to ensure the enforceability of a no re-export provision under a jurisdiction's antitrust or competition laws.[36]

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Extent of licensed rights. Licenses can run the gamut, from exclusive, royalty free, worldwide, perpetual, fully transferable, to non-exclusive, non-transferable, to use a limited amount of IP in a very specific territory, or for a limited time.[37] If the license is to be non-exclusive, a clause should be inserted expressly reserving the right of the licensor to use and sell the licensed technology within the contract territory.[38]

If the license of intellectual property is being granted to a joint venture company, great care should be taken to control the flow of information to the joint venture itself and not to the partner, especially if the partner is a state owned company or affiliated with a foreign government.

Obligation to support. If licensor will have an obligation to support licensee's use of the licensed technology, issues to be addressed include when such support may be invoked, expenses (i.e., hourly rate, level of employee sent for support, business class airfare if long distance travel is involved), and payment terms.[39]

Registration requirements. Some foreign jurisdictions require license agreements, particularly those involving intellectual property, to be registered with local authorities in order to be enforceable.[40] If legal, consider a pro forma version of a license agreement with the minimum amount of information necessary to register if the client wishes to keep other terms and conditions secret. If the licensee is an affiliated company of the licensor (i.e., technology holding companies), care should be taken not to trip any non-use statutes. Sometimes this problem can be solved by registering agreements in foreign jurisdictions.

Use restrictions. The licensor should clearly define what uses the licensed technology may be used for and exclude all non-defined uses.[41] In addition, the licensor should seek to restrain transfer of the licensed technology in all circumstances and may consider liquidated damages in the event of such a transfer. Due diligence is called for here. If a jurisdiction does not permit restraints on transfers of licensed intellectual property, the client may wish to revisit the scope of the license granted or negotiate a lower price for accepting a higher risk of leakage.

Product labeling. If the licensee is permitted to use the licensor's trade name or trademark under the license, the extent of use should be clearly defined. Drafting should also provide if the agreement is assigned under any circumstances, the right to use such trade name or trademark ceases immediately.

Payment terms. Payment terms, while generally a business matter for the client to negotiate, should be structured carefully under applicable local laws.[42] The parties should specify what currency the fees will be paid in and which conversion rate(s) will apply.[43] The frequency of payments, level of accounting to be kept by licensee, and the licensor's right to audit should be addressed. If licensor is to provide support services during the term of the agreement, those payment terms should be addressed as well.[44] Finally, consider whether the payment structure raises any issues related to creating a permanent establishment for tax purposes in the licensee's jurisdiction.[45]

Termination clauses. Careful consideration should be given to how to terminate the license, even if the term is a defined length of time.[46] At-will termination is a knife that can cut two ways and may be illegal in some jurisdictions. If termination is only permitted upon a material breach, will there be an opportunity to cure, and if so, how long will such opportunity last?[47] The parties' obligations upon termination, no matter how the termination occurs, should be addressed. At a minimum, the licensed technology should be returned and destroyed and cessation of use of the licensed technology should occur immediately upon termination.[48] The license agreement must spell out that any confidentiality obligations that run with the licensed technology shall survive any termination for the agreed length of the confidentiality obligation.[49] Bankruptcy or insolvency of the licensee should give rise to immediate termination by the licensor without liability.[50] Finally, consider a clause similar to the one used by BMW in its 1994 engine supply agreement that permitted BMW to make life unpleasant when an acquisition or change or ownership occurred.[51] Do not forget to account for changes in ownership that come about either through stock purchase or asset purchase.

Compliance with U.S. export controls. While some licensees may raise questions about this clause, it is critical as part of your client's export compliance efforts that licensees are made aware of your obligations with regards to controlled technology or software.[52]

Confidentiality clause. This clause is essential. Consider limiting individual persons and companies that will have access to the licensed intellectual property (i.e., which employees and subcontractors). All information exchanged with the licensee should be deemed confidential unless otherwise marked in writing or if disclosed orally, is followed up with an exception in writing. The duration of the confidentiality obligation should be identified,[53] and the clock should only start at the moment of disclosure. Finally, the agreement should protect for the licensor's decision to withhold information, without being in breach of agreement, until satisfied with licensee's intellectual property secrecy measures.[54]

Assignment. Licensor should reserve the right to assign to affiliated company in case of reorganization i.e., for tax purposes. Licensee is generally not permitted to assign for any reason to any entity.

Representations and Warranties. Licensee may seek warranties about the intellectual property being licensed, especially with regards to potential infringement claims from third parties.[55] Licensor should seek to limit the scope of these warranties.[56] The strongest warranty would be "Licensor's activities do not infringe on any third party's rights." A weaker form of the same warranty would be "To the best of Licensor's knowledge, Licensors' activities do not infringe on any third party's rights." Finally, the weakest warranty would be "Licensor has not received any written notice that its activities infringe a third party's rights." Especially in the area of software development, the licensor should ensure it is the rightful owner of any copyrighted works. If the software was not created as work for hire, for example, assignment of title needs to be effected before licensor can license the software. If licensee seeks warranties on the registration of intellectual property where registration is required, licensor should limit the scope of the warranty to exclude registrations "duly granted" or "valid" as they assume additional undertakings beyond mere registration. Both parties should also pay close attention to the effect of exceptions to any warranties that are disclosed on separate schedules. These exceptions fall outside the scope of the warranty being provided, and the schedules are often not delivered until signing of the license agreement is imminent, when the business client is least likely to want to re-open negotiations on the basis of an unexpected exclusion to a warranty. Of course, warranty language raises issues on opinion letters and indemnification, which are beyond the scope here.

Sublicenses. If the licensor will permit sublicensing of the intellectual property to second or third tier suppliers (i.e. suppliers to the licensee), how will enforcement of the license terms on such suppliers be effected? Actions upon termination (i.e. destruction and return of the intellectual property and cessation of use) should run to these sublicensees as well as the licensee.[57]

Taxes. The burden of paying income, withholding, stamp, registration, turnover, value added, and other charges should be addressed.[58] Be careful of undervaluing the intellectual property for purposes of reducing the taxable basis. Licensors should demand licensee pay the licensor's taxes and deliver tax receipts and should address the issue of offsetting taxes due with royalty or payments due. Local counsel should be consulted on the legality of shifting licensor's tax burden to licensee.[59] Finally, licensors should seek strong indemnification for tax claims against licensor.

Choice of Law. Sometimes, in spite of careful drafting and relationship management, intellectual property may be compromised, and a foreign jurisdiction may refuse to protect what would otherwise be protected under U.S. law.[60] Under some circumstances, a choice of law clause may be the saving grace. If a jurisdiction enforces arbitration clauses, getting the dispute into a friendly arbitral forum that will recognize U.S. law on intellectual property and then seeking enforcement of any subsequent arbitral award in a foreign jurisdiction may be the ticket.[61] Before deciding on a choice of law clause, counsel should consider what governing local law says about the duration of license agreements, royalty rates, ownership of intellectual property after termination, government registrations or approvals, export restrictions in the license, trademark usage restrictions or requirements in the license, obligation to provide future improvements in the technology (incremental vs. breakthrough), and withholding taxes on royalties (who is obligated to pay and what if licensee withholds and doesn't pay). Some jurisdictions will ignore choice of law and apply local licensing laws, in which case a clause on conflicts of law may be helpful.[62]

Arbitration. Depending on the licensee's jurisdiction, arbitration may be a necessity in the event of a dispute.[63] Counsel should advise clients, however, that choice of law and forum clauses only bind the original licensee. If the licensed intellectual property is compromised to non-parties, licensor will have to rely on national law enforcement for protection of its intellectual property rights – not an attractive proposition in some jurisdictions.

No agency, dealership, or franchise. This clause is important in order to prevent a foreign jurisdiction from imposing onerous agency protection statutes upon the licensor.

Non-compete clause. As part of the license grant, the client may wish for business reasons to consider a non-compete clause to bind the licensee for the license term. Be sure to check with local counsel on the enforceability thereof.

Severability, integration, nonwaiver of remedies, amendments. These "boilerplate" clauses, while taken for granted in the U.S., may provide important protections for the licensor, especially in jurisdictions where both business practices and local law reflect a different approach to business negotiations than American mores.

Language. Finally, the license agreement should provide for which language of the license agreement should control interpretation in the event translations are made.[64] The agreement should also address what language technical information and licensed technology will be made in as well as the language of correspondence and notices among the parties.

In addition to careful drafting of licensing agreements to account for local variances in law and practice, counsel should also give careful consideration to the effects of U.S. laws on the technology to be exported as well as the destination of certain exports. The following section provides an overview of these laws, many of which have extraterritorial application and may apply to non-U.S. entities.

A Licensing Alternative. If a license agreement is essentially a covenant not to sue, an interesting alternative to a license agreement may be appropriate in certain limited circumstances. This alternative involves relying solely on the law of contracts to protect the intellectual property owner's rights, sidestepping local laws (i.e., on withholding taxes, registration, ownership, and alienability rights) on license agreements altogether. Such an alternative is most appropriately found in a global franchise or sales and distribution agreement, and is most appropriate when there are a large number of agreements to enter into, in multiple jurisdictions.

Sample language in this license alternative may include:

> "The Distributor shall not contest the right of the [Principal] to the exclusive use of any trademark or trade name used or claimed by the [Principal], and upon written request of the [Principal], the Distributor shall immediately cease or modify, as requested by the [Principal], any use or infringement by the Distributor of any such trademark or trade name. The Distributor shall not have or acquire, either by usage, custom or operation of law, any right to [Principal's] trademark, trade name, coined word, or combination."

Caution is advised, however. Such contract language, while serving to put the distributor or agent on notice about the intellectual property owner's rights, may not hold up to scrutiny under analysis by a local court if it is deemed to evade (and possibly violate) local laws relating to license agreements. It can also invite many questions, as it is unfamiliar to most foreign practitioners, even those who practice intellectual property licensing. Nonetheless, such contract language may fit the bill for the narrow purposes described above.

III. Export Controls: BIS, OAC, OFAC and DTDC[65]

Most exports out of the United States, including exports of technology and intellectual property via licensing, do not require any sort of specific approval from the U.S. government.[66] Exporting, however, is a privilege, not a right, and what the government giveth, the government can taketh away. Before the terrorist attacks of September 11, 2001, the U.S. export control regime was treated by most attorneys as a wayward child. It was something to keep in mind, but not something to be overly concerned about. That child has grown up now, and it demands the full attention of all counsel involved in cross-border transactions, including (and in some cases, especially) international intellectual property licensing. Increased enforcement vigor by a U.S. government with a laser-focus on national security means that U.S. companies must continue to pay extreme heed to export controls and trade sanctions for the foreseeable future.[67]

From a legal perspective, the U.S. export control regime is fairly complicated but not indecipherable. Interpretation of gray areas within the rules (and there are many) often will result in the most conservative interpretation possible by government agencies (especially when asked to put it in writing), a result that would almost certainly grind a significant amount of commerce to a halt. On the other hand, an overly cavalier attitude towards the regime will almost certainly deliver consequences of the most unpleasant variety – negative publicity, heavy fines, and the possibility of prison sentences. With practice, most attorneys can become skilled at navigating the various statutes, regulations, and agencies that administer and enforce the regimes. Counsel who do not practice in this area on a regular basis are advised to seek counsel who are well versed and well practiced, however, as the nuances and subtleties in agencies' interpretation of the applicable law can change with the political winds. This section will deliver an introductory overview of the most important export control laws which all intellectual property counsel should be familiar with.

OFFICE OF FOREIGN ASSETS CONTROL ("OFAC")[68]

The Treasury Department's OFAC administers trade sanctions and embargoes against particular countries and entities. Currently, countries subject to economic sanctions include the Balkans, Burma (Myanmar), Cuba, Iran, Iraq, Liberia, Libya, North Korea, Sudan, and Zimbabwe.[69] Permitted activities differ under each country's sanctions regime and range from a "soft" embargo (i.e. Liberia, where the sanctions regime seeks to limit imports of rough diamonds into the United States[70] and Zimbabwe, which seeks mainly to prevent President Robert Mugabe and his family and senior officers from entering the United States)[71] to a complete trade embargo (i.e. Cuba)[72]. Special care should be taken with the Cuban regime sanction (based on the Trading With the Enemy Act), which expressly applies to foreign subsidiaries and branches of U.S. companies, wherever located,[73] and includes a travel ban to Cuba.[74] Special attention should be paid to Trading With the Enemy Act-based sanctions programs (which apply to the Cuban, North Korean, and certain portions of the Iranian sanctions programs) due to the heavy penalties associated with violations.[75] The sanctions regimes administered by OFAC are made even more confusing by recent actions relaxing the export of agricultural and in some instances, medical products to sanctioned countries. These exports are tightly regulated and prior approval by OFAC is necessary. "Blocking" legislation designed to prevent the extraterritorial reach of U.S. law on foreign-incorporated entities may create an uncomfortable situation for a foreign subsidiary faced with the choice of disobeying U.S. or local law. Other sanctions regimes, while not directly applicable to foreign-incorporated subsidiaries of U.S. companies (they still apply to foreign branches of U.S. companies and U.S. citizens everywhere), prevent the "approval" or "facilitation" of prohibited transactions by U.S. parent companies and U.S. employees. OFAC takes an extremely broad application of these words – caution is strongly advised.

Exporting . . . is a privilege, not a right, and what the government giveth, the government can taketh away.

OFAC also maintains sanctions against entities deemed to be hostile to U.S. interests. Currently, these regimes' targets include narcotic traffickers, the Taliban, terrorists, and proliferation of weapons of mass destruction. OFAC also maintains a list of "Specially Designated Nationals" and "blocked persons" that persons and entities subject to OFAC jurisdiction must not deal with and block assets of.[76] The list of governments, companies, persons and organizations that are off-limits to persons subject to U.S. jurisdiction changes constantly, and companies of all sizes involved in trading activities must maintain strong compliance programs including the use of automated screening software.[77] As many of these entities are based in the United States, even companies that conduct business exclusively in the United States should be checking their customers against OFAC's lists.[78]

OFAC maintains a compliance hotline that allows companies and individuals with questions to speak with a compliance officer. Calls are ostensibly handled on a confidential basis. Counsel is advised, however, to either block caller identification systems or to seek information via outside counsel, in order to maintain complete confidentiality and the privilege. In addition, do not expect OFAC compliance officers to interpret the law more clearly than what is already publicly available. One OFAC spokesman, when asked how fines were determined in a case involving the importation of Cuban cigars in 2000, unhelpfully replied, "There are a variety of ways to determine the fine."[79] In another case, job search assistance website Monster.com decided it had to scrub mention of OFAC-sanctioned countries from all its online resumes, resulting in charges of discrimination from Americans of Iranian descent.[80] OFAC, while claiming it did not ask Monster.com to make the move, insisted that the company had interpreted the law correctly.[81] Most compliance officers will answer questions broadly, err on the side of conservative interpretation, and recommend the filing of a license application to obtain a definitive answer.

Counsel are often asked by clients to predict when sanctions against a particular country may be lifted. Such tea-leaf reading is a dangerous task when it comes to sanctions on regimes for the political winds can shift suddenly. For example, the Burmese sanctions regime prohibited, for a long time, new investment in Burma while permitting exports and imports.[82] After the arrest of Nobel Peace Prize winner and winner of the last democratic election Aung Sung Suu Kyi, the United States tightened the sanctions noose around Burma with Congressional passage of the Burmese Freedom and Democracy Act of 2003 on July 23, 2003, and an Executive Order the next day, prohibiting the import of any "product of Burma" and the export of financial services to Burma.[83]

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A final word of caution, OFAC has recently announced a rule that would make disclosures of identities of companies that have settled allegations of violations of the sanctions regimes.[84] These disclosures occur even if a company voluntarily disclosed an inadvertent violation (most often this occurs when a foreign subsidiary, without malicious intent, engages in some form of prohibited conduct or when a U.S. parent company provides some form of support or facilitation to such foreign affiliate) and even if a company denies any wrongdoing and has not been adjudicated responsible in any administrative tribunal or court. This rule is fresh out of the comment phase,[85] and OFAC has started publishing the identities of alleged violators.[86] Public recriminations against the companies involved quickly followed.[87]

BUREAU OF INDUSTRY AND SECURITY ("BIS")

The BIS[88] administers the Export Administration Regulations ("EAR"),[89] which control the export of dual-use items (dual-use items are those that have both military and commercial applications). Every export out of the United States is potentially subject to the EAR. Additionally, exports from countries other than the United States are subject to the EAR if they are re-exports of U.S.-origin commodities and technical data, contain U.S.-origin parts and components used in the manufacture of a foreign end-product (subject to de minimis exceptions), non-U.S. produced direct products that result from U.S.-origin technical data, or commodities produced by a plant or major component of a plant located outside the United States that is the direct product of U.S.-origin technology or software.[90] Analysis under the EAR typically asks five questions: (1) What are you exporting? (2) Where is it going? (3) Who is the ultimate end-user? (4) What is the ultimate end use of the product? and (5) What else does your end-user do, such as contracting or financing?[91] Depending on the answers to these questions, an export license may be required before shipment. Additionally, information from the EAR is usually required to complete a Shipper's Export Declaration ("SED").[92]

One area of particular concern surrounds that of "deemed exports." Under the "deemed export" rule, an export can occur within the borders of the United States if covered technology or source code is released to a covered foreign national (i.e., a tourist, student, employee, or academic). Care should be taken in any licensing arrangement to ensure the burden of compliance with the EAR (including the deemed export rule) is clearly spelled out. Last year, BIS commenced the first criminal prosecution based on the deemed export rule by seeking indictment of two California companies and their presidents for "exporting" controlled technology to Chinese nationals in the U.S.[93]

OFFICE OF ANTIBOYCOTT COMPLIANCE ("OAC")

Anyone doing business (not merely exporting, but conducting all aspects of business including negotiations) with persons or entities in the Middle East needs to be mindful of U.S. antiboycott laws. The OAC, actually a division of BIS, administers the antiboycott provisions of the EAR[94], while the Internal Revenue Service administers the antiboycott provisions of the Internal Revenue Code. Both laws seek to prohibit U.S. companies from complying with the Arab League boycott of Israel.[95]

DIRECTORATE OF DEFENSE TRADE CONTROLS[96]

The Directorate of Defense Trade Controls (formerly Office of Defense Trade Controls, or OTDC) administers the International Traffic in Arms Regulations ("ITAR").[97] The ITAR seeks to control the export of defense articles and services, as listed on the United States Munitions List ("USML").[98] Companies which seek to export or re-export items on the USML must obtain prior permission from the DDTC. Additionally, licenses must be obtained before importing, even on a temporary basis, certain items. Companies wishing to apply for a license must first register with the OTDC. Registration is a simple process, but must be undertaken on a regular basis in order to prevent registrations from lapsing.

Special care and attention should be paid by companies seeking to enter into license agreements to provide a defense service. Such agreements may include manufacturing license agreements, technical license agreements, distribution agreements, or off-shore procurement agreements. These agreements may not enter into force without approval from DDTC and must be deposited with DDTC. In addition, the agreements must contain a certain level of information including statutorily-prescribed clauses.[99]

CONCLUSION

By and large, negotiating and drafting international intellectual property licenses is an enjoyable practice for most attorneys. Unlike joint ventures or distributorships, these licensing arrangements almost always involve a "win-win" business relationship between licensor and licensee. While horror stories can be found especially in the area of licensing in a merger or acquisition context or complying with the U.S. export control regime, careful attention to drafting, due diligence, and legal compliance will go a long way to mitigate those risks and concerns and keep the ghost of Hamlet's father away for a very long time.

END NOTES

1. In addition to the acquisition costs involved for both Volkswagen and BMW, the consumer confusion surrounding the transaction and future ownership of Rolls-Royce caused an immediate plummet in sales for the brand. See, e.g., Alex Taylor, BMW Takes Its Own Route, FORTUNE, Oct. 26, 1998, at 159.
2. WILLIAM SHAKESPEARE, HAMLET act 1, sc. 2
3. Andrew English, What a Carve-up! Ever wondered How Britain's Most Famous Motor Maker Ended Up in the Hands of the Germans?, THE DAILY TELEGRAPH (LONDON), Jan. 4, 2003, at 3.
4. Id.
5. Id.
6. Alan Cowell, A Rolls by Any Other Name?; BMW-VW Accord for Luxury Car Maker Hinged on Legendary Trademark, N.Y. TIMES, Aug. 7, 1998, at D1.
7. See, e.g., Andrew Lorenz, Vickers Deal Puts Rolls on New Course, SUNDAY TIMES (LONDON), Sept. 26, 1999, at Business Section. Another twist of irony to this tale occurred when Rolls-Royce PLC, which in 1999 was completely out of the motor vehicle business, acquired Vickers PLC, the former owner of Rolls-Royce Motor Cars Ltd. See id.
8. Cowell, supra note 6, at D1.
9. English, supra note 3, at 3.
10. Rolls Royce PLC, A Brief History, at http://www.rollsroyce.com/history/brief/default.htm (visited March 1, 2003).
11. Cowell, supra note 6, at D1.
12. English, supra note 3, at 3.
13. Garrick Holmes, A Vintage Year for European M&A: Deregulation and the Imminence of Unification Drive the Flow Deal, 33 MERGERS & ACQUISITIONS 16 (Mar. 1, 1999).
14. Id.
15. Id.
16. English, supra note 3, at 3.
17. Cowell, supra note 6, at D1.
18. Id.
19. Id.
20. A result no doubt planned by BMW. It allowed BMW to develop a new flagship Rolls-Royce product without any ties to what it considered to be antiquated resources. As the new Rolls-Royce CEO Tony Gott indicated, "All we had was a wonderful brand and a blank sheet of paper." Quoted in Leow Ju-Len, Opera of the Phantom; Built by Brits, Fought Over by the Germans, the Story of Rolls-Royce's Phantoms Has All the Makings of an Automobile Soap Opera, THE STRAITS TIMES (SINGAPORE), Jan. 8, 2003, at Life! Section.
21. Cowell, supra note 6, at D1.
22. See, e.g., Tom Buerkle, BMW Wrests Rolls-Royce Name Away from VW, INT'L HERALD TRIB., July 29, 1998, at 6; see also English, supra note 3, at 3 (remarking Piech looked noticeably "glum" at the press conference).
23. Merger Zeirgeist, AUTOWEEK, Aug. 10, 1998, at 2.
24. Such factors are beyond the scope of this article. See genrally English, supra note 3, for further theories.
25. Caveat emptor is the maxim stating: Let the buyer be aware. See White Lies of Advertisers Might Not Be So Little, BANGOR DAILY NEWS, Apr. 12, 2004, at C13.
26. Andrew English, The Wheel of Fortune, THE DAILY TELEGRAPH (LONDON), Sept. 15, 2001, at 1.
27. Id.
28. Id.
29. See, e.g., Gale R. Peterson, Overview of Intellectual Property, 762 PRAC. L. INST./PAT., COPYRIGHTS, TRADEMARKS, AND LITERARY PROP. COURSE HANDBOOK SERIES 11, 209 (2003) (giving examples of why it is beneficial for both local and national companies to use licensing as way to expand their market).
30. See Bradley Limpert et al., The Licensee is Here, the Licensor is There, and the Factory is in Indonesia: Global Considerations and Concerns, 87 A.L.I.-A.B.A. 159, 184 (2003) (stating a frequent problem with countries of former "closed" economies is contractual obligations were quite scanty, as many issues relating to the contracting parties would be resolved by political or bureaucratic means).
31. See Peterson, supra note 29, at 248.
32. See id. Sometimes it becomes necessary to enforce a U.S. judgment in a foreign jurisdiction, and sometimes the courts in those jurisdictions will not recognize U.S. choice of law provisions. Id. However, arbitration clauses for intellectual property are enforceable virtually world-wide as over one hundred countries of the 1958 New York Convention have approved intellectual property ratification. Robert H. Smit, General Commentary on the WIPO Arbitration Rules, Recommended Clauses, General Provisions and the WIPO Expedited Arbitration Rules, 9 AM. REV. INT'L ARB. 3, 6 (1998).
33. See, e.g., Limpert et al., supra note 30, at 214.
34. Ethan Horowitz & Goodwin Proctor LLP, Advanced Licensing Agreements, Patent & Technnology Licensing, 775 PRAC. L. INST./PAT., COPYRIGHTS, TRADEMARKS, AND LITERARY PROP. COURSE HANDBOOK SERIES 43, 50-51 (2004).
35. Limpert et al., supra note 30, at 202.
36. Peterson, supra note 29, at 248.
37. Id. at 229.
38. See Ethan Horowitz, Licensing Technology: Patents and Know-How, 692 PRAC. L. INST./PAT., COPYRIGHTS, TRADEMARKS, AND LITERARY PROP. COURSE HANDBOOK SERIES 419, 430, 435 (2002).
39. Peterson, supra note 29, at 240.
40. Limpert et al., supra note 30, at 196.
41. Id. at 201-202.
42. Id. at 203-204.
43. Id. at 205-206.
44. Peterson, supra note 29, at 240.
45. Limpert et al., supra note 30, at 195.
46. See Peterson, supra note 29, at 245-46. The fact that due consideration should be given in terminating the license is supported in the article as it finds the licensor's ability to terminate license is important. See id.
47. See id. at 246.
48. See id. at 248.
49. Id. at 247.
50. Id. at 246.
51. English, supra note 3, at 3.
52. Horowitz & Proctor, supra note 34, at 64.
53. Peterson, supra note 29, at 243.
54. Id. at 243. Both parties should know the duty of care owed in monitoring confidentiality. Id.
55. Id. at 249. Certainly, the licensees will want an express warranty of title. Id.
56. Id. at 250. Licensors typically resist express non-infringement clauses, especially if the technology is new, in a "crowded art", or if infringement analysis is difficult due to developing law. Id.
57. Limpert et al., supra note 30, at 202.
58. See id. at 195. Unless tax withholding and other tax issues are addressed early on in the negotiation of the transaction while the economic terms are being determined, one party may bear an unanticipated economic loss. Id.
59. See Horowitz & Proctor, supra note 34, at 64.
60. See Peterson, supra note 29, at 248.
61. See id. Sometimes it becomes necessary to enforce a U.S. judgment in a foreign jurisdiction, and sometimes the courts in those jurisdictions will not recognize U.S. choice of law provisions. Id. However, arbitration clauses for intellectual property are enforceable virtually world-wide as over one hundred countries of the 1958 New York Concention have approved intellectual property ratification. Smit, supra note 32, at 6.
62. See Peterson, supra note 29 at 248.
63. See Limpert et al., supra note 30, at 198.
64. Horowitz & Proctor, supra note 34, at 64. When contracts are drafted in more than one language, ambiguities in interpreting provisions can result. To avoid such ambiguities, Licensor should mandate in the event of disputes, the language version licensor is most comfortable with is the controlling version. Id. at 64-65.
65. Major websites related to U.S. government agencies with responsibility for administration and enforcement of U.S. export control regimes are linked at http://www.bxa.doc.gov/reslinks.htm (last visited April 2004).
66. Patterson Brown, Technical Advice for U.S. Exporters, Website for the Trade Information Center, at http://infoserv2.ita.doc.gov/ticweb (last modified April 2002).
67. See William New, Pushing Out the Borders, 34 NAT'L J. NO. 51 (2002) (describing the Bush administration efforts to reduce vulnerability to attack from WMDs).
68 OFAC's website can be located at http://www.treas.gov/offices/enforcement/ofac (last visited April 24, 2004).
69. See R. Richard Newcomb, Coping with U.S. Export Controls, 2003 Export Controls & Sanctions: What Lawyers Need to Know, 857 PRAC. L. INST./COM. L. & PRAC. COURSE HANDBOOK SERIES 653, 774 (2003).
70. Tracey M. Price, The Kimberly Process: Conflict Diamonds, WTO Obligations, and the Universality Debate, 12 MINN. J. GLOBAL TRADE 1, 43 (2003).
71. John B. Reynolds, III, et al., Export Controls and Economic Sanctions, 37 INT'L LAW 263, 272 (2003).
72. David Mowry, Lifting the Embargo Against Cuba Using Vietnam as A

Model: A Policy Paper for Modernity, 25 BROOK J. INT'L L. 229, 229 (1999).
73. See, e.g., U.S. v. Brodie, 268 F. Supp. 2d 408 (E.D. Pa. 2002) (imposing a criminal conviction against a U.S. citizen on conspiracy charges involving selling to Cuba in violation of the Trading with the Enemy Act and the Cuban Asset Control Regulations. With the use of Canadian and British affiliates, the conviction was later overturned by trial judge on insufficiency of evidence).
74. A ban that is currently fully enforced. See Rafael Lorente, Travelers Who Went to Cuba Will Face Judge; Ignoring Critics, the Administration Will Begin Hearings That Could Mean Big Fines, ORLANDO SENTINEL Nov. 9, 2003, at A19.
75. OFAC has proposed increasing these penalties to include $1 million fines for companies and ten year prison terms for individuals. See Managing Exports Miscellany, MANAGING EXPORTS, Dec. 2003, at 8.
76. For a detailed overview of all OFAC sanctions regimes, download the "Foreign Assets Control Regulations for Exporters and Importers document" from http://www.treas.gov/offices/enforcement/ofac/regulations/t11facei.pdf (last visited Dec. 1, 2003).
77. OFAC Regulations pose problems not just for manufacturing and export-oriented companies, but financial services and securities firms should also be wary. For more discussion, see James Swann, Pulling the Plug of Money Laundering: Tactics and Technology to Deal with Recent Changes, COMMUNITY BANKER, Sept. 1, 2003, at 48.
78. See, e.g., Donna Harris, Battle Against Terrorism Catches Auto Dealers Off Guard; High Price Could be Paid for Failing to Check Customers' Names Against Federal List, AUTOMOTIVE NEWS, Dec. 1, 2003, at 4 (describing the difficulties automotive retailers are encountering in checking OFAC lists against their customer lists).
79. Michael Thuresson, Local Firms Fined as U.S. Steps Up Trade Oversight, L.A. BUS. J., Nov. 17, 2003, at 7.
80. Greg Allen, Monster.com Limiting the Information that Job Seekers Can Mention Regarding Seven Nations U.S. Businesses are Prohibited from Doing Business With on Their Resumes (National Public Radio's All Things Considered radio broadcast, Apr. 28, 2003).
81. Id.
82. Ana E. Johannssen, A Silent Emergency Persists: The Limited Efficacy of U.S. Investment Sanctions in Burma, 9 PAC. RIM. L. & POL'Y J. 317, 328, 336 (2000).
83. Josh Kruskol, Legislative Watch/Legislative Focus, 11 NO. 2 HUM. RTS. BRIEF 38, 39-40 (2004).
84. Such a disclosure occurred in July 2002 pursuant to FOIA request, but this new rule makes disclosures a regular part of OFAC's business. See., e.g., Anitha Reddy, Ikea, Tyson Foods, Among U.S. Embargo Violators, WASHINGTON POST, Jul. 3, 2002, at E1.
85. See http://www.treas/gov/officces/enforcement/ofac/interim/civpen.html for received comments on the rule.
86. See http://www.treas.gov/offices/enforcement/ofac/civpen/penalties
87. See, e.g., Rex Nutting, U.S. Companies Quietly Caught Trading With the Enemy, at http://cbs.marketwatch.com/news/story.asp?guide={4CFAC07E-D176-42B2-A276-EFF1A8B9A452}&siteid=mktw&dist=&archive=true (visited April 15, 2003) (claiming when large corporations are fined for doing business with the enemy, the news is buried on an "obscure web site"); see also Shane Kite, Treasury's OFAC Publishes First Weekly Penalty List, SECURITIES INDUSTRY NEWS, April 14, 2003 (reporting that "the shaming has begun"); see also Thuresson, supra note 79, at 7.
88. Formerly the Bureau of Export Administration ("BXA"). BXA changed its name to BIS in April 2002. Website for U.S. Bureau of Industry and Security, at http://www.bxa.doc.gov/News/Archive97/entfacts.htm (last visited April 24, 2004).
89. See http://w3.access.gpo.gov/bis/ear/ear_data.html for the EAR.
90. 15 C.F.R. § 734.3 (June 2002).
91. Steps for Using the EAR, Export Administration Regulations Database, at http:// w3.access.gpo.gov/bis/ear/pdf/132.pdf (last modified 02-06-04).
92. Economic International Legal Considerations, at http://www.freeessays.cc/db/50/tyc41.shtml (Mar. 9, 2004).
93. See Michael T. Burr, Understanding Immigration and Deemed Exports; The Unfortunate Ones, CORP. LEGAL TIMES, Nov. 2002, at 1.
94. Pamela P. Breed, Antiboycott Provision of Export Administration Act, 570 PRAC. L. INST./CORP. L. & PRAC. COURSE HANDBOOK SERIES 193, 196-97 (1987); Donald W. Smith, Defense of Export Control Enforcement Actions, 844 PRAC. L. INST./COM. L. & PRAC. COURSE HANDBOOK SERIES 807, 847-48 (2002) (stating OAC administers antiboycott provisions under EAR).
95. Breed, supra note 94, at 196-97.
96. The Directorate's website is located at http://www.pmdtc.org
97. See U.S. Department of State website at http://www.pmdtc.org/whoweare.htm (last visited Apr. 23, 2004).
98. See U.S. Department of State website at http://www.pmdtc.org/whoweare.htm (last visited Apr. 23, 2004).
99. See 22 C.F.R. § 124 et seq. (2000).