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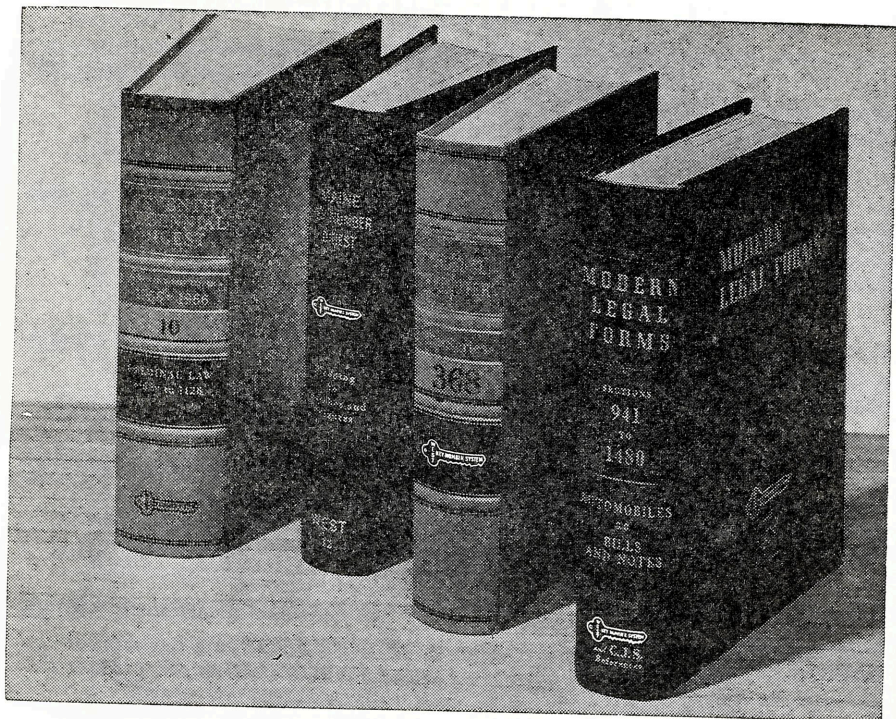
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From the Editor . . .

This issue marks the belated return of the student-written comment section to the pages of the JOURNAL. The Editors were quite concerned this past year that the most recent case commentary appeared in the Spring 1966 issue. Although delaying the publication date of the Fall issue, the Editors hope that, precedent having once again been established, student comments will continue as a regular feature of each future issue, and that the analysis and critique of decisions and legislation of particular importance to the Colorado bar and the legal profession will serve a useful function. Traditionally, a distinction has been made in law review circles between the student comment and the longer and more exhaustive student note. The JOURNAL has continued the practice of publishing student notes over the years, but the absence of the comment, noted for its brevity and analysis of a narrow area of law, has left a distinct gap in our continual efforts toward publication of a "well-rounded" JOURNAL that is responsive to the desires of our readership. Although maligned by certain segments of academia, brief commentary on recent decisions or legislation of particular import *can* serve a valuable function. As a preparatory tool for the future practice of law, JOURNAL members can hone their skills of legal research and writing. That law review members are generally recognized by the legal profession as better trained in research and writing cannot be attributed solely to the high academic standards for membership on a review. The opportunity for a student to publish his work in one of the recognized scholarly journals of our profession serves as a requirement that his writing be of a quality befitting publication. In addition, the comment has traditionally provided a ready source of initial research for the practitioner or judge confronted with a similar case or problem. The comment does not purport to be a thorough and exhaustive discussion of all the broader legal issues involved in a case or statute; it does purport to be a brief analysis that goes beyond the cursory report of recent decisions found, for example, in the Judicial Highlights section of the West Publication Company advance sheets. It was these concerns and thoughts of the JOURNAL Editors that motivated the reemergence of the student comment section.

The special issue of the JOURNAL devoted to Legal Aspects of Student-Institutional Relationships, published last November, has been very well received by the academic and legal community. Orders for the issue have been arriving at a brisk pace, keeping our business office continually hopping. The Editors are quite proud of the mark being made by the special issue in the growing sphere of debate and discussion on student academic freedom.

"Riots and the Law" is the subject of the upcoming Winter symposium issue. More than a dozen articles will be included, featuring the papers presented at the "Winter Rights — Summer Riots" conference held in Philadelphia last summer in conjunction with the American Bar Association convention. The Editors envision a favorable response to the issue, and we hope it will be a significant contribution to the growing volume of literature in this volatile area.

Just a brief addendum to the article by Mr. Barkley Clark, "The Revolution in Consumer Credit Legislation," appearing in this issue: The Uniform Consumer Credit Code has recently been introduced in the Colorado Legislature. As this issue goes to press, the bill has not yet emerged from that deliberative body, but it is hoped that Mr. Clark's contribution will enhance passage of this valuable piece of legislation.

Thomas R. Sharp
Editor-in-Chief

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SYMPOSIUM ON INTERNATIONAL BUSINESS TRANSACTIONS: THE TRANSFER OF TECHNOLOGY IN TRANSNATIONAL BUSINESS

INTRODUCTION

THE building of a successful international business requires that American industries make continuing contributions to the market by way of special services, unique products, and new techniques in the application of know-how for materials. In this sense, technology and commerce are progressing together to expand the horizons of businessmen. Today technology offers the American and foreign businessman the opportunity to share in a mutually beneficial transnational enterprise heretofore beyond contemplation. Technology plays a dual role in transnational business. Through technological advances in transportation and communication new markets have appeared, and goods can be shipped to remote ports in less time and in better condition than ever before. Also, technology itself has become a marketable commodity which can be profitably transferred to foreign customers by various means. Thus, the American businessman has truly become a "merchandiser of science" in transnational transactions.¹

Lawrence C. McQuade has described the situation most accurately in his recent article in the *Denver Law Journal*, which sets the theme for this symposium.

Out of technology — that vigorous offspring of science — flows an impulse to change and innovation in commerce and industry. For the businessman of breadth and imagination, it opens new horizons. For the self-satisfied and the stand-patters, it poses a peril to markets and customers which can no longer be taken for granted. For the lawyer, it calls for adaptation and change at a rate fast enough to foster the new, yet moderate enough to preserve a responsible measure of stability and respect for the virtues of values which have endured the tests of experience.²

¹ Remarks by Emmett H. Heitler, Executive Vice President, Samsonite Corporation, in his Keynote Address to the Western Regional Conference on Transnational Transactions, Denver, Colorado, April 21, 1967.

² McQuade, *Transnational Transactions, Technology and the Law*, 44 DEN. L. J. 327, 328 (1967).

The partnership of technology and transnational business necessarily contemplates an exciting challenge for the creative lawyer. Each businessman entering into a transnational relationship seeks first of all to benefit from the transaction. Secondly, each party must see that his interests are protected to the fullest possible extent from violation by his "foreign partner." Third, he must have the necessary language in the legal contractual document that gives it the strength to guide both purposes to a successful conclusion.³ In order to accomplish these basic objectives, the advice and planning of counsel is a necessity. The lawyer's function in this transnational setting is one of anticipating and providing for the unforeseen yet avoidable disputes wrought by uncertainty and ambiguity in such agreements. These issues must be resolved within a legal framework, acceptable to both parties, which will promote the mutual confidence and good faith essential to a successful working relationship.

On April 21, 1967, the University of Denver College of Law hosted the Western Regional Conference on Transnational Transactions. The theme of the Conference was "Science, Industry and Law in Transnational Transactions." Its twin objectives were (1) to promote a wider participation of the community, both legal and business, in matters of international concern; and (2) to clarify basic policies through an in-depth discussion of some specific practical problems of transnational business transactions, including those pertinent to the Rocky Mountain region. The *Denver Law Journal* is privileged to include in this symposium articles representing the finished product of many of the issues raised at the conference.

In this symposium, two basic policy questions are discussed relating to the assumption that the goal of transnational business is to achieve the ultimate success of transferring technology in the most expeditious and mutually profitable manner. First, should the product of technology or the process itself be transferred, and what legal problems in the protection of the transfer might arise? Mr. Campbell, in his article on licensing, addresses this issue, suggesting that with careful planning, technological know-how can be licensed abroad and receive capital gains tax advantages in the United States. Furthermore, patent protection for the product of technology or for the process is discussed in an article which was not presented at the Conference, but which serves as an important contribution to the symposium theme. Secondly, what kind of arrangement should the American businessman enter into with his foreign neighbor for

³ Remarks by Phillip B. Smith, Vice President, Great Western Sugar Company, at the Western Regional Conference on Transnational Transactions, Denver, Colorado, April 21, 1967.

the transfer of his technology abroad, and what legal problems should he be prepared to encounter? The foreign joint venture arrangement and the distributorship are discussed in separate articles as feasible in particular circumstances. Problems of drafting agreements are considered also, with special regard to choice of law and choice of forum in order to anticipate possible questions of foreign law that might arise in transnational litigation.

Clearly, there is no single way to do business properly and profitably in the various countries throughout the world. There is no simple solution to building a transnational business. Each company and each product, each service, each country offers a potentially different problem and requires its own legal and business solution.⁴ However, the discussion contained in this symposium may serve as a guide to the lawyer with transnational business clients. It can serve as a springboard of ideas to spark his imagination and inventive genius as he faces the challenge of technology in the transnational business world.⁵

Timothy B. Walker
Symposium Editor

⁴ Remarks by Emmett H. Heitler, *supra* note 1.

⁵ The Board of Editors would like to thank Messrs. Emmett H. Heitler and Phillip B. Smith for having submitted notes and ideas to us for incorporation into this issue.

THE FOREIGN JOINT VENTURE CORPORATION: SOME LEGAL AND BUSINESS CONSIDERATIONS

BY WILLIAM R. ROSS*

Private international law involving the organization of corporations under foreign civil and common law systems can be an exciting and challenging experience for an American lawyer. One such corporate organization is the foreign joint venture corporation, involving local ownership and management participation. Mr. Ross discusses some basic requirements of foreign law and major business considerations with which the American lawyer must be acquainted in order to form such a business venture. He emphasizes the importance of participation and counsel of the lawyer during the early stages of negotiation. He points out the importance of choosing the proper foreign corporate form as a firm foundation for immediate and continued success of the venture and offers ways of handling the problem of control of management. Mr. Ross concludes that with proper investigation, negotiation, and planning from both legal and business points of view, the foreign joint venture corporation can be a useful and satisfactory way for American businesses to enter or expand activities in foreign markets.

INTRODUCTION

EVER since the famed clipper ships, and before, United States businessmen have sought and discovered new markets in international trade. As the industrial revolution of the 19th century progressed, the export-import trade began to grow and it has continued to expand, picking up momentum particularly in post-World War II years when the industrial nations of Europe began to get back on their feet. Manufacturing subsidiaries of U. S. corporate parents have been established around the world to bring facilities producing U. S. goods closer to the far-flung marketplaces. In recent times it has become the policy of the large industrial concerns of this nation to treat the entire globe as a single market for goods and services of practically every kind.

As a result of this continuing trade explosion, which has made this nation the foremost industrial country in the world, the commercial, financial, legal and governmental interests and problems have taken on new dimensions, creating new complexities and adding new matters which must be considered by the lawyer called into the private international field.

For example, in past years the expansion of foreign trade and

*Counsel for International Operations, The Gates Rubber Co.; member of the Wyoming Bar and the Colorado Bar.

the in-flow and out-flow of capital and earnings occasioned by international investment have not been as significant in the private and governmental sectors as they have become today. Thus, a matter of which we are much more aware and which is important to all U. S. companies doing business abroad is that of maintaining a favorable balance of payments at the national level. This problem is at the moment of vital concern to the U. S. Government, and while there may be other factors having equal or greater influence on this problem, such as the national government itself, the President of the United States has asked for increased export trade and decreased direct investment in foreign ventures to combat the problem.¹

International trade is becoming more and more involved as an instrument in foreign affairs. Hardly any policy of the United States relating to international commerce does not first require review by or approval of the United States State Department. For example, recent legislation enacted and approved to permit rationalization of U. S. and Canadian manufacture and trade of automobiles and original equipment automotive parts was first proposed to the Congress by the Administration after representatives of the U. S. Departments of Commerce and State had participated in the discussions and negotiations leading to the rationalization agreement and the preparation of the implementing legislation.² The General Agreement on Tariffs and Trade is of major importance in foreign affairs. And a system of import quotas can be detrimental to the commercial interests of a foreign country and, thus, to the foreign relations of the United States; such a system also can be imposed with conditions designed to influence a foreign country's position on important political interests of the United States.

The newly emerging and so-called less-developed nations of the world are more and more becoming a significant influence on international trade by providing new markets and new sources of goods. To these nations world trade is required for their survival and growth, and, to that end, it is a policy of the U. S. Government to foster, encourage and promote participation by private enterprise in foreign economic development.³ Many of these nations have

¹ See McQuade, *Corporate Voluntary Balance of Payments Program and the Lawyer*, SYMPOSIUM, PRIVATE INVESTORS ABROAD—STRUCTURES AND SAFEGUARDS 205 (Southwestern Legal Foundation 1966). See also 33 Fed. Reg. 49 (1968) (establishing mandatory controls on foreign direct investment).

² *Hearings on H.R. 9042, An Act to provide for the implementation of the agreement concerning automotive products between the Government of the United States of America and the Government of Canada, Before the Senate Comm. on Finance, 89th Cong., 1st Sess., at 122, 490 (Sept. 14, 15, 16, 20 and 21, 1965).*

³ Important to all U.S. investors considering less-developed countries is the investment guaranty program of the U.S. Agency for International Development under the Foreign Assistance Act of 1961 which guarantees investments against certain political and business risks.

established incentives designed to encourage investment from abroad to develop industrial and trade potential.⁴

In recent years, various countries, both developed and less-developed, have become nationalistic in their attitudes toward world trade and investments from abroad, undoubtedly a result of expanded industrialization and trade programs. Their concern, of course, stems in part from foreign exchange problems and their purpose is to protect industrial and commercial activities which have been established. Attempts to accomplish this purpose are by several means, including raising of tariffs, imposing conditions on investments from abroad and closing their borders to imports of goods also manufactured by newly established local facilities.

This does not mean that the American businessman is no longer welcome in the world of industry and trade; it does mean, however, that he will not be able in all instances to invest as freely as he has in the past. In these circumstances, more and more attention has been directed lately by American businessmen to associating with a local partner in a joint venture corporation as a way of bringing their companies to the markets of the world or of expanding existing international endeavors.

It is the purpose of this article to set down some characteristics of the foreign joint venture corporation — its definition, establishment, management and operation requirements — hopefully raising for the lawyer some practical legal, governmental and business considerations which will be of assistance to him in his private international practice.

I. THE JOINT VENTURE CORPORATION

A. *Definition*

A foreign joint venture corporation can be defined as a separate legal entity formed abroad usually by two corporations, one U. S. and one local, to achieve an economic objective in which the participants desire limited liability for an indefinite term and, from the American point of view, a familiar corporate framework of organization, management and operation. It combines the advantages of the incorporated business organization with those of the traditional joint venture relationship.

The joint venture corporation concept has been in existence in

⁴ Typical of such incentives are those offered by Ghana to enterprises that develop the productive capacity of the economy, expand exports and offer management and technical training to Ghanaians. Such incentives include exemption from payment of income and other corporate taxes, special depreciation allowances and waiver of tax on dividends to non-residents. See BUSINESS INTERNATIONAL CORP., INVESTING, LICENSING AND TRADING CONDITIONS ABROAD (May 1966). One should also note that so-called developed nations likewise offer attractive incentives to encourage economic expansion and the establishment of new industries. See, e.g., Law Office, Frank Boas, Esq., *Doing Business in Belgium*, 2 CCH COMM. MKT. REP. ¶ 6455 (1967).

this country for a good many years.⁵ And, as we will examine later, it can be quite useful as a successful foreign undertaking to manufacture and to sell locally produced goods. And, it fits in compatibly with the corporation and company laws and commercial codes of the countries of the world.

B. *Advantages of a Joint Venture*

There are several reasons why an American firm may want to consider the use of a joint venture to enter or expand its activities in the general world market or a particular foreign market. The basic reason, of course, is to take advantage of a favorable and profitable demand for a firm's products in a market area. In so doing, it may be useful and wise to rely on the knowledge and reputation of a well established local business firm in order better to understand the likes and dislikes of the local consumer and to obtain more intimate knowledge of the local customs and practices of commerce; also, manufacturing and marketing skills may be pooled. Another reason is that an American company may be able to furnish idle equipment and machinery which, although used, may be more than satisfactory to local requirements of both a potential partner and the market; it is likely that such equipment can be contributed in return for all or a major portion of the interest in the new corporation. The joint venture also permits the U. S. partner to enter more markets or to diversify by spreading investment capital while at the same time, perhaps, meeting local or U. S. public policies calling for limitations on investments. It limits the financial risks involved in those countries where political and economic stability and commercial benefits are in doubt; it satisfies in many instances the nationalistic attitudes of the local government, a development which, particularly in the emerging nations and in Japan,⁶ has effectively restricted the introduction of U. S. capital; it limits resentment toward U. S. investment.

There are disadvantages to the joint venture. In some instances, it is possible that joint ventures may be too rigid to meet today's fluid markets, restricting the American company's capacity to adjust strategy and tactics, like shutting down operations which are un-

⁵ Note, *Joint Venture Corporations: Drafting the Corporate Papers*, 78 HARV. L. REV. 393 (1964).

⁶ See FOREIGN TAX AND TRADE WINDS, Oct. 1966 [Release No. 96(10-66), Matthew Bender & Co.], in which it is reported that a U.S. company lost a two-year fight to establish a wholly-owned subsidiary in Japan. A ruling handed down by the Ministry of International Trade and Industry [MITI] required 50% ownership by a local Japanese firm in the undertaking applied for, and consultation by the U.S. company with the Japanese government about its production plans for the first three years. See also FOREIGN TAX AND TRADE WINDS, Apr. 1967 [Release No. 102(4-67), Matthew Bender & Co.], and BUS. INT'L., Mar. 3, 1967, which report some liberalization by the Japanese government of investment requirements.

profitable or no longer necessary, or altering the product mix of a given plant. Another disadvantage is that the American firm could suddenly find itself competing with a joint venture in which it holds an interest in markets where tariff barriers are falling and customs unions or free trade associations are formed, such as EEC, EFTA, LAFTA, CACM and the Arab Common Market.⁷ Still another disadvantage — and this may be a quite important one, depending upon the circumstances — the American firm may not have the control of the operation it desires or is accustomed to having. Despite these factors, the joint venture has been useful for American investment abroad.⁸

C. *Finding the Partner*

Probably the most important initial step in the establishment of a joint venture relationship is finding a suitable local partner. And finding such a partner may take a great deal of time and effort. Careful and painstaking investigation of all potential partners is required. The goal is to find a local partner who has like or nearly like business objectives, corporate history, policies and requirements, management philosophy and the like. Compatibility is the byword, for it, together with complete good faith exhibited and practiced by both partners at all times, really determines in the long run the success or failure of the joint venture. The association hopefully is to be successful and continuing. Keeping this in mind, potential partners should hold extensive "sounding out" discussions to decide, initially, whether the relationship is desirable. All matters pertinent to the venture ought to be discussed, at least to some degree, to the end that the scope of the joint venture can be defined. In this connection, attention should be given to the possibilities of growth. The manufacturing and marketing potential of the products involved, and the ability of the prospective venture to manufacture and to sell them should be studied. The delicate matter of management decision making must be thoroughly explored in depth to determine whether conceivable conflicts between the two exist or could develop over the manner in which the decisions are to be made. Generally, the parties should attempt to discover any reservations either may have with regard to matters which could, slowly or rapidly, deteriorate relationships during the course of the joint venture operation.

These are, essentially, business considerations, but the lawyer will be called upon to render counsel and advice in a number of matters and to draft and review various documents required in the

⁷ 75 BUSINESS INTERNATIONAL CORP., MANAGEMENT CHECKLISTS FOR FOREIGN OPERATIONS 31 (1966), *citing* BUS. INT'L., Sept. 4, 1964.

⁸ See JOINT INTERNATIONAL BUSINESS VENTURES (Friedmann & Kalmanoff eds. 1961).

transaction, and he will need to recognize the business problems which arise in order that his analyses and advice can be meaningful and valuable. Hopefully, he will be permitted to attend all or nearly all discussions so that he can become intimately acquainted with all aspects of the proposition.

II. ORGANIZATION OF THE JOINT VENTURE CORPORATION

A. *The Preorganization Agreement*

Prior to the establishment of the joint venture corporation, the parties would be well advised to reduce to writing important agreements reached during the negotiation stage. This document, called the preorganization agreement and executed by both parties, will evidence agreement of the partners to proceed with the project. It will constitute a reflection of the intention of the parties, general in some respects and specific in others, with regard to the objectives and policies of the joint venture corporation. It also will serve as a sort of "legislative history" of the joint venture organization which can be used to assist in the interpretation of any agreements the new company might have with either partner.

A typical preorganization agreement should set forth the principal objectives of the new company; the amount of authorized capital it is to have; how much capital is to be issued; how the capital is to be paid in and when; shares of capital each partner is to have; conditions pertaining to transfer of shares (*e.g.*, right of first refusal). It should describe generally what the articles of association of the new company are to contain, such as provisions for compensation of directors, officers or managers and how it is to be determined, voting and quorum requirements, procedure for amending the articles, and the like. It should state the corporate structure and how it can be changed. It should also state whether there are to be any agreements between the new corporation and the individual partners, such as lease agreements covering plant and equipment, agreements to furnish management for the new company, agreements to furnish technical assistance, agreements to license rights respecting patents, know-how and trademarks. There should be a description of the duties of each partner in organizing the new corporation; a provision stating how the costs of organization of the new corporation are to be borne; and a stipulation as to whether any disputes between the partners arising under the agreement are to be referred to arbitration, and, if so, who is to act as arbitrator and where the arbitration is to take place. Finally, dissolution and liquidation procedures should be specified as well as the laws of the country under which the agreement is to be construed and the juris-

diction to which the parties submit. Other matters may be included, depending upon the requirements of the parties.

B. *Choosing the Corporate Structure*

There are several matters which are primary in choosing the kind of corporate organization best suited to the venture. The size and the objectives of the venture will be important considerations in the choice. Local laws and practices generally will be influencing factors, particularly where they relate to the manner of organization and management and to investment and repatriation of profits and capital. The amount of capital to be required, initially and in the future, and the liability of each partner could be influencing factors. In the final analysis, however, the partners should seek the kind of structure which is easy to organize and which furnishes flexible, economical and profitable operation with only as much publicity as is necessary.

A joint venture corporation, regardless of its type, will encounter in its daily problems the same kinds of laws as will practically any other corporation, such as negotiable instruments law, sales law, customs requirements, property law, insurance law, taxation codes and trade regulations, to name just a few. And, although the lawyer will find it necessary to think through all problems with which he is confronted in choosing the kind of corporate structure, perhaps this is a good time to point out that he will not need, nor will he be able, to gain a comprehensive knowledge of the legal systems of the various countries of the world. He must equip himself with a general understanding of applicable laws of the country in which the venture is to be organized and operated; in some instances, he will have to gain specific knowledge and understanding. Generally, he will find most applicable civil law concepts in force in one civil law country descriptive of the practices in other civil law countries. In all instances relating to problems specific in nature, he should be guided by the advice and counsel of a competent local attorney.

In establishing a foreign joint venture corporation, the American partner will want to give specific consideration to the local laws pertaining to corporate organization, taxation, industrial property rights, special laws or aspects of laws relating to foreigners, and, perhaps, the property law, antimonopoly law and social and labor legislation.⁹ Of special importance will be laws and regulations respecting restrictions on remittance of profits and repatriation of

⁹Not to be overlooked is the applicability of U.S. tax and antitrust laws and trade regulations, topics not covered in this article.

capital, including limitations on payments by local companies of royalties and fees. All such laws will be part of the framework within which the joint venture corporation will be established and operated. They also will furnish the basis for answers to the basic question of whether a joint venture corporation is the kind of operation desirable to the objectives of the American company and whether it furnishes a practicable and profitable method for meeting the business purposes intended.

The American lawyer will most probably find that the form of organization to be chosen for the joint venture corporation will, regardless of its type, resemble fairly closely the corporate structure familiar to him in the United States. The elements of its structure will be drafted to meet the business purpose much the same as the provisions of the articles of incorporation of a company in this country are selected and directed. However, because the foreign joint venture corporation is multi-national, considerations will arise which will complicate usually uncomplicated corporate questions. For example, the local partner probably will not be as large as the American client and his operation may be family-held and managed; he, thus, may take a more personal view of the operation of the venture. The American partner, on the other hand, will consider the venture as a subsidiary or affiliated part of his world-wide organization. The result could be a basic divergence of views, and possibly there will immediately arise the question of whether one or the other is to have control of a particular function, especially where it may be a 50-50 equity ownership venture.

In most foreign countries there are two kinds of corporations. One is the kind which most closely corresponds to our corporation: the *société anonyme*, *sociedad anonima* or *Aktiengesellschaft*. The second form is what is called the limited liability company — known as the *société a responsabilite limitee*, the *sociedad de responsabilidad limitada*, or the *Gesellschaft mit Beschränkter Haftung*.

1. The Corporation

Under the civil law, the corporation is a creature of contract and not a creature of charter granted by the state. Simply stated, the shareholders execute a contract of organization similar in form and substance to articles of incorporation. When filed with the proper registry, the contract becomes the basic corporate document and, after completing certain other formalities, the corporation is then authorized to commence operation.

A civil law corporation is similar in many respects to the U. S. corporation. It constitutes an individual legal entity distinct from

that of the associates or shareholders.¹⁰ Each shareholder's liability is limited to a definite contribution.¹¹ Although not a creature of government charter, the civil law corporation usually is governed fairly strictly by the commercial and civil laws of the nation and by the organization contract.¹² The reason, of course, is to afford protection for its stockholders and the persons with whom it deals. The laws, once properly translated, are quite readily understandable; they normally set down the requirements in logical order and concise terms, and the kinds of requirements are not unlike those prevailing in common law jurisdictions. For example, the formation requirements will specify the number of organizers necessary (the number will vary from country to country, usually from three to seven). And it is not unusual for the laws to require a minimum number of continuing stockholders, usually the same number as that required to organize the corporation in the first instance.¹³ Most civil law countries permit some or all of the stockholders to be foreign corporations. This provision is, of course, vital to the establishment of the joint venture.

The capital structure requirements are much the same as in this country: the capital is divided into shares and normally they can be common or preferred, of one or more series, and either nominative or to bearer. No par shares are permitted in some countries.¹⁴ Bearer stock has been used extensively because of its flexibility in transfer and the fact that it provides anonymity, a consideration which has been of significance to stockholders in civil law countries, perhaps to avoid taxes imposed on transfer. Each shareholder has one vote for each share of stock issued to him. However, in some countries the voting powers of holders of large blocks of shares may be limited.¹⁵ Statutory provisions may impose minimum capital requirements and will state how much of the authorized capital must be subscribed. Usually a specified portion of authorized capital must be paid in. Corporate shares are freely transferable after a minimum subscription price has been paid in. It is possible that some countries will require every corporation to list its shares on a stock exchange even though no shares are to be

¹⁰ See, e.g., CODE OF COMMERCE (TITRE IX DES SOCIÉTÉS) art. 2 (Belg.). See generally 1 DOING BUSINESS ABROAD (H. Landau ed. 1962) for a discussion of civil code corporations.

¹¹ CODE OF COMMERCE art. 26 (Belg.).

¹² *Id.*, art. 1.

¹³ In France, for example, there may not be less than seven shareholders. FRENCH COMPANY LAW OF JULY 24, 1966, art. 73.

¹⁴ See, e.g., CODE OF COMMERCE art. 41 (Belg.)

¹⁵ In Belgium, no person may cast a number of votes exceeding one fifth of the total votes pertaining to all the outstanding shares or two fifths of the votes pertaining to the shares actually represented. CODE OF COMMERCE art. 76.

made available to the public generally. Payment of capital subscriptions usually can be made in cash or kind, but contributions in kind may be subjected to careful scrutiny. In some countries, it is the practice to require appraisal by experts to determine the proper value of the contribution.¹⁶

It is in the area of corporate management where the peculiarities of the civil law corporation are most recognizable in their differences from the American corporation concept. What we in this country would normally regard as decisions taken by the Board of Directors may in civil law countries be acted upon only by the stockholders in meetings. Under the civil law concept, directors are the officers—they run the corporation in its day-to-day activities. They are elected and may meet in much the same manner as in this country. Usually they will act among themselves to name from their membership the chairman of the board, or the managing director as he may be called, who under our concept would be the president.¹⁷ The American partner will be called upon, and perhaps be hard-pressed, to understand that the question, “Will we be able to control the Board of Directors?” is usually not appropriate or applicable when referring to a foreign corporation. Voting control as we know it must be had in the stockholders’ meetings, for it is by this body that the administrative officers are elected, the dividends to be distributed are determined, and the acts of management are approved.

Directors may not have to be stockholders, nor in all countries must they be nationals, but it may be required that they be residents of the country.¹⁸ Their duties usually are defined as representing and acting for the company, carrying on the operations which constitute its business and appointing employees and agents. Ordinarily each director will have authority to perform all acts necessary to the normal operation of the business, and each may act individually unless the organization agreement provides otherwise.¹⁹ They may meet periodically to decide matters necessary to their functions as administrators, but always subject to the direct control

¹⁶ In Belgium, a certified public accountant is required to report in particular on the description of each contribution in kind, on the methods of evaluation adopted and on the remuneration to be attributed in return for the contribution. CODE OF COMMERCE art. 29 *bis*.

¹⁷ In West Germany, the functions of corporate operation are directed by three main bodies: the board of management (whose members are appointed by the board of directors); the board of directors (some of whose members are appointed by the shareholders and some by the employees); and by the shareholders’ meeting. AKTG, HANDELSGESETZBUCH [HGB] §§ 70, 86 & 105.

¹⁸ In Venezuela, residents may be elected as alternate directors who may substitute for nonresident directors. See J. BENSON, REPORT ON VENEZUELAN TAX, LABOR AND CORPORATION LAW para. 858 (1964).

¹⁹ In Italy, the direction of a corporation (*societa per azioni*) may be placed with a single director (*amministratore unico*). CIVIL CODE art. 2381.

and supreme authority of the stockholders and with the reservation that important policy decisions will be taken by the stockholders in meeting.

Stockholders' meetings usually are called by notice, but sometimes by publication in a newspaper, or by written notice. They usually are required to be held in the country where the head office is located. Proxies are permitted. Voting requirements and majorities may vary depending upon the question, and protection of minority stockholders is handled much the same as it is in common law countries.

One requirement of civil law corporations which American businessmen may find a bit strange and sometimes objectionable is that which calls for the publication, usually in an official gazette, of the corporation's annual financial statements, annual reports of the directors and of a statutory auditor²⁰ regarding financial and commercial operations, the minutes of the meetings of the stockholders and any amendments to the organization agreement.

Formation of a civil law corporation is relatively easy. The first step is the preparation of the organization agreement. This agreement will contain all provisions relating to the corporate name, principal office, purposes, duration, capital, shares, administration, management, shareholders' meetings, financial statements, dissolution and liquidation and any other provisions which the shareholders may find appropriate to include.

The next step is the subscription of the capital, which may be either public or private. If by private subscription, the incorporation is effected by written agreement to the articles, either in meeting or recorded by notary, signed by the organizers or on their behalf by an attorney-in-fact. When the documents of incorporation, including the minutes of the organization meeting, have been recorded and published,²¹ the corporation is then ready to commence operations.

2. The Limited Liability Company

Usually we think of corporations as being associations of capital; the shareholders who contribute the capital to the association have little involvement with day-to-day corporate operations. Other types of business organizations, on the other hand, may be thought of as more personally associated with the contributors of capital;

²⁰ Most civil law countries require by statute the appointment of an auditor or board of auditors whose primary function is to inform the shareholders periodically of the financial condition of the company. In some countries, the authority of the auditor is quite extensive, including the right to call shareholder meetings in the event of the failure to do so by the directors. CIVIL CODE art. 2406 (Ital.).

²¹ Filing is with a national governmental agency, usually the ministry serving commerce or industry, and publication may be required in an official gazette.

it is usually the case that the contributors of capital also contribute a great deal of their time and efforts to the day-to-day operation and management of the enterprise. Somewhere in between lies the limited liability company, which involves both the personal and the capital association factors. It combines the benefits of a corporate form with the flexibility of operation of a partnership. It is a legal entity commonly available in most countries of the world; it is used usually for business firms which most closely resemble in character our closely- or family-held corporation. It may also be desirable for almost any small or medium-size enterprise.²²

Shareholders are referred to as "partners" or "members" and usually only two are necessary to form the limited liability company. Foreign corporations or non-resident individuals²³ may be shareholders, and in many countries it is not necessary for the foreign corporate shareholder to register or qualify in the country in order to hold membership. Requirements as to maximum and minimum capitalization vary from country to country.

As in the case of corporations, the liability of each shareholder is limited to his subscription, but there is an important difference. All shareholders are jointly and severally liable for the total amount of capital not paid in at the time of organization and remaining unpaid. Usually, all capital must be subscribed, but the amount which must be paid in at the time of organization may vary from country to country.²⁴ Capital contributions in kind are permitted and in some countries may be valued informally,²⁵ but in others a formal appraisal may be required.²⁶

The capital is divided into shares,²⁷ each share having the same fixed value; there is only one class of shares and there are no bearer

²² For a discussion of limited liability companies, see Eder, *Limited Liability Firms Abroad*, 13 U. PITT. L. REV. 193 (1952). See generally 1 DOING BUSINESS ABROAD (H. Landau ed. 1962), for a discussion of limited liability companies.

²³ See, e.g., Brazil's DECREE-LAW No. 3,708 of Jan. 10, 1919, which governs limited liability companies in that country. In Belgium, however, only physical persons may be shareholders. CODE OF COMMERCE art. 119.

The author acknowledges the assistance of Dr. Joaquim Renato Correa Freire of the law firm of Davids, Freire, Caiuby & Fernandes, Sao Paulo, Brazil, for the Brazilian authorities cited in this article.

²⁴ In Brazil, while the entire amount of the capital must be subscribed, there appears to be no requirement as to the amount which must be paid in. DECREE-LAW No. 3,708 of Jan. 10, 1919. In Venezuela, all capital must be subscribed and at least 50% must be paid in. See J. BENSON, REPORT ON VENEZUELAN TAX, LABOR AND CORPORATION LAW para. 894 (1964). In Belgium, all capital must be subscribed and a minimum of 50,000 francs paid in. However, if authorized capital exceeds 50,000 francs, each share subscribed in cash must be at least 20% paid in. CODE OF COMMERCE art. 120.

²⁵ See DECREE-LAW No. 3,708 of Jan. 10, 1919 (Braz.).

²⁶ Cf. FRENCH COMPANY LAW OF JULY 24, 1966, art. 40, which requires formal appraisal by a Commission of Contributions appointed by the shareholders for that purpose. Shareholders are jointly and severally liable for a period of five years from organization for the value attributed.

²⁷ In some countries, a partner's holding may not be represented by shares. Each partner has a single share of the company which represents his proportional ownership in the company.

certificates. Normally, however, ownership is evidenced by the organization agreement, which is amended to reflect the transfer of ownership.²⁸ In any event, generally, ownership is not readily transferable.²⁹ One aspect of a limited liability company which is different from the corporation form and which may be of particular interest to American businessmen is that it is not required, usually, to publish minutes of meetings or annual financial statements.

Management of a limited liability company is carried out with much greater flexibility than is the case with a corporation. Regular, formal meetings of shareholders may be provided for (with provisions for proxies) but ordinarily they are neither required nor held. Some decisions of shareholders may be agreed to by correspondence — even by cable.

Responsibility for conduct of company business normally is placed with one or more managers rather than with a board of directors. Usually one or more of the managers must be a resident; and in some countries the managers must be shareholders.

The limited liability company is organized by execution and filing³⁰ of an organization agreement that may be in the form of a private instrument, and it need not be published. Normally the organization agreement will set forth the nationality of the founders, the amount of the capital, each member's share, how the capital is realized — *i.e.*, in cash or through contributions in kind — how the financial statements are to be prepared and distributed, rules for distribution of profits and a provision for an auditor, if desired or required by local law.³¹ Additionally, it may be advisable to include in the organization agreement provisions specifying how management is to be carried out (especially who is to have management authority regarding particular matters), a description of duties of the managers, a provision for compensation of the managers, grounds for which a shareholder may be excluded, special voting requirements, if any, for particular purposes, how amendments to the agreement may be made, and any other matters which in the circumstances may be important to the protection of the investment.

²⁸ It is advisable, even though provided for by law, to include in the organization agreement a restriction on the transfer of shares, especially where such transfer may be occasioned by the death of an individual shareholder. In Belgium, transfers between living persons and upon death can be made only with the consent of 50% of shareholders holding three fourths of the capital, excluding the capital represented by the shares in question, unless the shares are transferred to the surviving spouse, to ascendants and descendants in direct line, to another shareholder, or to someone approved in the organization agreement. CODE OF COMMERCE art. 126. This kind of provision is particularly important where it is necessary to use nominee-shareholders.

²⁹ Ordinarily, a share can be transferred only with the consent of a majority of the shareholders. Sometimes the consent of all shareholders is required.

³⁰ See note 21 *supra*.

³¹ The appointment of an independent auditor normally is not required but probably is desirable.

3. Which One?

Which of the corporate forms the partners to the joint venture choose is vitally important; whether the venture is successful in "getting off the ground" may depend in large measure on the corporate structure selected.

Both the corporation and the limited liability company have acceptable features; individual advantages of one may be preferable to those of the other in meeting the requirements assigned by the partners. Generally, however, it would appear that for most foreign joint venture endeavors, the limited liability company form will more nearly meet the tests of ease of organization, flexibility and economy of operation and privacy in its business affairs.

C. *This Matter of Control*

A matter which can become a serious problem, and one which can be most misunderstood in negotiations between the parties to a joint venture corporation, is that of control of the corporation, either in its executive management or day-to-day operation, or both. For some years now American business usually has had the luxury of having control of a foreign operation, either by ownership of a majority of the equity or by voting arrangements where a board of directors is controlled by the American company. The traditional reasons therefor have been quite logical: to exercise independence in the operation of the venture, to integrate the local operation into the world-wide operation of the American corporation with minimum influence by local ownership, and to obtain as much of the profits from the business operation as possible, all justified by the American investor on the basis that he has filled an investment void. Lately, however, local investors are demanding at least equal representation by ownership or otherwise, and, as indicated earlier, their governments are backing them up. Consequently, the American businessman is now forced to reappraise his philosophy and approach regarding foreign investments. Even so, American businessmen, in a great many instances, are still called upon to contribute a great deal more than the local partner is able in the circumstances to produce.

Usually the American partner will be the one who furnishes technical assistance and know-how needed in the manufacture of the products of the joint venture corporation. Often the U. S. company will be able to furnish the benefits of its marketing experience in the marketplaces around the world. Also it may be that the U. S. partner has a patent which is particularly attractive to the local partner. Another important consideration is the fact that the American partner might bring to the joint venture a world-wide reputation

which could foster an immediate market penetration and provide the impetus for fast growth in the market. And it is also possible that the American partner will be able to provide business and management consulting services.

More often than not, these are the reasons why the local partner wants to become associated with the American partner in the first place. And to the American businessman, these reasons justify his expecting final authority on various matters, if not the total operation, while at the same time splitting the profits on the basis of the investment contribution of each. The American partner, however, should not overlook equally important contributions which can be made by the local partner. As already indicated, his knowledge of local customs regarding acceptable marketing practices and consumer demands will be extremely valuable to the venture. As a matter of fact, the local partner's marketing organization may be entirely satisfactory for the distribution of the new company's products. Capable management may be furnished by many local partners. Contacts with governmental officials and practices, at all levels, may be beneficial. Accordingly, the local partner, as well, may be able to expect final authority in matters in which he is competent and, thus, complement the joinder — a desirable end.

But in these circumstances, and certainly in a 50-50 ownership joint venture corporation, the stage is set for the ever-present possibility of deadlock, regardless of the good faith both parties sincerely indicate and intend in the negotiations and establishment of the undertaking. Therefore, positive steps ought to be taken to express or provide a means of resolving differences, particularly where they vitally affect the purposes and objectives. Such measures should be discussed and adopted prior to organization, or at least during the early stages of operation, to avoid as much as possible the danger of deadlock resulting from the veto power accompanying evenly-divided ownership.

There are various means by which the problem can be handled. One is for the principal partners to own 49% each of the equity of the new company with the remaining 2% owned by a third, independent party who would be called upon to break any deadlock. Another is to state simply in the organization agreement that one or the other is to be responsible for the management. A more satisfactory arrangement is to provide in the organization agreement for the assignment to each partner of responsibilities and authority for various functions necessary to the operation of the venture. In this way successes and failures in each of the functions can be identified with the partner responsible.

Authority can also be granted by operating and management contracts. For example, it is not uncommon (or unreasonable) for the partner furnishing technical assistance to have control over the quality of the products manufactured, a factor vital to the objectives of the venture. The quality standards to be maintained will, of course, be established by the partners based on the requirements of the markets served. But to meet and maintain those standards, acceptable production practices and techniques may be necessary and ought to be established and supervised by the one furnishing the assistance. Obviously this kind of authority must be exercised wisely and with restraint.

Another way in which the matter can be handled is by arbitration. But an objection in principle to this kind of procedure is that the partners really are parties to a proceeding which is adversary in nature, while actually the carrying on of a joint venture operation contemplates something other than adversity. Sometimes, however, arbitration can be useful, and if the parties should decide that it would be desirable, the provision therefor should state that a court or body of a specified third country be used and that the matters be resolved according to the laws of that country. This would assure that the controversy would be heard before a neutral court or body of arbitrators.

CONCLUSION

For the American businessman, association with a local partner in a foreign joint venture corporation offers many advantages. An established local partner can furnish part of the capital, thus decreasing the amount of the investment required of the American investor; he can provide knowledge of the local market, distribution facilities and qualified management. In recent years, American businesses of many kinds have discovered this form of investment a satisfactory way to enter and expand activities in foreign markets. The lack of complete financial control has not appeared to be a serious problem to either partner. Joinder with a local partner also helps to meet requirements of local governments and to support the policies of our own national government.

For the American lawyer, it is a challenging and exciting experience to join together two different legal systems, taking desirable features from each for use in achieving for his businessman client a workable framework for, hopefully, a profitable and long-lasting undertaking.

CONFLICT AVOIDANCE THROUGH CHOICE OF LAW AND FORUM

BY COURTLAND H. PETERSON*

A lawyer, when involved in the drafting of an international contract for a client, may, in general, adopt one of two approaches. He may, as is the custom of civil law lawyers, identify the law which is to govern the contract, or specific provisions thereof, by incorporating by reference an identifiable legal system. Or, if inclined to use the second approach as are many common law lawyers, he may attempt to foresee any problems which might arise and deal with them through precise provisions. Professor Peterson discusses the two approaches, the rationale that perpetuates them, and the advantages and disadvantages of each. Although each contract must be treated individually, Professor Peterson suggests that every contract should include provisions specifying choice of law and forum. Such provisions can at least minimize the uncertainty which is necessarily involved in a contractual situation involving more than a single legal system.

IT is fundamental that basic terms in the formation of a contract — price, quantity and quality, timing of delivery or other performance — are almost entirely economic decisions for the client to make. The function of the lawyer with regard to drafting such terms is therefore not so much to advise about their desirability as it is to express them clearly and unambiguously in the contract documents. Given an approximate equality of negotiating ability on each side of the contract, such basic terms will reflect with fair accuracy both market value and other bargaining strengths of the parties.

The role of the lawyer is clearly larger with respect to those supplementary provisions of the contract which deal with the implementation of performance, interpretation, modification, termination and enforcement. As to these matters he must advise on the wisdom of inclusion as well as perform the mechanics of drafting. Moreover, since these provisions present legal issues, they presuppose the applicability of a legal system against which they can be evaluated. When several legal systems are potentially applicable, either alternatively or cumulatively, the drafting problems are obviously magnified. This is especially true where the systems in question are those of different countries, with different legal traditions and institutions.

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In such cases the systems serving as the regulative background for evaluation and enforcement may vary widely, not only as to specific rules but also as to the broader principles of propriety and public policy.¹ The purpose of the present article is to review some of the important factors which bear on these magnified problems, to alert the reader to some of the dangers of reliance on oversimplified answers to highly complex questions, and to suggest a common sense approach to drafting for the international transaction.

It should be noted at the outset that the contract provisions referred to above as supplementary are, except for highly onerous clauses, less clearly affected by market and bargaining strength than are the basic contract terms. The consequence of this fact is that more latitude is usually available for differences in the approach to drafting. The lawyer therefore has greater freedom to express his experience, prejudices and legal risk-taking propensities. This somewhat mixed blessing is reflected in the great variation of drafting philosophy between practitioners.

To the extent that generalization about drafting philosophy is possible, however, there are two schools of thought on the subject. One of these, which may be called the incorporation-by-reference school, attempts to solve the problem of the applicable law by the relatively simple adoption of an identified legal system as a matter of contract, or by the adoption of one system to govern one defined aspect of the agreement and one or more other systems to govern other aspects. Such a provision may or may not be coupled with a contractual choice of forum. This incorporation view, which is usually favored by lawyers with training or experience in the civil law countries, results in rather simple, straight-forward documents with a minimum of detail beyond the basic terms.²

The second approach, which may be called the legislative or codification view, attempts to foresee as fully as possible the problems which may arise under the particular agreement and to deal with them by fairly precise provisions in the contract itself. This approach obviously tends in the direction of highly complex docu-

¹ Diversity of legal rules is, of course, an interstate as well as an international phenomenon, but substantial homogeneity of legal traditions, the growth of common American theories about conflict of laws, and the wide adoption of the Uniform Commercial Code have all tended to dampen the effects of diversity in the interstate sphere. Such ameliorating influences have as yet had much less impact on international transactions.

² See Lalive, *Negotiations with American Lawyers — A Foreign Lawyer's View*, in SYMPOSIUM ON NEGOTIATING AND DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS, 1965, at 1, 8-18 (Southwestern Legal Foundation 1966). There are, of course, some European contracts which are traditionally detailed, but these are the exception rather than the rule. Van Hecke, *A Civilian Looks at the Common-Law Lawyer*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 5, 9-10 (1962).

ments. It is the view most often favored by lawyers with common law backgrounds.³

The broad subject of arbitration is beyond the scope of the present inquiry, but before taking a closer look at these two drafting approaches it should be noted that the increasing use of arbitration in international contracts cases has an impact on drafting philosophy. The rules and procedures under which arbitrators decide cases vary widely, of course, depending on the terms of submission. But even where the contract contains a choice of law clause, and especially when it does not, arbitrators frequently feel greater latitude than courts in the search for applicable legal rules. In some cases, as for example where the arbitrator is designated an *amiable compositeur*, almost complete discretion is left to the arbitrator. Since most arbitrators do feel bound, however, to follow express provisions as the "law of the contract" whatever else may appear in the terms of submission, contracts containing arbitration clauses are rather uniformly ones in which the legislative or codification approach is most satisfactory.⁴

Several factors may be suggested to explain the preference of civil law lawyers for incorporation and the inclination of common law lawyers toward more detailed drafting. The lawyer in a civil law country is, of course, accustomed to working with detailed codes. Whether such codes really do contribute to greater certainty in the judicial process is debatable, but the civil law lawyer does argue with some justification that the individual draftsman of a contract cannot be expected to supply the same degree of foresight or detail as has gone into the drafting of the code.⁵ The conclusion then follows logically enough that the contract draftsman should content himself with detailed drafting only in those areas where the specific transaction requires adaptation; beyond that he should simply refer to an appropriate legal system. This conclusion is reinforced by the rather uniform willingness of courts in civil law countries to permit party autonomy in such matters. Especially in the European coun-

³ Van Hecke, *supra* note 2, at 10-11; Brudno, *Negotiations with Foreign Lawyers — An American Lawyer's View*, in SYMPOSIUM ON NEGOTIATING AND DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS, 1965, at 23-39 (Southwestern Legal Foundation 1966).

⁴ Cf. Mezger, *The Arbitrator and Private International Law*, in INTERNATIONAL TRADE ARBITRATION 229, 231 (M. Domke ed. 1958). See also Lagergren, *The Limits of Party Autonomy II*, in THE SOURCES OF LAW IN INTERNATIONAL TRADE 201 (C. Schmitthof ed. 1964).

⁵ Cf. Lalive, *supra* note 2, at 9. Lalive's interesting discussion suggests, however, that these differences in attitude are quite complex, involving historical and psychological influences as well. *Id.* at 8-18.

tries, civil law courts not only enforce the parties' choice of law but also regularly defer without objection to the parties' stipulation of a particular forum.⁶

The common law lawyer, on the other hand, is haunted by the famous pronouncement of Learned Hand in *E. Gerli & Co. v. Cunard S. S. Co.*⁷ In that case a bill of lading, delivered in Italy and covering a shipment from Milan to New York via Southampton, contained both a limitation of the carrier's liability and a stipulation that the contract was to be "governed by English law." The limitation of liability was probably invalid under the British Carriage of Goods Act, but Hand, holding the limitation clause valid in the absence of proof by libellant that it was invalid under Italian law, declared:

People cannot by agreement substitute the law of another place; they may of course incorporate any provisions they wish into their agreements — a statute like anything else — and when they do, courts will try to make sense out of the whole, so far as they can. But an agreement is not a contract, except as the law says it shall be, and to try to make it one is to pull on one's bootstraps. Some law must impose the obligation, and the parties have nothing whatever to do with that; no more than with whether their acts are torts or crimes.⁸

The case law,⁹ scholarly opinion¹⁰ and even statutes¹¹ have since ameliorated the effects of this devastating attack on party autonomy

⁶ See Van Hecke, *Choice-of-Law Provisions in European Contracts*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 44-53 (1962). There are, of course, exceptions for particular types of matters, such as domestic relations, real property, bankruptcy, etc., but the exceptions are not the same in all countries. Uniformity of exception as well as of recognition of party autonomy was encouraged by the adoption in 1963 of a Draft Convention on the General Jurisdiction of Contractual Forums by the Hague Conference on Private International Law. The text of this Draft Convention is reprinted in 13 AM. J. COMP. L. 160 (1964). A comparison of the recognition of forum contracts in the United States and British Commonwealth jurisdictions with each other and with the provisions of the Draft Convention can be found in Cowen & Da Costa, *The Contractual Forum — A Comparative Study*, 43 CAN. B. REV. 453 (1965). For the situation in Latin America see Folsom, *Choice-of-Law Provisions in Latin American Contracts*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 54-63 (1962).

⁷ 48 F.2d 115 (2d Cir. 1931).

⁸ *Id.* at 117.

⁹ One of the leading American cases is *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189 (2d Cir. 1955), which makes an interesting comparison with *Gerli* because it also involved Cunard as defendant and was decided by the same court. See also Maw, *Conflict Avoidance in International Contracts*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 23-35 (1962).

¹⁰ See A. EHRENZWEIG, *CONFLICT OF LAWS* 467-68 (1962); H. GOODRICH, *CONFLICT OF LAWS* 202-03 (4th ed. Scoles 1964); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 332a (Tent. Draft No. 6, 1960); A. VON MEHREN & D. TRAUTMAN, *THE LAW OF MULTISTATE PROBLEMS — CASES AND MATERIALS ON CONFLICT OF LAWS* 246-50 (1965).

¹¹ UNIFORM COMMERCIAL CODE § 1-105.

by one of our most distinguished jurists, but the enforceability of choice of law clauses is even yet a matter of some doubt in American law.¹² Of course the power to select a forum often exerts a strong though indirect influence on the law actually to be applied to a transaction. And it now appears clear that contractual consent to the jurisdiction of a particular court, if coupled with actual notice, satisfies the demands of the due process clause even if the agreement is an adhesion contract.¹³ But whether the parties can confer exclusive jurisdiction on a designated forum by contract is a matter of even greater uncertainty than their power to choose an applicable law.¹⁴ Small wonder that the American lawyer takes Hand's advice: If you want to be sure that a particular rule is applicable, express it specifically in the contract.

One anomaly resulting from the dubious enforceability of choice-of-exclusive-forum clauses in American law is that in some cases the preferences of civil and common law lawyers involved ought to be reversed. Suppose, for example, a contract is made in New York between American and German parties which designates German law as applicable and German courts as exclusively competent to adjudicate. The New York courts (or other United States courts) are much more likely to ignore these provisions than a German court would be if the designation were New York law and an

¹² Even *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189 (2d Cir. 1955), discussed in note 9 *supra*, expressed some doubt as to the parties' ability to stipulate the law governing the validity of their contract, although affirming their power to designate the law governing interpretation. 221 F.2d at 195. The RESTATEMENT (SECOND), *supra* note 10, takes a broader view but also imposes restrictions. For an interesting article discussing the attitudes of various United States courts toward party autonomy and the relevant considerations that affect such attitudes, see Johnston, *Party Autonomy in Contracts Specifying Foreign Law*, 7 WM. & MARY L. REV. 37 (1966).

¹³ *National Equipment Rental Ltd. v. Szukhent*, 375 U.S. 311, 316 (1964) (case involving internal as opposed to international conflict of laws question).

¹⁴ In 1955 the Second Circuit Court of Appeals upheld an advance agreement on forum, deferring to the foreign jurisdiction where this was "reasonable." *Wm. H. Muller & Co. v. Swedish American Line Ltd.*, 224 F.2d 806 (2d Cir. 1955). Three years later the Fifth Circuit declined to enforce a choice of forum clause on the ground that such agreements to oust the jurisdiction of courts are contrary to public policy. *Carbon Black Export, Inc. v. S.S. Monrosa*, 254 F.2d 297 (5th Cir. 1958). The Supreme Court denied certiorari in *Muller*, 350 U.S. 903 (1955). In *Carbon Black certiorari* was granted but later dismissed as improvidently granted, on the (questionable) theory that no conflict between circuits was presented, since *Muller* involved an in personam and *Carbon Black* an in rem proceeding. 359 U.S. 180, 183 (1959). Recently, however, the Second Circuit itself, sitting en banc, has resolved the question against enforcement of such clauses by overruling *Muller*. *Indussa Corp. v. S.S. Ranborg*, 377 F.2d 200 (2d Cir. 1967). Since this was done principally on the theory that such clauses are forbidden by § 3(8) of the Carriage of Goods by Sea Act (46 U.S.C. §§ 1300-15), *Indussa* presumably leaves the matter open as to contracts not covered by that Act. See also *Lenhoff, The Parties' Choice of a Forum: "Prorogation Agreements,"* 15 RUTGERS L. REV. 414 (1961).

American forum. Therefore, a German lawyer desiring to obtain the benefit of some specific rule of German law would be better advised to express it in the contract than to simply designate German law as applicable. By the same token the lawyer on the American side of the transaction should have less concern about the applicability of German rules to a potential dispute under an omnibus choice of German law and forum clause than he would have if the drafting were more specific. The rather rare occurrence of this reversal of attitudes, one suspects, is attributable to the fact that lawyers drafting international contracts seldom are able to foresee or investigate the specific advantages or disadvantages which will accrue from the choice of a particular law or forum.

However fair it may be to describe the incorporation and legislative philosophies of drafting as general tendencies, several factors operate to blur the differences in result to which a sharp distinction between them might otherwise lead. One such factor is that the common law lawyer, having drafted more or less exhaustively, is likely to include a choice of law or forum clause in his boilerplate as a backstop to his own limited foresight. An opposing factor is at work on the civil law lawyer; if the transaction involves reference to a common law system, he is likely to indulge in more detailed drafting because of his own uncertainties about what the applicable common law rule may be. Clients, of course, usually favor simplicity in drafting, either through lack of understanding of the legal complexities and risks involved, or else on the more rational ground of a desire to keep the transaction flexible and negotiable. This is offset to some extent by clients' normal suspicion of foreign courts or any foreign law. The net effect of these conflicting pressures is usually a set of contract documents falling somewhere between simple incorporation by reference and very detailed codification, but involving elements of both. The choice of law clause is a very common element. Clauses consenting to jurisdiction or designating exclusively competent forums are less frequently included, but are by no means rare. A separate but related type of clause is frequently used to designate the controlling text, when the contract documents are drafted in more than one language.

There are thus four different types of clauses, with a host of possible variations and combinations. The following are fairly standard examples of these basic types:

- (1) *Choice of law*: This agreement shall be construed in accordance with the laws of [name of state or country] and

the legal relations and obligations of the parties shall be governed by said laws.¹⁵

- (2) *Consent to jurisdiction*: The parties hereby consent to the jurisdiction of the courts of general jurisdiction of [name of state or country] for the resolution of any dispute arising under this agreement.¹⁶
- (3) *Exclusive forum*: The parties agree that the courts of general jurisdiction of [name of state or country] shall have exclusive jurisdiction for the resolution of any dispute arising under this agreement.
- (4) *Controlling text*: This agreement has been drafted in both the [] and the [] languages. Each text shall be valid; nevertheless, in the event of conflict in the interpretation of the obligations of the parties, it is agreed that the [] text shall be controlling.¹⁷

All four of these clauses might well be found in the same contract, in one form or another. If all four did appear in one document then normally — but not necessarily — the first three clauses would name one state or country and the fourth clause would designate the language of that country as controlling. In fact, however, it is rather rare to find all four in the same contract, or even to find all of the first three in one contract drafted in a single language. The important point to be observed is that each of these clauses deals with a related but separate problem of uncertainty in private international law; the problems are separate, but because of the relationship between them the “partial drafting” which deals with

¹⁵ Many lawyers apparently use only the first half of this clause and omit the latter part, either on the theory that the word “construed” includes legal effect as well as interpretation, or on the theory that no stipulation as to law governing validity would be enforced anyway; see note 12 *supra*. But it certainly is not clear that stipulations as to law governing validity are wholly unenforceable, and even less certain that interpretation includes validity by implication. Also, the normal assumption seems to be that the law referred to by a choice of law clause is the local law of the designated state or country. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 332a (Tent. Draft No. 6, 1960). This may be a safe assumption from the American point of view, but there is some danger in assuming that it holds true in other countries. The leading English case on stipulations as to governing law interpreted such a clause as adopting the whole law, including the conflict of laws rules of the designated country. *Vita Food Products, Inc. v. Unus Shipping Co.*, [1939] A.C. 277. (P.C.) (n.s.). *But cf.* *Siegelman v. Cunard White Star Ltd.*, 221 F.2d 189, 194 (2d Cir. 1955).

¹⁶ Such clauses should probably provide for adequate notice by the complaining party, although formal service of process is not usually regarded as necessary under such a clause. Otherwise the provision may run afoul of due process standards, and this might be true even if actual notice were given. *Compare* *National Equipment Rental Ltd. v. Szukhent*, 375 U.S. 311 (1964), *with* *Wuchter v. Pizzuti*, 276 U.S. 13 (1928).

¹⁷ See generally on such clauses de Vries, *Choice of Language in International Contracts*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 14-22 (1962); Folsom, *Clauses in International Contracts Involving Choice of Law, Language, Forum, and Conflict Avoidance*, in SYMPOSIUM ON NEGOTIATING AND DRAFTING INTERNATIONAL COMMERCIAL CONTRACTS, 1965, at 49-52 (Southwestern Legal Foundation 1966).

some but not all of these problems may give rise to some unexpected results.

Consider, for example, a contract drafted in French and English texts which contains only a choice of law clause designating the law of France as applicable. If a conflict of interpretation arose, would the French text be regarded as controlling? Presumably a French court would say it was, but would an American court do so?¹⁸ Would a French court regard the choice of law clause as consenting to the jurisdiction of the French courts, so as to justify the acquisition of personal jurisdiction without service of process?

Or take the case of a contract consenting to the jurisdiction of a foreign court, but without further provision for the other problems. Does such a consent dispense with the necessity for notice to the defendant, even if it is clear that formal service of process would not be required? Would a foreign judgment rendered without such notice be enforceable in the United States?¹⁹ Would either an American or the foreign court assume that the consent to jurisdiction of the foreign court contained by implication an adoption of that foreign law? To what extent may a consent to jurisdiction, especially if coupled with a choice of law clause looking to the law of the same country, be regarded as a designation of the courts of that country as exclusively competent? To what extent should the designation of a particular forum as exclusively competent be regarded as a choice of law²⁰ or as consenting to jurisdiction of that forum without formal service? To what extent does a controlling text clause imply a selection of forum or a choice of law?²¹

These questions could be multiplied, not only to show the relationship between individual clauses but to demonstrate the varying impact which different combinations of clauses may have. When one adds the complication that the courts of different countries hold a variety of attitudes not only about party autonomy as a single concept but also about different aspects of party autonomy, the possibilities for unforeseen results from "partial drafting" become very complex indeed.

The present writer willingly confesses to preference for the codification or legislative view of drafting — which basically means putting just about everything into an important contract which the drafter can get past opposing counsel and his own client. But it should be emphasized that the problems raised above apply not only to the codifier but also to the incorporator by reference. In fact,

¹⁸ Cf. Folsom, *supra* note 17, at 51.

¹⁹ See note 16 *supra*.

²⁰ See Van Hecke, *supra* note 6, at 46.

²¹ See Folsom, *supra* note 17, at 51.

in many situations they apply with special force to the latter because the balance of the contract affords fewer clues to the resolution of disputes in his case than in that of the codifier. It should also be pointed out that these problems are not avoided by the lawyer who engages in "partial drafting" intentionally, who, typically, includes a choice of law clause but consciously avoids jurisdiction clauses.²² If his intention is to keep the issues of interpretation and enforcement fluid and uncertain, of course, then that is an end to the matter, although one may wonder why in that state of affairs he bothered with a choice of law clause. But if he supposes that his choice of law clause alone either solves the other problems by implication, or that it is somehow exempt from consideration by a tribunal confronted with the jurisdictional issues, then he may be brought to a rude awakening.

The moral to be derived from all of this is a rather obvious one. At least to the extent one can assume the primary purpose of contract drafting is the avoidance of uncertainty, then all of the problems of choice of law and forum should be dealt with expressly. If it is intended that permissible inferences about the resolution of one such problem should not be drawn from express provision for another problem, then that too should be stated expressly. In either case the successful draftsman is normally the one who not only foresaw the possibility of litigation but was also able to forestall it by his advance identification of the rules that were to govern the transaction. Because choice of law and forum comprise not a single problem but a complex of problems, these suggestions therefore also transcend other differences in drafting philosophy.

These comments do not, of course, tell us very much about which law or which forum to choose, and it is doubtful whether that choice ought ever to be made in the abstract. Some lawyers prefer always to designate their own law as applicable and their own courts as forum, and when two such lawyers from different countries face each other across the negotiating table the result is apt to be a test of bargaining strength or no provision for the problems at all. Other lawyers may be inclined to avoid the problem of such a "home team" influence by choosing both a neutral forum and a neutral law, but there is great danger in this choice because many courts, especially in the United States²³ but also in Europe,²⁴ refuse to permit party autonomy in these matters in the absence of

²² There may, of course, be perfectly valid reasons for avoiding choice of forum clauses. See Folsom, *supra* note 17, at 55.

²³ See Yntema, *Autonomy in Choice of Law*, 1 AM. J. COMP. L. 341 (1952). *But cf.* A. EHRENZWEIG, *CONFLICT OF LAWS* 469 (1962).

²⁴ See Lagergren, *supra* note 4, at 214-15.

a "reasonable relation" between the transaction and the forum or law selected.

There is never any really adequate substitute for knowledge of the alternative effects which would be produced by the choice of particular systems or forums. Unfortunately, except for the special knowledge of a foreign system which a draftsman may happen to have, or except as the existence of especially advantageous rules may come to light in the process of negotiation, the obstacles to comprehensive research in the law of a foreign system are simply too great to permit much of this sort of weighing of alternatives.²⁵ There is, however, one rule of thumb that has much to recommend it. If the weighing of alternative effects is not possible, then the principal advantage of choice of law for the international contract is the identification of the rules to be applied, whatever they may prove to be. In the event that a dispute does arise, such a clear identification of applicable rules is most apt to permit negotiation and settlement without litigation. It follows, therefore, that any choice of law or forum should be one likely to be observed and enforced by the courts of both parties. This, of course, is the primary reason for avoiding the choice of neutral law and neutral forum, because the chances are fairly high that such party autonomy will not be permitted and that the benefits of any choice at all are therefore endangered. If the highest obtainable degree of certainty in the selection of applicable law is to be the objective, however, this rule of thumb would go beyond the minimum assurance resulting from selection of a system with a "reasonable relation" to the transaction. It would suggest, in addition, the selection of a system to which the otherwise applicable choice of law rules of the parties' own systems might reasonably be expected to lead.²⁶ This does not mean that choice of law can safely be left to choice of law rules and ignored in drafting, but rather that uncertainties in the application of conflict of law rules can be avoided while at the same time obtaining the most favorable possible climate for the recognition of party autonomy.

The scope of the present article does not permit discussion of a number of other factors which bear upon these problems, such as the desirability of compliance with the formality requirements in all potentially applicable systems,²⁷ the juggling of place of perform-

²⁵ Cf. Brumbaugh, *Choice-of-Law Provisions in Licensing Contracts*, in PARKER SCHOOL SYMPOSIUM ON INTERNATIONAL CONTRACTS 36 (1962).

²⁶ It is interesting to compare this rule of thumb with the suggestion that choice of law should always designate the place of performance. Folsom, *supra* note 17, at 55. The latter rule appears to be more nearly an illustration of the approach suggested here, rather than a departure from it.

²⁷ See Maw, *supra* note 9, at 27-28.

ance or other contacts as a method of influencing the selection of the applicable law,²⁸ or the impact of mandatory rules of law of a forum on the whole complex of autonomy problems.²⁹ Another vital area which must here be left untouched is the potential enforceability of a judgment once obtained, whether it be an American judgment exported for enforcement abroad³⁰ or a foreign judgment presented for enforcement in the United States.³¹ What has been said, however, is perhaps enough to suggest that choice of law and forum clauses, while not foolproof, are useful enough devices to deserve thorough rather than matter of course drafting in the preparation of international contracts.

²⁸ See Maw, *supra* note 9, at 28-30. *But cf.* Folsom, *supra* note 17, at 54.

²⁹ See Battifol, *Public Policy and the Autonomy of the Parties: Interrelations Between Imperative Legislation and the Doctrine of Party Autonomy*, in INSTITUTE ON THE CONFLICT OF LAWS AND INTERNATIONAL CONTRACTS 68-81 (Univ. of Mich. 1949).

³⁰ See Graupner, *Some Recent Aspects of the Recognition and Enforcement of Foreign Judgments in Western Europe*, 12 INT'L & COMP. L.Q. 367 (1963); Kulzer, *Some Aspects of Enforceability of Foreign Judgments: A Comparative Study*, 16 BUFF. L. REV. 84 (1966); Lorenzen, *The Enforcement of American Judgments Abroad*, 29 YALE L.J. 188 (1919); Nadelmann, *French Courts Recognize Foreign Money-Judgments: One Down and More to Go*, 13 AM. J. COMP. L. 72 (1964).

³¹ See Peterson, *Res Judicata and Foreign Country Judgments*, 24 OHIO ST. L.J. 291 (1963); Reese, *The Status in This Country of Judgments Rendered Abroad*, 50 COLUM. L. REV. 783 (1950); Smit, *International Res Judicata and Collateral Estoppel in the United States*, 9 U.C.L.A.L. REV. 44 (1962). For an exhaustive appendix of the reported cases in this country involving foreign judgments see C. PETERSON, *DIE ANERKENNUNG AUSLAENDISCHER URTEILE IM AMERIKANISCHEN RECHT* 107-27 (1964).

INCREASING PROFITS FROM FOREIGN KNOW-HOW LICENSING

ROLAND P. CAMPBELL*

Many United States businesses have a substantial investment in research and development but because of a lack of capital, or for other reasons, are not able to export their products to foreign markets. Mr. Campbell explores the possibility of licensing technical know-how for use in foreign markets, as a method of increasing profits where investment through direct export of products is impossible. He outlines the requirements necessary for royalties from such licensing to be treated as capital gains for tax purposes. He demonstrates that it is possible to satisfy capital gains requirements by transferring all substantial rights in proprietary technology, while, at the same time, retaining rights to cancel the license for any act of the licensee which impairs the licensor's security or property interest in the licensed technology.

WITH world markets becoming closer and more accessible in terms of the lowering of tariff barriers and transportation costs, the U.S. businessman is becoming increasingly aware of the opportunities for profits in the foreign marketplaces. For U.S. companies with ample capital, foreign profits may be realized by direct investment in manufacturing facilities or equity investment in established companies. Those U.S. companies manufacturing products suitable for export find their profits through the normal export channels. But there are many U.S. companies that lack the capital for direct investment and who manufacture products that, for one reason or another, cannot be exported. For such companies the route to foreign profits may be confined to the foreign licensing of that technical know-how that has made them successful in the domestic market.

Even though foreign profits may be limited to licensing revenues, it does not necessarily follow that these profits are less than those obtainable from the more conventional methods of doing business abroad. Certainly if profits are measured in terms of return on investment, the profit from licensing is indeed gratifying since seldom, if ever, is there capital invested. The research and development necessarily undertaken to maintain and increase a competitive position in the domestic market is normally expensed for U.S. tax purposes. And it is the results of this expensed research and development that are used as the subject matter of the know-how license agreement. If favored tax treatment, such as capital

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gain treatment of royalty, can be added to a no-capital cost investment in the form of a number of foreign licenses, the profit picture obviously becomes much more attractive.

One of the objectives of this article is an attempt to relate the legal requirements for capital gain know-how licensing to the usual expectations of the parties in a know-how licensing arrangement. Another objective is to outline the salient requirements for capital gain licensing, having in mind that the basic parameters of a foreign license agreement are often agreed upon by U.S. businessmen when they are abroad—before consulting legal counsel and without counsel participating in the negotiations.

I. KNOW-HOW AS PROPERTY

The proper transfer of all substantial rights in the property aspects of know-how will entitle the transferor to capital gain treatment of the royalty income from the transfer.¹ Before coping with the considerations involved in properly transferring all substantial rights, it is necessary to at least attempt to define "know-how" and those classes of know-how which constitute property.

Since we are primarily concerned here with the licensing of manufacturing technology, "know-how" may be defined as machine designs, drawings, process techniques, manufacturing specifications, technical notes, and other technical information which is of importance to the licensor in his manufacturing operations. Much of this know-how is documented, but some exists solely in the minds of the licensor's skilled technical personnel. All know-how will not be considered as property. But it has been established that know-how such as process techniques, and machine designs which are reduced to practice and kept secret, will qualify as property,² whereas that know-how which is not reasonably secret or comprises services will not be property and thus royalty derived therefrom will be treated as ordinary income for tax purposes.³

Within the context of capital gain know-how licensing considerations, it is not necessary to think of secret technology in the same manner as would be necessary in trade secret litigation. Be-

¹ *E.I. Du Pont De Nemours & Co. v. United States*, 288 F.2d 904 (Ct. Cl. 1961); *Stalker Corp. v. United States*, 209 F. Supp. 30 (E.D. Mich. 1962). In each of these cases the court ruled against the taxpayer but established guide lines as to what would be considered a transfer of all substantial rights. The basis for capital gain treatment of intangible property rights such as patents, trademarks and know-how is found in INT. REV. CODE of 1954, §§ 1221, 1231.

² *Nelson v. Commissioner*, 203 F.2d 1 (6th Cir. 1953). See also Nash, *The Concept of "Property" in Know-how as a Growing Area of Industrial Property: Its Sale and Licensing*, 6 IDEA 289, 294-96 (1962).

³ Rev. Rul. 64-56, 1964-1 (Part 1) CUM. BULL. 133, and cases cited therein. See *Bell Intercontinental Corp. v. United States*, 152 U.S.P.Q. 182 (1966) (report of trial comm'r), *aff'd per curiam*, 381 F.2d 1004 (Ct. Cl. 1967) (reprinting report of trial comm'r).

cause of the difficulties a plaintiff encounters in proving his case with respect to an appropriation of trade secrets, there is a tendency for the prospective licensor to dismiss important technology as not being licensable for capital gains purposes. Until there is good reason for doing otherwise (and good reason may mean a rejection of the licensor's claim for capital gain treatment from a license agreement), it is suggested that for license planning purposes the prospective capital gains licensor adopt the following portion of the definition of a trade secret from the American Law Institute's *Restatement of Torts*:

[I]nformation which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it;⁴

as modified by the following:

[T]he secrecy with which a court of equity deals is not necessarily that absolute secrecy that inheres in discovery, but that qualified secrecy that arises from mutual understanding, and that is required alike by good faith and by good morals;⁵

and

A plurality of individual discoverers may have protectible, wholly separate rights in the same trade secret.⁶

For the purposes of this article, the term "proprietary technology" will be used with reference to the property aspects of know-how rather than "trade secret," with the suggestion that such definition includes that reasonably secret technical know-how which should be considered as property. The term "transfer" will be used in some instances rather than "license" since the transfer or grant of rights necessary in capital gains licensing more nearly approaches a sale rather than a permissive use.

A. *Some Uncertainties*

The legal requirements for an entirely satisfactory foreign licensing program that will also result in capital gain treatment of royalty will not be found in today's case law concerning know-how nor in the Internal Revenue rulings. We do, however, find certain suggestions and some case law that, in most respects, will enable a practical licensing arrangement to be consummated and yet produce the desired tax result.⁷

⁴ RESTATEMENT OF TORTS § 757, comment *b* (1939).

⁵ *Vulcan Detinning Co. v. American Can Co.*, 72 N.J. Eq. 387, 67 A. 339, 343 (1907).

⁶ *E.I. Du Pont De Nemours & Co. v. United States*, 288 F.2d 904, 911 (Ct. Cl. 1961).

⁷ The few tax cases handed down in connection with licensing or selling secret technology adopt, by analogy, the many cases dealing with the licensing and sale of patents. See, e.g., cases cited note 1 *supra*. The analogy doctrine is also used with respect to antitrust questions in the licensing of know-how. See Macdonald, *Know-how Licensing and the Antitrust Laws*, 62 MICH. L. REV. 351 (1964); Stedman, *Legal Problems in the International and Domestic Licensing of Know-how*, 29 ABA ANTI-TRUST SECTION 247 (1965).

Lest the prospective licensor becomes discouraged at this point, one might ask how often the businessman has the opportunity to resell the same property a number of times. Yet this is exactly what he does when he licenses the same technology in a number of different countries.⁸ While there are some uncertainties, the objective is to handle the foreign licensing program and the individual licenses so as to stay within the precedents and sound conclusions that may be drawn therefrom, while avoiding these uncertainties until such time as the law further develops.

B. *Transfer of All Substantial Rights*

Accepting the fact that a transfer of all substantial rights in proprietary technology (property) will entitle the licensor to capital gain treatment on the royalty income, it is necessary to determine how all substantial rights may be transferred. A 1964 Revenue Ruling can be used as a starting point and provides in part as follows:

The unqualified transfer in perpetuity of the exclusive right to use a secret process or other similar secret information qualifying as property within all the territory of a country . . . will be treated as the transfer of all substantial rights in the property in that country.⁹

While Revenue Ruling 64-56 is helpful with respect to the requirement of an exclusive and perpetual right to use, it is somewhat misleading as to the requirements for a transfer of all substantial rights in a licensing transaction. The property right in a trade secret essentially consists of the right to prevent a wrongful or unauthorized use or disclosure.¹⁰ Therefore, in order to transfer all substantial rights, it is necessary that the licensor grant not only the exclusive right to use, but also the right to prevent all others from using or disclosing.¹¹

⁸ This is a difficult concept to grasp but may be thought of with reference to foreign patenting. A U.S. patent application may be filed and issued in a number of foreign countries, thus representing a different property right in each country for a single inventive act in the U.S. To the extent secret technology is protected by the laws of the various foreign countries, the owner of such secret technology should have protectible property rights in such country. For an enlightening treatment of the foreign law of "know-how" see Ladas, *Legal Protection of Know-how*, 7 IDEA 397 (1964).

⁹ Rev. Rul. 64-56, 1964-1 (Part 1) CUM. BULL. 133, 135. While this ruling is not directly in point in licensing, it is helpful as illustrating I.R.S.'s property view on secret technology. For an analysis of this ruling see Cohen, *Long-awaited Ruling on Transfer of Know-how Sets Guidelines in Important Areas*, 21 J. TAXATION 38 (1964).

¹⁰ E.I. Du Pont De Nemours & Co. v. United States, 288 F.2d 904, 911 (Ct. Cl. 1961).

¹¹ E.I. Du Pont De Nemours & Co. v. United States, 288 F.2d 904 (Ct. Cl. 1961); *Stalker Corp. v. United States*, 209 F. Supp. 30 (E.D. Mich. 1962). One must assume from *Du Pont* that a U.S. court will think of the foreign law as being comparable to U.S. law in that the owner of secret technology has the right to prevent a wrongful use of disclosure and that this is a property right. Rev. Rul. 64-56, 1964-1 (Part 1) CUM. BULL. 133, 134, also indicates that the foreign law must offer substantial protection for secret information, thus suggesting the I.R.S. test for "qualifying as property."

While U.S. courts have held that there is an implied covenant in a sale of secrets that the transferor will not be able to use or disclose such secrets,¹² it seems clear from the court's reasoning in *Du Pont and Stalker, supra*, that a positive promise on the part of a licensor not to disclose is also necessary in order to establish a complete transfer. The licensor's promise should not, however, be absolute since he would then be precluded from licensing in other countries; but it should be sufficient that the licensor promises not to disclose to others in the licensee's country, nor to disclose to any third parties elsewhere except under a requirement of secrecy, and to disclose for use by others only in territories other than that in which the licensee has been granted rights.¹³

Since the license agreement must contain a restrictive secrecy covenant on the part of the licensor with respect to disclosing the proprietary technology, it is necessary to consider carefully what know-how should be included in the contract as "proprietary technology" quite apart from the tax considerations. Otherwise, the licensor may well find that he has materially restricted his freedom of action with respect to subsequent, or parallel, licensing of similar technology in the same country. Discretion should lead the licensor to include, as proprietary technology, only that know-how reasonably qualifying as such. Non-proprietary know-how may be included in the agreement under a separate heading and the licensee can be required to keep such know-how in secrecy, while the licensor need not so limit himself. Of course, royalties on such non-proprietary know-how are not subject to capital gains treatment.

It is not uncommon for a given item of proprietary technology, for example, a process, to have usefulness for producing products other than those which have been manufactured by the licensor or desired to be manufactured by the licensee; or the secret process may be used by the licensor to produce a variety of different products and it is preferred to transfer rights to use with respect to only one of the products. The question is then raised as to whether the transfer of rights to use for less than all purposes is a transfer of all substantial rights since the licensor is left with the right to use for other purposes. There is authority in tax cases concerning patents that a transfer of less than for all uses or products covered by the patent will still qualify for capital gain.¹⁴

¹² *Radium Remedies Co. v. Weiss*, 173 Minn. 342, 217 N.W. 339 (1928).

¹³ The task here is to preserve the trade secret status of the technology in each license and to go only far enough to give the licensee a right equivalent to that of the licensor in the licensed country.

¹⁴ *United States v. Carruthers*, 219 F.2d 21 (9th Cir. 1955); *First Nat'l Bank v. United States*, 136 F. Supp. 818 (D.N.J. 1955); *Rouverol v. Commissioner*, 42 T.C. 186 (1964). *But cf. Merck & Co. v. Smith*, 261 F.2d 162 (3d Cir. 1958).

While courts have followed the reasoning in patent tax cases when deliberating transfers of trade secrets, the recent *Pickren* decision casts some doubt on the scope of the analogy doctrine.¹⁵ Therefore, unless a limitation with respect to use is of such importance that the licensor is willing to risk the capital gain treatment, caution dictates that the transfer of rights be not so restricted.

C. *Unqualified Transfer*

In the broad sense, the transfer of proprietary technology may be thought of as being comparable to the sale of a chattel. In the usual sale of a chattel, the buyer acquires completely free of restraints as to the nature and locale of the use and has the right to dispose of the chattel as he sees fit. In the event the total purchase price is not paid at the time of transfer, it is customary for the seller to condition the sale. He does this by prohibiting use of the chattel outside a specified area, requiring the transferee to carry insurance to protect the property value of the chattel, and imposing such other conditions on the sale as may be necessary to protect the transferor's security interest. However, the transaction is still a sale and, to the extent reasonably necessary to protect the property right or the security interest, the licensor may also condition or qualify the transfer and still effect a disposition of all substantial rights in his property.¹⁶

In considering the licensor's needs with respect to the security and property interest in the proprietary technology, the restrictions or qualifications which may be imposed in connection with the transfer should be based upon payment of the monetary considerations and the need to keep the proprietary technology in secret and to control its use. These interests are secured by the licensor retaining the right to cancel the licensee's use of the proprietary technology for breach of contractual requirements protecting the licensor's security and property interests. The following areas are of major concern to the licensor and reservation of the right to cancel for breach should not adversely affect the capital gain status of the transaction.

¹⁵ In looking at whether the contract as a whole evidenced an intent to make a complete transfer of all rights, the court attached significance to the transfer being the exclusive right "to manufacture, or have manufactured, use and sell, or have sold, the products derived from the aforementioned formulas" instead of granting "rights *in and to* the secret formulas." It is difficult to visualize what right could be retained in view of a grant to make products derived from the formulas. Nevertheless, a transfer limited to a given use, field of use, or products is far more restricted than a transfer of all rights in and to the proprietary technology. *Pickren v. United States*, 378 F.2d 595, 597, 600 (5th Cir. 1967) (emphasis added).

¹⁶ This conclusion may be drawn from the court's reasoning in the patent cases, e.g., *Commissioner v. Celanese Corp. of Am.*, 140 F.2d 339 (D.C. Cir. 1944); *Kimble Glass Co. v. Commissioner*, 9 T.C. 183 (1947); *Myers v. Commissioner*, 6 T.C. 258 (1946). So long as there has been a complete transfer, a court should not consider those conditions that may accompany the transfer to detract therefrom when based upon considerations which protect the respective business interests.

Royalties — Licenses are rarely paid for on a lump sum basis at the time of grant. Instead, the licensor is reimbursed over a period of time in accordance with the use made of the licensed technology. Therefore the licensor's security interest will exist during the period of the agreement in which royalties are payable by the licensee.¹⁷ In the event minimum royalties or production rates are required, the same reasoning will apply.¹⁸

Best Efforts Provisions — A licensor will want the licensee to use the proprietary technology to the widest extent reasonable under the circumstances. Therefore, it is common to insert a "best efforts" provision in the contract. This should be deemed a reasonable restriction during the royalty payment period in view of the licensor's dependency upon the licensee's use for his income.¹⁹

Bankruptcy — Insolvency — The licensor may cancel in the event the licensee becomes insolvent or bankrupt during the royalty payment period.²⁰ This is a proper protection of the licensor's security interest. It would seem that the licensor should also be able to cancel in the event the licensee files bankruptcy proceedings even after all royalties are paid. This should be considered as a protection of the licensor's property interest in the proprietary technology which otherwise might pass into the hands of creditors free of the secrecy restrictions.

Sublicensing — Since the capital gain licensor cannot again license the same proprietary technology in the licensee's country, he may want to give the licensee sublicensing rights. It is important, however, that the sublicensing agreements be worded properly so as to protect the proprietary technology. Therefore, the licensor should be able to condition the license by making all sublicenses subject to the licensor's reasonable approval.²¹

Secrecy and Enforcement — It is clear that an unrestricted disclosure to a third party destroys the property value of proprietary technology²² and thus the licensor may properly qualify the transfer by requiring the licensee to hold the technology in confidence.²³ It should arguably follow that the licensee could be required to take

¹⁷ Reid v. Commissioner, 26 T.C. 622 (1956).

¹⁸ Watson v. United States, 222 F.2d 689 (10th Cir. 1955); Golconda Corp. v. Commissioner, 29 T.C. 506 (1957).

¹⁹ See Kronner v. United States, 110 F. Supp. 730 (Ct. Cl. 1963).

²⁰ See Commissioner v. Celanese Corp. of Am., 140 F.2d 339 (D.C. Cir. 1944) (dictum).

²¹ See Rollman v. Commissioner, 244 F.2d 634 (4th Cir. 1957). The same also applies to assignments. See Crook v. United States, 135 F. Supp. 242 (W.D. Pa. 1955).

²² Pomeroy Ink Co. v. Pomeroy, 77 N.J. Eq. 293, 78 A. 698 (1910).

²³ If the licensor ever expects again to license the same proprietary technology in other countries, he should require the first and subsequent licensees to hold in confidence in order to protect the trade secret status of such proprietary technology.

action against a wrongful user or discloser in the licensed territory, since the licensor must give the licensee the right to do so pursuant to *Du Pont* and *Stalker*, *supra*.

The foregoing represent only the more significant conditions for breach of which the licensor will wish to retain the right to cancel. The test as to cancellation rights is whether the licensor has transferred all substantial rights to the proprietary technology. Therefore, a right to cancel for events not within the control of the licensor, and conditioned with respect to events occurring after the transfer, should be proper as long as the cancellation right can be related to the licensor's property or security interest.²⁴

D. *Exclusive and Perpetual Use Within All the Territory of a Country*

It is necessary that the transfer of rights to use the proprietary technology be exclusive and perpetual within all the territory of a country.²⁵ At first glance, the words "exclusive" and "perpetual" have a tone of conclusiveness such that the businessman inherently hesitates because of the presumed finality of the transaction and the fear that a poor licensee may be chosen. However, we have noted that the transfer may be qualified in a number of respects that will greatly reduce the business risks in terms of protecting the licensor's security and property interest in the transferred technology. Since it necessarily follows that the exclusiveness and perpetualness of the transfer is also thus qualified, and when it is remembered that licensing has been chosen as the method of doing business abroad, it becomes possible to view the transaction more objectively.

Depending upon the exact nature of the technology, the market for the products produced, and the licensee's position in that market, an exclusive or perpetual transfer or grant of rights may be viewed as reasonable under widely varying circumstances.

Assume, for example, that the proprietary technology to be licensed consists of design and engineering drawings for apparatus specifically designed by the licensor to produce a given product

²⁴ For a collection of cases dealing with cancellation rights, see *Bell Intercontinental Corp. v. United States*, 381 F.2d 1004 (Ct. Cl. 1967).

²⁵ See Rev. Rul. 64-56, 1964-1 (Part 1) CUM. BULL. 133, 135. The need for this language is derived from the analogy concept established by *E.I. Du Pont De Nemours & Co. v. United States*, 288 F.2d 904 (Ct. Cl. 1961), and *Stalker Corp. v. United States*, 209 F. Supp. 30 (E.D. Mich. 1962). A trade secret, if kept secret, may have a perpetual life and thus is analogous to a trade name in this regard. *Reid v. Commissioner*, 26 T.C. 622 (1956), and *Seattle Brewing & Malting Co. v. Commissioner*, 6 T.C. 856 (1946), hold that capital gain treatment will be accorded royalty received from an exclusive and perpetual transfer of a trade name. Since a transfer of rights less than throughout the territory of a country would leave the licensor still free to license others in such country, the transfer must be with respect to the country as a whole in order to transfer all substantial rights.

which could be substantially as well manufactured by other apparatus known to, or perhaps even used by, the transferor. An exclusive and perpetual transfer of the right to use the drawings leaves the transferor completely free, if he so wishes, to manufacture the same products in the first licensee's country.

In some industries, the requirements for effectively competing require almost continuous improvement and development of new products, processes, or production apparatus. The perpetual transfer of today's technology could well mean that the licensee has rights, and the licensor has given rights, which are valuable for only a few years. And when the licensor's new technology is developed, he is free to license another or again license the former licensee under a new agreement.

It is not unusual, particularly in the less industrialized and geographically smaller foreign countries, to find that one company has most of the business in a given product or product line. In this case, an exclusive license to such company is really not more restrictive on the licensor than would be a nonexclusive grant. Also, if the technology is such that substantial capital investment is needed in the way of new plant or equipment, the licensor could well find that all prospective licensees will insist on the protection of an exclusive license.

Because the exclusive grant of rights to use must be throughout the territory of a country, it is possible that the otherwise ideal licensee, because of product shipping costs or other problems, may not be able to effectively cover his national market and the licensor is penalized in that he will not obtain the optimum royalty return. With the formation of trading blocs such as the European Economic Community, European, Latin American, and Central American Free Trade Associations, and as progress continues toward the lowering of trade barriers between member states, the requirement that the grant of exclusive rights to use be throughout the territory of a country will become of diminishing and perhaps even negligible importance in many instances. Since the exclusiveness of the grant need only be with respect to use of the manufacturing technology, and not as to sales of products produced through use of the technology,²⁶ a licensor could grant, for example, an exclusive license to a company in southern France and feel reasonably certain that if he licensed a Belgian concern, the latter would adequately cover the northern French market.

²⁶ E.I. Du Pont De Nemours & Co. v. United States, 288 F.2d 904 (Ct. Cl. 1961); Stalker Corp. v. United States, 209 F. Supp. 30 (E.D. Mich. 1962). A transfer of use with respect to products may be dangerous in view of *Pickren v. United States*, 378 F.2d 595 (5th Cir. 1967).

II. NON-PROPRIETARY TECHNOLOGY AND SERVICES

As a practical matter, licensees would not normally be satisfied with receiving only the proprietary technology aspects of the licensor's know-how. In initially negotiating the license, the licensor will normally agree to give the licensee all technical information reduced to written or pictorial form for the agreed-upon royalty consideration. That know-how existing primarily in the minds of the licensor's technical staff is given the licensee on the basis of an hourly charge or per diem for consulting services rendered. To the extent that non-property know-how is included for the stipulated royalty, an allocation would probably be made by the Internal Revenue Service setting a portion of the royalty against the proprietary technology and the balance against the non-proprietary portion of the know-how.²⁷ Therefore, for tax purposes it is desirable to classify the know-how provisions in the agreement into proprietary technology, non-proprietary technology, and consulting services, and assign values to each, recognizing that the consideration for the non-proprietary technology and services will be considered as ordinary income. The licensee should not find this objectionable so long as the values do not exceed those previously agreed upon.

In classifying the know-how, Revenue Ruling 64-56 is of some help in connection with the "services" question. This ruling indicates that to the extent services are ancillary and subsidiary to the property (proprietary technology) transfer, the services will be treated for tax purposes similarly to the property. Examples given in the ruling as ancillary and subsidiary services are those "in promoting the transaction by demonstrating and explaining the use of the property, or by assisting in the effective 'starting-up' of the property transferred."²⁸ A question of fact is involved in each instance, depending upon the character of the proprietary technology and additional technology and services provided.

III. IMPROVEMENTS

It is customary in international licensing arrangements for each of the parties to desire the use of the technical improvements made by the other. The licensor is primarily motivated by the possibility of the licensee improving the licensed technology to the point where the licensee may become a significant competitive threat. On the other hand, the licensee often suspects that the licensor is willing to grant licenses because he has some valuable improvements in the offing and therefore is merely disposing of old technology.

²⁷ Rev. Rul. 64-56, 1964-1 (Part 1) CUM. BULL. 133, 134-35.

²⁸ *Id.* at 134.

When the licensor includes technical improvements in the license, the consideration therefor is usually included in the basic royalty rate which is then set, having in mind both the proprietary and non-proprietary technology and the improvements. The reason for this is the difficulty in predicting what improvements may be made as well as what values should be assigned to future technology yet to be developed. In nonexclusive licensing, the licensor's improvement rights need not be coped with on the basis of their status as property. This is also true with respect to the licensee's improvements which, if provided for in the agreement, should be treated as nontaxable additional compensation to the licensor.

In capital gain licensing, attention must be given as to how to license the use of improvements which cannot be classified as proprietary technology and consequently should not be considered as property. If improvements are included in the agreement as a single class, and payment therefor is an unspecified portion of the royalty, then it should follow that an allocable share of the royalty would be treated as ordinary income since routine nonsecret type improvements should be considered as services and not property.²⁹ The allocation problem should be avoided if only reasonably secret improvements in the proprietary technology are included under the theory that improvements in trade secrets must of themselves be trade secrets. However, an improvement clause so restricted is not in accordance with general licensing practice, since the licensee will want all know-how improvements.

One solution to the allocation problem would be to divide the licensor's improvements into two classes: those that are more important and would normally be considered by the licensor as reasonably secret, and a second class to include the more routine improvements. The secret class should also be treated so as to vest rights in the licensee more than six months after the reduction to practice thereof so as to satisfy the six-month holding period.³⁰ The transfer of the secret improvements should be effected in the same manner used for the basic proprietary technology. Also, care should be taken in drafting the secrecy covenants so as to preserve the property status of these improvements. The nonsecret improvements could be handled in the same manner as technical services or non-proprietary technology and so defined.³¹

²⁹ *Id.* at 135. One of the patent cases, *Kronner v. United States*, 110 F. Supp. 730 (Ct. Cl. 1953), holds that improvements under a patent have the same property status as the patent. However, it is suggested that the *Kronner* holding applies only to improvements clauses which purport to convey rights to improvements which come within the scope of the patent claims.

³⁰ INT. REV. CODE OF 1954, § 1222.

³¹ When both the licensor and licensee are to give rights to improvements, consideration might be given to a separate agreement providing for a royalty-free exchange of such rights.

IV. FOREIGN LAW

It would be far beyond the scope of this article to do more than suggest that detailed consideration be given to the foreign law aspects of the license agreement. The requirement of an exclusive and perpetual grant, which is necessary for the desired U.S. tax treatment, deserves particular attention in view of the applicable foreign law. As one example, such a grant may create an implied warranty that the licensee may use the technology free of third party claims, including patents. Therefore, it would be well, during license negotiations and in the license agreement, to specifically negate any such warranties.

If the licensee is located within one of the European Common Market countries, the provisions of Articles 85 and 86 of the Treaty of Rome³² and the implementing regulations concerning licensing³³ deserve special attention in view of the exclusive and perpetual grant by the licensor, the secrecy covenants, and also in connection with licensee improvements provisions if included in the license.

CONCLUSIONS

From the foregoing it may be concluded that the license agreement necessary to produce capital gain treatment of royalty need not necessarily impose undue limits on the licensor's freedom of action should the agreement be tested by the major problems encountered as a result of any licensing transaction.

In the final analysis, whether the licensor successfully meets any such test will be determined by his rights to cancel the licensee's use of the know-how. We have observed that the licensor may cancel for the licensee's failure to pay minimum and other royalties or use best efforts, insolvency, bankruptcy, misuse of sublicensing rights and, in general, for any act of the licensee which impairs the licensor's security or property interest.

When it is considered that the licensor is making his know-how available abroad for the purpose of gaining further profit from the results of his domestic R&D expenditures, it is submitted that the capital gain license will provide him with a viable arrangement leading to increased profits.

³² See 1 CCH COMM. MKT. REP., ¶¶ 2000-11 (1965-1967) (Transcript of Article 85 is found at ¶¶ 2005, 2031, and 2051; transcript of Article 86 is found at ¶ 2101). Articles 85 and 86 of the treaty spell out the substantive law of the Common Market on restrictions of competition. See Ladas, *Antitrust Law in the Common Market with Special Reference to Industrial Property Agreements*, 23 OHIO ST. L.J. 709 (1962).

³³ Regulation 17, Art. 4 (1962), 1 CCH COMM. MKT. REP., ¶ 2431 (1965) and Regulation 17, Art. 5 (1962), 1 CCH COMM. MKT. REP., ¶ 2441 (1965) (amended by Regulation 59, see 1 CCH COMM. MKT. REP., ¶ 2441.10 (1965)). While certain permissible provisions in the nature of restraints in patent licenses are clarified by Regulations 17 and 59, know-how licenses are treated on their merits. See Van Notten, *Know-how Licensing in the Common Market*, 38 N.Y.U.L. REV. 525 (1963).

AGREEMENTS FOR THE TRANSMISSION OF TECHNOLOGY ABROAD: THE DISTRIBUTOR RELATIONSHIP

BY JOHN A. MOORE*

The foreign distributorship is a widely used means for the transmission of United States technology in international commerce. Mr. Moore points out some of the legal and business problems that may arise in the distributor arrangement because of incomplete or faulty drafting of the distributorship agreement. In order to avoid some of these pitfalls, Mr. Moore discusses the major points of consideration in drafting such agreements. Such matters as trade restraint, U.S. export controls, choice of governing language and law, payment and termination provisions should be clearly set out in the agreement in order that the scope of the distributorship relation will be clearly understood and mutually agreeable to the parties involved. As an Appendix to his article, Mr. Moore includes a sample Distributor Agreement which may serve as a useful drafting guide to the attorney.

I. OLD AND NEW DEVICES

THE interrelationship of law, science and industry is vividly present when the lawyer is called upon to prepare the legal instruments governing transmission of goods and technical information and services across national boundaries. With increasing trade and overseas operations, a great variety of new and old legal devices are being employed. The lawyer must be alert both to use old and familiar arrangements and to develop new and useful variations of traditional legal arrangements when required. The ordinary American lawyer finds that he cannot rely solely on traditional and tested legal devices known to him when it comes to the transnational field. Innovation is required because of at least two major factors: (1) the changing patterns of overseas activities and the constantly changing requirements of national and regional laws; and (2) the fact that the legal results flowing from the use of a particular legal device will not be the same in the transnational field as when that device is used in a purely national setting.

The American lawyer should be aware of the great variety of legal arrangements and relationships being used for the transmission of technology and goods. The following are a few examples:

A great variety of *joint venture arrangements* have proliferated in the international sphere. These may be for direct participation by

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the joint venturers, or agreements to participate in a new form or entity overseas.¹

A great growth of *licensing agreements* has occurred over the years in encouraging the use of patents and know-how and in deriving overseas profits without direct investment.²

Equipment leasing agreements have grown in importance in making technical equipment available across boundaries in ways that are economically possible for the receiving areas.³

Agreements for engineering services are vital in the international sphere, as are *agreements for construction* of highly complicated industrial plants.⁴

Agreements for the rendering of services and technical assistance assume a whole new variety of forms.⁵ What is thought of as one kind of services arrangement here may be cast in quite a different mold for overseas use, to take advantage of special currency or licensing regulations.

Employee and consultant agreements are widely used and raise special problems of secrecy of information and ownership of developed technology.⁶

Representation and "finders" agreements are widely used.

Manufacturing and assembly operations will be the subject of legal agreement where these operations are conducted overseas.

Parent-subsidiary agreements regarding overseas activities of the

¹ A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS 196 (W. Surrey & C. Shaw eds. 1963) (a publication of the Joint Comm. on C.L.E. of the A.L.I. and A.B.A.). See also Blondeel, *Problems Involved in Operating Within the EEC*, in DOING BUSINESS IN THE COMMON MARKET, CCH COMM. MKT. REP., SPEC. REP. 15, 17-20 (1963). These may often be "coerced." See Murphy, *Structuring International Business*, in SYMPOSIUM, PRIVATE INVESTORS ABROAD—STRUCTURES AND SAFEGUARDS 23, 47 (Southwestern Legal Foundation 1966). There is some leveling off in the Common Market. See Duerr, *Alternative Methods of Operation Within the EEC; Factors to Weigh in Doing Business in Europe*, in DOING BUSINESS IN THE COMMON MARKET, *supra* at 3, 6. An interesting German development is described in Laundry, *The GmbH & Co. Kommanditgesellschaft: German Partnership Vehicle For Joint Ventures*, 23 BUS. LAW. 213 (1967).

See Mr. Ross's treatment of joint venture possibilities elsewhere in this symposium.

² G. POLLZIEN AND G. BRONFEN, INTERNATIONAL LICENSING AGREEMENTS 1 (1965); A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 1, at 105-80. See generally 2 DOING BUSINESS ABROAD 586-619 (H. Landau ed. 1962); Haight, *International Protection of Rights in Technology* in SYMPOSIUM, PRIVATE INVESTORS ABROAD—STRUCTURES AND SAFEGUARDS 173, 186 (Southwestern Legal Foundation 1966) and authorities cited therein.

³ Eckstrom, *Licensing, Equipment Leasing and Patent and Trademark Protection in the European Common Market*, 2 SOUTHWESTERN LEGAL FOUNDATION, 1960 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 249, 282.

⁴ See generally Powell, *Some Legal and Practical Problems Encountered by U.S. Concerns Performing Services in Latin America*, 4 SOUTHWESTERN LEGAL FOUNDATION, 1962 INSTITUTE ON PRIVATE INVESTMENTS ABROAD 41.

⁵ Compare Murphy, *supra* note 1, at 27, 36-38.

⁶ Discussed in Haight, *supra* note 2, at 178-82.

subsidiaries become most vital in determining the effect of tax and other rules on overseas operations.⁷

Franchise, trademark use and management agreements are other devices used in the transmission of technical and administrative skills.⁸

The focus of this paper is on one relationship for the transmission of products and technology: the agreement between the U.S. manufacturer or distributor and a distributor in another country.

II. OVERSEAS DISTRIBUTOR AGREEMENTS

A. *Aspects of the Relationship*

Distributor agreements are, of course, exceedingly widely used in the international sphere.⁹ This is a classic way for the manufacturer to enter the export market, hopefully through carefully selected and reliable distributors who will push the product successfully in the right foreign market. The setting up of a distribution network can aid in the marketing of products all the way from those which are simply bought and used or consumed without change, to those which have a variety of technical installation, servicing or adaptation problems.

The distribution network may be used in a variety of ways. Moreover it is rather common for a U.S. manufacturer to go into direct manufacturing and sales in certain foreign areas where the market warrants it and the product can justify the investment, and still maintain sales through distributors in other areas. The clear advantage of using a distributor is to gain access to a foreign market through a foreign seller who is familiar with the language and the industry and selling patterns in the foreign area. The manufacturer typically invests little or no capital in the foreign area and he may not have to retain extensive and expensive language and other foreign area skills on his own staff. As a result, of course, he shares a good deal of his profit with the foreign seller.¹⁰

⁷ Drachler, *Parent Control of Subsidiary*, in 1 *DOING BUSINESS ABROAD* 228 (H. Landau ed. 1962); Weidenbruch, *Planning for Business Operations Involving Related Taxpayers: Foreign Aspects*, N.Y.U. 25TH INST. ON FED. TAX. 379 (H. Sellin ed. 1967); Tillinghast, *The Application of Section 482 to International Operations: Inter-Company Pricing Problems*, N.Y.U. 24TH INST. ON FED. TAX. 1433 (H. Sellin ed. 1966).

⁸ See generally Eckstrom, *supra* note 3, and material cited in 2 *DOING BUSINESS ABROAD*, *supra* note 2; compare agreement forms X & XII, Foreign Operations Service, Inc., Contracts and Agreements II (mimeo. Essex, Conn.), and form 9, *id.* III.

⁹ A good practical analysis is found in P. MACDONALD, *PRACTICAL EXPORTING AND IMPORTING* 61-69 (2d ed. 1959). An excellent discussion of various legal aspects is found in Meek, *Overseas Distributorship Agreements*, 21 *BUS. LAW* 661 (1966). Problems in lining up distribution and possible use of a Combination Export Manager are treated in U. Ammann, *Doing Business in the European Common Market*, Oct. 1, 1963 (unpublished thesis in University of Denver Library), at 59-62.

¹⁰ Moon, *Administrative and Legal Controls: How and Who?*, in *SYMPOSIUM, PRIVATE INVESTORS ABROAD — STRUCTURES AND SAFEGUARDS* 1, 4 (Southwestern Legal Foundation 1966).

As has been pointed out, the distributor relationship at its best is one that provides incentives to both manufacturer and distributor.¹¹ The rewards to the distributor must be sufficiently great to induce him to invest the time and expense necessary to obtain substantial sales. And the arrangement must provide enough return to the manufacturer to warrant the maintenance of inventories with locally adapted specifications, and to provide sales and service materials and supplies adequately to back up his product in the foreign target area.

However, the commencement of any distributor relationship is necessarily somewhat experimental. Therefore the distributor agreement will usually provide an inexpensive exit for either side if the expectations are not achieved.¹² This will be particularly important for the manufacturer who must be able to switch from an unsatisfactory performance by a distributor to a better one in order to maintain sales revenues sufficient to justify his capital investment at home.

Variations in the distributor pattern are (1) sales to the foreign distributor f.o.b. manufacturer's location or a U.S. port, with no overseas establishment by the manufacturer; (2) employment for a foreign country or area of a manufacturer's "factory" representative, whose duty it will be to establish and assist authorized distributors and be relatively near at hand when problems or special requirements arise; and (3) establishment of a bonded warehouse or assembly or manufacturing establishment overseas from which deliveries are made as required by the distributors. Important legal considerations in these arrangements will be considered hereafter without purporting to give an exhaustive or complete comment on all aspects of the relationship.

B. *Formality*

Distributor agreements assume a wide variety of forms. As businessmen and lawyers know, they are frequently extremely simple, being not much more than appointment by the manufacturer of a given firm to a distributorship. However the simplicity of these less formal arrangements is deceptive. When a legal problem arises, it will usually be found that much of the actual distribution agreement, for legal purposes, is contained in the flow of special instructions, circulars, sales policy, correspondence and other communications going back and forth between the manufacturer and the distributor. Indeed, it is common for the manufacturer to find that his factory representative abroad, or his sales director at home,

¹¹ *Id.*

¹² "Trial" periods are also employed. P. MACDONALD, *supra* note 9, at 63.

has created by these communications a legal arrangement of which he has little knowledge.

As an appendix to this paper, the reader will find a form of distributor agreement intended to be something of a guide and to illustrate certain of the points raised. As with all forms, no claim can be made that this form is adequate for all situations.¹³ Distributor agreements frequently represent the result of a compromise between the desire of the client to have a very simple formal arrangement and the wish of his lawyer to have the arrangement spelled out in some detail. This is of course the case with many legal agreements, but it occurs particularly with distributor agreements because a great deal of business custom and usage is known and assumed in the distributor relationship.

The writer does not suggest the client should be saddled with an unnecessarily complex agreement. However, he does recommend a formal agreement and one that is somewhat more detailed than often found in practice. It is submitted that this will be an advantage to the manufacturer in the long run for a variety of reasons. One advantage is that the written agreement gives an ideal opportunity to explain the expected relationship to both parties. This is particularly useful in the transnational setting because the assumptions on either side concerning the distributorship may be quite different. It is commonplace that the chief problem in foreign trade is clear communication. Spelling out what is expected of the parties allows questions to come up at an early stage before erroneous assumptions are acted upon. Further, there is no escape from the conclusion that the distributor relationship will consist of a series of legal rights and duties regardless of whether these are set forth in a written agreement. If a rather formal agreement is not used, these rights and duties, as mentioned above, may be built up in the various communications that flow between the parties. The businessman will find it far easier, clearer and cheaper to turn to a written agreement when a problem arises than to puzzle through years of correspondence to find his answer.

To take the simple case of termination, it is a great deal easier to look at a specific termination clause in an agreement than to dig back into the client's files and examine correspondence setting up the distributorship in the hope the parties said something reasonably clear about rights to terminate and results of termination. Trying

¹³ Other forms may be found in Foreign Operations Service, Inc., *Contracts and Agreements II* (mimeo. Essex, Conn.), e.g. form XI(A), and Hess, *A Mid-Continent Lawyer's Initial Approach to Foreign Trade*, Counseling Mid-Continent Clients Who Trade Abroad 1, 18 (U. Mo. Int'l Law & Foreign Trade Div., Symposium 1965). A good checklist for the distributor agreement is found in P. MACDONALD, *supra* note 9, at 65-69.

to determine what a so-called "informal" agreement really provides can be very expensive in lawyer's time and court or arbitrator determinations, and the results still may be unclear and unsatisfactory.

Both the supplier and the distributor will experience turnover of personnel from time to time. There is a distinct advantage in having written agreements which new people can review to see what is expected instead of relying largely on oral, and possibly erroneous, training of new people.

If a matter comes to arbitration or court controversy, the arbitrator or judge will be much more likely to give effect to clear, written agreements in order to carry out the intention of the parties. In the absence of clarity of the arrangement, he will be much more likely to fall back on general principles of law which more likely than not will favor the distributor.¹⁴

The use of a formal, rather detailed agreement also helps the supplier to establish consistent arrangements from one distributor to another and from one country to another, which is most desirable in setting up a simple and effective network.¹⁵ Naturally, the agreements must vary from country to country and from situation to situation, but using a formal agreement will encourage the use of standard terms to the maximum extent.

The mere fact that one starts from a written form of agreement forces both manufacturer and distributor to think about future possibilities before they arise. In the enthusiasm of setting up a new relationship, the parties are not likely to want to think about termination, arbitration, travel cost and other items unless they are required to.

Required government filings of distributor agreements are on the increase.¹⁶ Having a written agreement in some detail allows clear and expeditious filing without extensive narrative explanation of the relationship. In effect, the greater use of formality allows the parties more latitude in choosing the legal regime of their relationship rather than leaving it to some relatively unknown body of law to establish it for them.

C. *Relationship*

The manufacturer or supplier will normally want to establish a principal-to-principal relationship in dealing with his distributor. He will want to avoid, to the extent legally possible, the creation of a relationship of principal and agent or employer-employee with the distributor. For this reason, something should be said directly about

¹⁴ See generally Meek, *supra* note 9.

¹⁵ *Id.* at 663.

¹⁶ See the discussion of Trade Restraints, *infra*, part II D.

this in the agreement (compare paragraphs 2 and 3 of the form in the Appendix). Moreover, continual buttressing throughout the agreement is needed. Allowing too much control by the supplier and too much dependency of the distributor on the supplier may result in the creation of a dependent relationship regardless of what the parties say the relationship is.¹⁷

In any event, the American lawyer must understand that the relationship created may be governed to a large extent by the law of the country where the distributor is located regardless of the contractual provisions between the parties. A variety of laws may affect the situation and the lawyer should be familiar with these wherever a distributor is established in order to avoid undesirable effects.

Taking Belgium as an example, general law and the agreement between the parties will govern nonexclusive distribution arrangements and exclusive distribution agreements entered into for a definite period of time.¹⁸ However, the Law of July 27, 1961, provides a special regime for exclusive distribution agreements entered into for an indeterminate period of time.¹⁹ Except when one of the parties fails to comply with his obligations, the distributorship can be terminated only by giving the other party a reasonable notice period or a just indemnity. The length of the notice period or the amount of the compensation may be determined by the parties only at the time notice is given. The option between notice and indemnity belongs exclusively to the party who cancels the contract. The notice period must be long enough to permit the other party to find another principal (or another distributor) of the same ability. If the parties fail to agree, the courts will settle the matter in equity. If the notice period granted is deemed by the court not to be sufficient, it will determine the amount of compensation to be paid, taking into account the advantages which would have accrued during a reasonable notice period.

The Belgian law gives further protections to the distributor. If the principal terminates an exclusive contract for reasons other than serious fault on the part of the distributor, or if the distributor terminates by reason of serious fault by the supplier, the distributor can claim a special indemnity (in addition to receiving notice) established under the following criteria: (1) additional clients acquired by the supplier as a result of the distributor's efforts; (2) expenses incurred by the distributor which will benefit the supplier after

¹⁷ See Meek, *supra* note 9, at 665-66.

¹⁸ Law Office, Frank Boas, Esq., *Doing Business in Belgium*, 2 CCH COMM. MKT. REP. ¶ 6438.01 (1967).

¹⁹ *Id.* ¶¶ 6438.01-11.

termination; and (3) amounts which distributor must pay to his personnel whom he is obliged to release as a result of termination.

The Belgian law has very strong statements to the effect that it will apply notwithstanding any agreement to the contrary by the parties, and to the effect that litigation may always be brought before the Belgian courts which will apply Belgian law.²⁰

Generally, in reviewing the applicable local law, the American lawyer would do well to consider the following:

- (1) Are there any special statutes enacted for the protection of distributors in countries where the distributor will operate?
- (2) Does the relationship which is contemplated bring into play any special provisions of the local law regarding commercial agents or other commercial relationships?
- (3) Will provisions of local labor law be deemed to apply to the relationship?²¹

D. Trade Restraints Considerations

Various legal problems will be encountered if the distributor agreement contains any features which may be construed as restricting freedom of trade. This is particularly true with respect to so-called "exclusive" features of the distributorship relation. Here, as in all trade restraint problems, the American lawyer will be confronted with the necessity of considering three bodies of law: (1) United States law bearing on foreign trade arrangements; (2) national law of the country or countries where the distributor is located or operating; and (3) regional law set forth in treaties and other legal materials bearing on trade relations among states parties to a regional arrangement. The leading example here is, of course, the law deriving from the Treaty of Rome²² establishing the European Economic Community.

Reviewing these laws is a formidable task and the problem is not made easier by the fact that United States law affecting foreign trade is difficult to ascertain, in flux, and often confusing. A widely knowledgeable commentator has recently said:

Antitrust laws are another matter. Given the requisite nexus with the foreign or domestic commerce of the United States, in this instance the domestic law applies to the foreign operations

²⁰ See *id.* ¶¶ 6438.09-11, which refer to arts. 4 and 6 of the Belgian Law of July 27, 1961. For special problems of arbitration and comparison of rules for agency agreements, see *id.* ¶¶ 6438.11, 6438.50.

²¹ Meek, *supra* note 9, at 666-73, contains a fine discussion of how to apply this analysis in civil law countries, particularly in the Dominican Republic, Puerto Rico, Cuba, Colombia, Argentina, Brazil, Venezuela, Mexico, Belgium, France, Germany, Italy, the Netherlands, Denmark, Sweden and Switzerland.

²² See 1 CCH COMM. MKT. REP. ¶ 121 (1967) for a profile of the Treaty of Rome which was signed on Mar. 25, 1957, and made effective on Jan. 1, 1958.

of a domestic company, notwithstanding the use of foreign subsidiaries or other insulating devices. But the requisite nexus is often unclear, and there are many problem areas that cry out for analysis and classification. The critical question is not the existence of hard-core horizontal offenses under the Sherman Act such as horizontal price fixing or division of markets, but the legality of vertical distributional and licensing arrangements under the Sherman, Clayton and Federal Trade Commission Acts.

For example, may an exporting manufacturer grant his foreign dealer exclusive trade territories and product lines? May he designate resale customers?

....

Under present law the answers to these questions are at best uncertain and at worst so inconsistent with traditional international commercial practices as to evoke disbelief and even derision on the part of foreign dealers and licensees.

....

If precisely the same standards of antitrust legality apply in foreign as in domestic commerce, the plain truth is therefore that the U.S. exporter or investor is at a serious competitive disadvantage. If different standards apply in foreign commerce the U.S. businessman should be so informed — promptly, authoritatively, and without equivocation.

....

What is needed is a statement of policy from the Department of Justice clearly identifying distributional and licensing practices in foreign commerce in which businessmen may engage without fear of prosecution.²³

Fortunately, the field of trade restraints is one in which a relatively large amount of up-to-date material is available to the American lawyer.²⁴ Frequently the foreign, national and regional law is clearer than that of the United States, and it is more common to allow for advance administrative clearance of a proposed practice.²⁵ It may generally be said that the tendency is toward more rules governing trade and enlarging the area of free competition as the years go by. It is not possible within the scope of this article to analyze antitrust or restraint of trade legislation in a large number of jurisdictions. No is it possible to treat the U.S. rules fully.²⁶

²³ Murphy, *supra* note 1, at 45-47 (footnotes omitted).

²⁴ For example, detailed European Economic Community materials are kept up to date in *CCH Common Market Reporter* and special reports published in connection therewith; national and regional laws are published and supplemented in *Guide to Legislation on Restrictive Business Practices — Europe and North America* (Organization for Economic Cooperation and Development, Paris, last supplemented in April, 1967); both U.S. and foreign developments are reported in *Antitrust and Trade Regulation Report* (Bureau of National Affairs, Washington); and a wide range of subjects is covered in the volumes of the *American Bar Association Section of Antitrust Law and The Antitrust Bulletin* (Federal Legal Publications, Inc., New York.)

²⁵ Compare procedures under the German Act Against Restraints of Competition of July 27, 1957, set forth in II ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, GUIDE TO LEGISLATION ON RESTRICTIVE BUSINESS PRACTICES — EUROPE AND NORTH AMERICA, Germany 2.0, at 1-21 (June 1966).

²⁶ A brief summary is contained in A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS, *supra* note 1, at 631, and an extensive bibliography is found, *id.* at 673-92. See also Timberg, *Foreign Distribution Arrangements and the Sherman Act*, 1 ANTITRUST BULL. 80-86 (1955); 1 TRADE REG. REP. ¶ 2800 *et. seq.* (1965).

However, comment should be made on a recent development in the Common Market having great significance to distributor networks in that area.

Common Market authorities, economists, lawyers and businessmen have been addressing a great deal of attention to "exclusive distributorships" in the past several years in their effort to develop a truly common market for Europe. At the outset, it should be observed that the term "exclusive distributorship" is frequently employed as if it had a common, accepted and specific meaning. This is far from the case. The EEC work particularly has shown there are many "exclusive" features of an arrangement, and distributor agreements may have some, all, none or many combinations of these features. The most common "exclusive" features are

- (1) The appointment of a firm as the sole dealer for the manufacturer's product or products in a certain area or market. This is frequently accompanied by the right of the dealer to advertise this fact and to identify itself as a carrier of manufacturer's goods.
- (2) The obligation of the dealer not to sell goods competing with those of manufacturer.
- (3) The undertaking by the dealer of a promotion and sales program. This may be limited to a certain area or language and may contain minimum required actions and expenditures, usually with aid of various kinds by the manufacturer.
- (4) The obligation of the dealer to service and repair the goods, to replace defective goods or parts, and to carry specified minimum stocks and to offer specified services to customers.
- (5) The obligation of the manufacturer to prevent all imports of his goods from other areas, by agreements with other dealers and other devices.
- (6) The obligation of the dealer not to sell outside a certain area, and to refer inquiries and orders from outside its territory to the appointed dealers in the areas from which they come.
- (7) Freedom for a dealer to sell outside a specified territory, but the obligation to split his profits or commissions with the appointed dealers in the areas affected.
- (8) The obligation of the manufacturer to offer new products through the previously appointed distributor, or the obligation of the dealer to handle new products.
- (9) The obligation of the dealer to take various actions in its area to protect the name, trademarks, patents, licenses and

other property of the manufacturer; similar obligations on the manufacturer to protect and promote dealer's position.

- (10) Variations of these arrangements: a manufacturer may appoint a dealer for a territory or a market, but reserve the right to sell directly to certain customers or industries within the market.

The use of some of these devices has of course come under question or prohibition under the broad protection of competition rules of the Treaty of Rome.²⁷ Dealers in the Common Market know that certain trade arrangements and practices are prohibited, certain ones are allowed if notice is given to the EEC Commission, and certain ones may be allowed by specific exemption if an application for exemption demonstrates benefits to trade that outweigh anti-competitive features.²⁸

Some important EEC and national court and EEC Commission struggles over distributorships having been disposed of, the Commission issued in March 1967 its Regulation No. 67/67²⁹ exempting a large group of bilateral exclusive dealer agreements from the antitrust prohibitions of the Rome Treaty. Some 30,000 agreements which have been notified to the Commission under its regulations are expected to be exempted by this group decision. Agreements in existence on March 13, 1962, and notified before February 1, 1963, will be exempt if modified to conform to the new regulations before August 2, 1967, as long as the Commission was notified of the changes before October 3, 1967.³⁰ Exemption under the new regulation will be good until December 31, 1972.³¹ Future agreements meeting the requirements of the regulation need not be notified to the Commission.

The American lawyer who is accustomed to groping through court developments in this field in the U.S. may find this regulatory "blueprint" by the Commission a great help. The Commission generally recognizes that exclusive dealing agreements in international trade may result in improvement in distribution of goods because a firm can concentrate its selling activities and not be obliged to maintain business ties with too large a number of dealers. In this

²⁷ Treaty of Rome, arts. 85 and 86, 1 CCH COMM. MKT. REP. ¶¶ 2005, 2101 (1967).

²⁸ The law and literature on these subjects is extensive. See generally 1 CCH COMM. MKT. REP. ¶ 2000 (1967); Deringer, *Exclusive Agency Agreements with Territorial Protection under the EEC Antitrust Laws*, 10 ANTITRUST BULL. 599 (1965); Deringer, *Problems of Distribution Within the Common Market*, 10 ANTITRUST BULL. 105 (1965); Stanton & DeCroy, *Much Ado About Restrictive Business Practices in Europe*, 21 BUS. LAW. 891 (1966); Newes, *Exclusive Distributorship Agreements in the Common Market*, 22 BUS. LAW. 533 (1967).

²⁹ Official Journal No. 13, Feb. 21, 1962, at 204. English translation at 1 CCH COMM. MKT. REP. ¶ 2727 (1967).

³⁰ Art. 5, Regulation No. 67/67, 1 CCH COMM. MKT. REP. ¶ 2727E (1967).

³¹ Art. 1, *id.* ¶ 2727A.

way businessmen may better overcome difficulties resulting from linguistic, legal and other differences in markets. Furthermore greater sales promotion may be expected in these arrangements, more exploitation of the market, and a better flow of goods. The Commission recognizes that designation of exclusive dealers is often the only way small and medium-size firms can enter the market as competitors.³²

The new regulation is fairly specific. It applies generally to agreements in which only two enterprises take part and in which one agrees to deliver products only to the other for resale within a specified area of the Common Market or where one agrees to purchase for resale products only from the other.³³ Certain restrictions on competition are authorized to be imposed on the distributor. These include (1) the obligation not to manufacture or distribute, during the life of the agreement or for one year after, products competing with the products under contract; and (2) an obligation not to advertise the products, establish a branch or maintain a distribution warehouse outside of a specified territory. (3) It will be permissible to obligate the distributor to purchase complete lines, or minimum quantities, to require selling with certain packaging or trademarks, and the distributor may be obligated to undertake certain sales promotion measures, including maintenance of inventory, assumption of responsibility for customer services and guarantees, and employment of personnel having specialized or technical training.³⁴

The possibility of parallel imports must be maintained. Therefore, it will specifically *not* be possible to take measures or use industrial property rights to prevent other dealers or consumers from obtaining the products from other sources in the Common Market or from selling them in the specified territory. Also, a reservation is made to the effect that some agreements, although qualifying on paper for the group exemption, may have effects that are incompatible with the Treaty requirements. In such cases, the Commission may engage in ordinary cartel procedures and withdraw the exemption, especially where there is reason to believe the goods are not competing with similar goods in the territory, that other manufacturers do not have access to the trading level of the exclusive dealer, or that the exclusive dealer is making improper use of the exemption.³⁵

The result of the Common Market developments has been to make it completely clear that the antitrust provisions of the Rome

³² Preamble, *id.* ¶ 2727.

³³ Art. 1, *id.* ¶ 2727A, with certain further provisions.

³⁴ Art. 2, *id.* ¶ 2727B.

³⁵ Arts. 3 & 6, *id.* ¶¶ 2727C, 2727F. Background comment on the drafting of Regulation No. 67/67 is found in BUSINESS EUROPE, Apr. 12, 1967, at 113 (Business Int'l S.A., Geneva); EUROPEAN COMMUNITY, Apr.-May 1967, at 22 (European Comm. Information Service No. 102, Washington).

Treaty apply to vertical agreements. Furthermore, the escape provisions of Article 85(3) are going to be rather strictly construed. Thus, a showing that there is a production or distribution advantage to the manufacturer or distributor involved is not going to be enough to gain specific exemption. Manufacturers dealing in the Common Market will have to take careful note of these developments in establishing or modifying their distribution arrangements.

E. *Export Controls*

Exporting manufacturers should be aware of severe limitations under U.S. law on certain exports, primarily in the areas of goods having military and important economic significance.³⁶ The chief laws involved are the Trading with the Enemy Act,³⁷ the Export Control Act of 1949³⁸ and the Mutual Security Act.³⁹ Detailed regulations have been issued under the various statutes, and the exporter finds he may be dealing with the Commerce Department, the Department of State and other U.S. agencies.

Normally an exporting manufacturer will arrange for the licenses and other procedures necessary and his distributor will not be involved. However, there are at least two problem areas. First, if the manufacturer believes there is any danger of future government controls not now present, or if he anticipates any delays or prohibitions in shipping his products, he should be certain to include an appropriate *force majeure* clause in his agreement. Second, is there any duty on the exporter to investigate or try to control resale of his products overseas? There certainly is no perfect answer but it is likely many companies follow the practice described by one commentator:

Generally, the rule is that the American company should exercise reasonable care to determine whether or not the exported U.S. products are intended for use in the prohibited countries. It is not, however, necessary that the American company affirmatively investigate the subsequent use or disposal of goods or materials sold to an unrelated Distributor who purchases for his own account.⁴⁰

F. *Disputes and Governing Language and Law*

If disputes arise which are so serious that they cannot be worked out between the parties through discussion or correspondence, then

³⁶ The laws and regulations are discussed generally in Meek, *supra* note 9, at 662-63. Analogous problems of a licensor are discussed in detail by Hannon, *Government Regulation of Exportation of Technical Data Under Foreign License Agreements*, 20 BUS. LAW. 51 (1964).

³⁷ 40 Stat. 411 (1917), *as amended*, 50 U.S.C. App. §§ 1-6, 7-39 (1959), *as amended* and supplemented by the Foreign Assets Control Regulation and the Transaction Control Regulations.

³⁸ 63 Stat. 7 (1949), *as amended*, 50 U.S.C. App. §§ 2021-32 (1959), *as amended*, (Supp. V, 1964).

³⁹ 22 U.S.C. § 1934 (1964).

⁴⁰ Meek, *supra* note 9, at 663.

the arrangement is probably at an end. In this case, most manufacturers and distributors will want dispute settling machinery which is quick in action and simple and inexpensive in procedure. For one thing, most disputes will concern relatively minor matters: commissions due on sales by others in the distributor's territory; the proper calculation of termination payments; return or allowances on defective shipments. Even if the dispute is serious, it may primarily involve questions of fairness and compensation computation.

These considerations suggest the use of arbitration. Many will prefer this rather than recourse to the courts.⁴¹ Manufacturers particularly may fear the local courts will favor the distributor. If arbitration is to be employed, it should be provided for in the agreement (see, for example, paragraph 15 of the form in the Appendix to this paper). In designating arbitration as a dispute settling mechanism, it is well as a minimum to specify where it is to take place and the rules governing the arbitrators. The drafter may wish to go further and specify a mechanism for the parties to select arbitrators, maximum times for submission and award, and provisions governing the division of the costs of arbitration.

It is most desirable for many purposes, including disputes, to specify the official language of the text of the agreement. Even though the text of only one language is used in the signed agreement, the existence of translations for various purposes may lead to confusion and dispute over the authoritative version. It is very easy for different language versions of the agreement and its amendments to have widely varying meanings and interpretations.

Another factor favoring arbitration is the multitude of laws and legal systems which may have a bearing on the agreement, as various sections of this article have sought to demonstrate.⁴² Analysis of these laws and their use and proof in court may be quite difficult and expensive. Therefore, it is most desirable to have choice of law provisions included in the agreement.⁴³ This remains true even when arbitration is specified, since it will give the arbitrators a specific legal reference. And it may prove useful should one party refuse to arbitrate, or refuse to honor an award when rendered.

U.S. manufacturers are somewhat prone to specify the law of one of the American states as the governing law. This has some advantages. For example, the U.S. state law may be easier for the U.S. supplier to ascertain and quote when arguing its position, and it may be somewhat more favorable to freedom of contract, and

⁴¹ See generally Burstein, *Arbitration of International Commercial Disputes*, 6 B.C. IND. & COM. L. REV. 569 (1965), and authorities cited therein.

⁴² See *id.* at 570-71.

⁴³ See Professor Peterson's treatment of this subject elsewhere in this symposium.

thus support the protection of the U.S. supplier. Also, the U.S. party or lawyer may feel more comfortable in attempting to have his home law apply.

These advantages may be more theoretical than actual. In matters touching public policy and the protection of the distributor, a foreign court is very likely to apply local law regardless of the contract language.⁴⁴ Moreover, if a dispute actually comes to a court trial and U.S. law is applied, it can prove extremely costly to ascertain the U.S. law on the subject and set it forth in the manner necessary for use in the foreign court. This is particularly true in Rocky Mountain States where the applicable law is often unsettled. Therefore, it may be more practical to specify as governing law the law of the area in which a dispute is most likely to arise and be argued. In any event, it is clearly desirable to be aware of the essential features of the foreign law, and be prepared to meet them or contract out of them, regardless of the choice of law provision.

G. *Payments*

The drafting lawyer and his client will wish to provide mutually acceptable payment procedures and terms and at least the basic outline of shipping arrangements. These provisions will include credit terms which will vary widely with the goods involved and the standing of the distributor. Normally, but not always, the distributor will make all of its own arrangements for credit terms to its customers.

In preparing these provisions, thought should be given to the currency or currencies in which payment is to be made. Currency restrictions in the target country may dictate these terms. On the other hand, foreign currency remittances may be possible but the agreement may have to require the distributor to obtain necessary permits. Where inflation is a factor, or devaluation is expected or feared, the manufacturer will usually want payment in U.S. currency if this is possible to obtain. Where long-term credits are used, serious loss may result from failure to provide for payments in U.S. or other "hard" currency, or payments geared to a standard expected to be stable. The usual device in the latter case is to require payment in foreign currency equivalent to a specified amount of U.S. dollars calculated at the time of payment.⁴⁵

H. *Termination*

Even the best of relationships may come to an end. Distributor performance may become unsatisfactory or even deteriorate to the point where it is damaging to the manufacturer. The manufacturer

⁴⁴ Compare the Belgian requirements discussed at note 20 *supra*.

⁴⁵ Exchange problems and additional protective devices are discussed in P. MACDONALD, *supra* note 9, at 421-32.

may wish to terminate an exclusive appointment and appoint competing distributors, or create smaller territories or markets where volume has increased. It may even wish to engage in direct sales, or switch to a more promising distributor. There may be pricing or servicing problems; the distributor in turn may wish to switch to competing products with greater profit potential. These and other factors may bring a distributorship to an end, and the reasons for termination may have a definite effect on the legal ramifications of the termination.

In trading relationships there has been a tendency for the stronger, better financed manufacturers to insist on broad freedom to terminate a distributor, with or without specific cause, and with no particular compensation or protection for the distributor. This practice has been tempered by concepts of fairness, the desire of the manufacturer for a good reputation, and the ability of effective distributors to bargain for contractual protection. Now it is increasingly the case that local law will give some protections to distributors for abrupt, unfair or "abusive" terminations.⁴⁶

This development is not surprising. The distributor is enabling the manufacturer to enter the foreign market, and a firstclass distributor will have taken some or all of these measures: (1) deciding to sell a particular manufacturer's goods to the exclusion of competing lines which might return profit; (2) advertising and promoting the goods and name of the manufacturer; (3) building customer relations by expense and effort; servicing the goods supplied and solving customer problems; and (4) maintaining an inventory of goods, investing capital in warehouse and office, building a staff of salesmen and technicians.

The longer the distributor relationship continues, the greater may be the investment in effort and money by the distributor, and the greater its resistance to sudden termination of what it may consider a satisfactory line. In considering termination, three principles seem paramount:

- (1) The agreement should have a definite termination provision. Termination should not be faced without advance agreement on how it is to be handled.
- (2) Consideration should be given to the kind of commitment each side will be giving to the relationship, and a termination provision should be drafted that will give a fair opportunity for reduction or liquidation of that commitment.

⁴⁶ For Common Market developments see Blondeel, *supra* note 1, at 15-17; these and other developments are discussed in Meek, *supra* note 9, at 664-71; cf. Pavia, *Methods of Operation in Italy*, 6 B.C. IND. & COM. L. REV. 501 (1965). For termination aspects of dependent and independent agents in Germany, see 2 CCH COMM. MKT. REP. ¶ 6640 (1966).

- (3) Special protective provisions of local law should be known and provided for in the agreement to the extent legally possible.

The form in the Appendix provides, in paragraph 11, a simple example of termination with certain notice provisions and arrangements for inventory disposition. Notice itself is a great protection, giving each side time to make other commercial and employee arrangements, and to use up stocks and selling materials.

As shown in the discussion of Belgian law in this paper,⁴⁷ a termination provision of the kind in the Appendix may not be sufficient under the applicable foreign law. An indemnity may be necessary to compensate a terminated distributor for his investment. For example, in France there are extensive protections for commercial terminations, and the French courts have extended some of these protections to distributors in instances where the manufacturer terminated with malice or with results deemed to be inequitable.⁴⁸

In short, some of the care employed in investigating and establishing a mutually advantageous relationship should be used to prepare, in advance, the machinery for a graceful exit, and careful consideration of the distributor's real problems should be given when it becomes necessary to make that exit.

⁴⁷ See note 19 *supra*.

⁴⁸ Blondeel, *supra* note 1, at 15-16.

APPENDIX
DISTRIBUTOR AGREEMENT

THIS AGREEMENT, made in Junction City, Colorado, U.S.A. as of _____, 19____, between TECHNO MANUFACTURERS, INC., a corporation organized under the laws of the State of Colorado, U.S.A., (called "Manufacturer") and IMPO & SONS, a _____ (called "Distributor"), organized under the laws of _____

WITNESSETH:

WHEREAS, Manufacturer has developed and manufactures certain industrial products catalogued in Manufacturer's literature, together with certain service equipment (all called the "Techno Products"); and

WHEREAS, Distributor wishes to act as a distributor of the entire line of Techno Products with respect to the territory described in paragraph 1;

NOW, THEREFORE, in consideration of the undertakings and covenants set forth in this Agreement, Manufacturer and Distributor agree as follows:

1. Appointment of Distributor and Territory.

Manufacturer appoints Distributor a distributor of Techno Products with primary marketing responsibility for the following territory (called "the Territory"):

2. Distributor Relationship.

The purpose of this appointment is to provide for the development and maintenance in the Territory of a substantial volume of sales of Techno Products and adequate service of the Products in the mutual interests of Manufacturer and Distributor. Manufacturer will sell to Distributor and Distributor will purchase from Manufacturer Techno Products to be resold by Distributor. Distributor accepts its appointment and undertakes diligently to canvass for purchasers of Techno Products and in all reasonable and proper ways vigorously to promote the sale of Techno Products in the Territory. Distributor will maintain adequate sales, service and warehouse facilities in the Territory and a representative and adequate inventory of Techno Products.

3. Distributor Not Manufacturer's Agent.

This Agreement shall not constitute Distributor the agent or legal representative of Manufacturer for any purpose whatsoever, nor shall Distributor hold itself out as such. This Agreement creates no relationship of joint adventurers, partners, associates or principal and agent between the parties, and both parties are acting as principals. Distributor is granted no right or authority to assume or create any obligation or responsibility for or on behalf of Manufacturer or otherwise to bind Manufacturer or to use Manufacturer's name other than as may be expressly authorized by Manufacturer. Distributor shall bear all of its own expenses for its operation and staff, except for such items as Manufacturer shall by prior written agreement undertake to pay.

4. Manufacturer's Sales Policy.

Distributor shall carry out Manufacturer's sales policy with respect to the Territory and Techno Products as set forth in the written Sales Policy of Manufacturer as supplied to Distributor, and as may from time to time be communicated to Distributor in written additions to or revisions of such Sales Policy.

5. Shipment and Delivery.

Manufacturer shall in good faith supply requirements of Distributor for Techno Products and make shipments promptly in accordance with Distributor's orders. Whenever Manufacturer shall deliver to a common carrier any Techno Products ordered by Distributor, Manufacturer shall not be responsible for any delays or damages in shipment. Distributor may specify the routing as well as consignees for shipments ordered, but in all cases billings shall be directed to Distributor by Manufacturer.

6. Failure to Ship for Reasons Beyond Manufacturer's Control.

If Manufacturer shall fail for reasons beyond its control to make shipments of any orders, such orders shall be subject to cancellation at the discretion of Distributor unless shipment is commenced within 30 days from the date called for in the order.

7. Payment.

Distributor shall purchase Techno Products from Manufacturer F.O.B. its plant at Junction City, Colorado, at such United States dollar prices as are scheduled in Manufacturer's export price list, payable in United States currency and upon terms of payment net 30 days from date of invoice with a _____% distributorship discount from list price.

8. Warranty, Servicing and Returns.

Manufacturer's warranty of Techno Products is set forth in its Sales Policy, and Distributor shall handle warranty problems, returns, obsolescence and servicing in accordance with such policy. Manufacturer shall bear once each year the out-of-pocket cost (but not salary) for one Distributor representative to attend a three week training school in Colorado for instruction in Techno Products servicing.

9. Selling Aids and Advertising.

9.1 Manufacturer shall supply to Distributor without cost reasonable quantities of Manufacturer's selling literature and displays, and other sales aids and devices as may be designed and made available by Manufacturer from time to time. Distributor shall at its own expense employ such items and participate in such trade and industry meetings and shows in the Territory as in its judgment will enhance the sale of Techno Products.

9.2 Distributor shall cause Techno Products to be advertised in suitable media in the Territory with due regard to its appeal to industry. Manufacturer shall furnish to Distributor at no expense to Distributor samples of advertising materials used in other territories, with the right to use the same, but Distributor shall not be bound by these and may in its discretion adopt such advertising methods and displays as its believes most effective for the market in the Territory. Upon advance approval of copy and media, Manufacturer will contribute up to \$_____ per annum for Distributor's advertising budget for Techno Products, provided that Distributor's total annual advertising budget for Techno Products shall be at least three times the amount contributed by Manufacturer.

10. Inquiries and Information.

10.1 Manufacturer shall forward to Distributor for its handling all inquiries and orders received by Manufacturer from the Territory, both from correspondence and personal visits in the Territory, along with copies of any acknowledgments Manufacturer may have made, and Manufacturer shall make available to Distributor such sales, product and technical information as may be useful to Distributor in handling the inquiry or order. Distributor will supply Manufacturer with information as to the disposition of all referred inquiries or orders.

10.2 On request by Distributor, Manufacturer will render such sales, product and technical information, and estimates and specifications, as shall be helpful to Distributor in promoting the sale of Techno Products. At least once each year Manufacturer shall have its representative call upon Distributor and supply any information needed concerning the use, application or development of Techno Products. Distributor shall forward reports of significant sales and technical information gained in the Territory concerning the use and development of present Techno Products and possibilities for new developments in the industry.

11. Term of Agreement; Disposition of Inventory.

11.1 The term of this Agreement shall be for three (3) years from the date hereof, but the Agreement may be terminated at any time during such period by either party without cause upon the expiration of 90 days after

written notice to the other party. The term of the Agreement may be extended for successive periods by the joint written consent of both parties. If there is any such extension, the notice period for termination without cause shall be increased to six months. In the event of a breach of any term or condition of this Agreement by either party, the Agreement may be terminated by the other party upon giving 30 days written notice of such termination. In the event a petition in bankruptcy or similar proceeding shall be filed by or against either party, or if either party shall make an assignment for benefit of creditors, this Agreement may be terminated by the other party on five (5) days written notice.

11.2 In the event Manufacturer terminates this Agreement, it shall purchase or cause to be purchased from Distributor its then inventory of Techno Products which may be in unopened factory packing, and any other items that are resalable as new, provided that such items are listed on Manufacturer's then current export price list, at Distributor's cost less 15%, plus return freight cost. If Distributor shall terminate this Agreement, Manufacturer assumes no responsibility with respect to Techno Products then or thereafter in possession of Distributor, provided however, that Manufacturer will have the right within 30 days after the effective date of such termination to purchase all or any Techno Products in Distributor's possession at Distributor's cost less 15%, plus return freight cost. In the event of any termination, Distributor agrees to return all sales aids and materials in its possession at the direction of Manufacturer who shall bear the freight cost.

12. Notices.

Any notices hereunder shall be in writing and shall be deemed given when properly deposited in the normal mails, airmail postage prepaid, addressed as follows:

To Manufacturer: Techno Manufacturers, Inc.,

Junction City, Colorado,
U.S.A.

To Distributor: Impo & Sons,

13. Waiver of Breach.

The failure of either party to require the performance of any term of this Agreement, or the waiver by either party of any breach of this Agreement, shall not prevent a subsequent enforcement of such term nor be deemed a waiver of any subsequent breach.

14. Amendments.

Any modification or amendment of any provision of this Agreement must be in writing and bear the signatures of the authorized representatives of both parties.

15. Disputes.

Any disputes, controversies or claims between the parties arising out of or relating to this Agreement shall be settled by arbitration in accordance with the rules of the _____ Arbitration Association. This Agreement shall be enforceable and judgment upon any award rendered by the arbitrators may be entered in any court having jurisdiction. Arbitration shall take place in _____, or such other place as the parties may mutually agree.

16. Construction of Agreement; Language.

This Agreement shall be construed and the relations of the parties shall be determined, in accordance with the laws of the State of Colorado; provided, however, that if any provision of the Agreement is in violation of any applicable law, such provision shall to such extent be deemed null and void, and the remainder of the Agreement shall remain in full force and effect. The English language text of this Agreement shall be the authorized text for all purposes.

17. Assignment and Benefits.

Neither this Agreement nor any interest in it shall be assigned directly or indirectly by either party without the prior written consent of the other. Further, upon any substantial change in the ownership or management of either party, such party shall give written notice of the change and the other party may terminate this Agreement after 30 days written notice given not later than 30 days after notice of the change. Subject to the foregoing provisions of this paragraph, this Agreement shall be binding upon and inure to the benefit of the legal representatives, successors and assigns of the parties.

IN WITNESS WHEREOF, the parties have executed this Agreement as of the date first written above.

TECHNO MANUFACTURERS, INC.

By _____
President

IMPO & SONS

By _____
Title:

PATENT PROTECTION IN INTERNATIONAL BUSINESS TRANSACTIONS

BY COOPER H. WAYMAN*

The transfer of technology abroad may require the acquisition of patent rights in foreign countries by American businessmen. Mr. Wayman discusses the contrast between United States patent laws and the laws of several foreign countries in terms of acquisition, duration, and protection of patent rights. He demonstrates the uncertainties inherent in the various systems, pointing out that recent international meetings in Geneva may give rise to a workable international patent system in the future. Until then, Mr. Wayman suggests that arbitration may be a possible solution to the inherent difficulties in the enforcement of patent claims abroad.

INTRODUCTION

NEARLY 100 countries currently have systems for granting patents on inventions, processes or products. There are many variations, the most important of which involve exceptions to patentability for certain types of products. For example, special provisions frequently are applicable to food, medicinal and chemical products. Some countries grant patents both on manufacturing processes and the products themselves. Others grant patents only for processes.¹ An excellent description of the vast differences in patentability is noted in the following statement:

Let us take first a new chemical substance which is not a medicine. A claim for a new process of making the substance can be obtained in all the countries of the group. In addition a product claim can be obtained in Belgium, France and Italy. A product claim can also be obtained in Germany and Luxembourg if the substance is a composition or mixture but not if it is a single chemical compound. However, in the latter case a process claim can be obtained for the use of a known type of process to prepare the product provided that the product is new and has unexpected advantages. This is the so called "analogy process" claim — in form a process claim but relying for patentability on the features of the product rather than the features of the process. To the extent that such a claim is broad and covers alternative processes, it may be almost as good as a product claim in providing protection for the invention.

In Holland a product claim cannot be obtained either for a mixture or a single compound but it is possible to obtain an "analogy" type of process claim for methods of preparing the product,

*Assistant Professor of Chemistry, Colorado School of Mines; B.S., Rutgers, 1951; M.S., University of Pittsburgh, 1954; Ph.D., Michigan State University, 1959; J.D., University of Denver, 1967.

The author originally prepared this paper for the Seminar on International Business Transactions, at the College of Law, spring 1967.

¹Lightman & Lee, *Patent Laws Worldwide*, INT'L COMMERCE, Feb. 22, 1965, at 4.

and in many cases also a process claim for bringing the product in the necessary form for a new use.

Turning now to pharmaceutical products or medicines, the situation is as outlined above except that only process claims, and not product claims even for a composition, can be obtained in Germany and Luxembourg. In Italy not even a process claim can be obtained. In France a product claim can be obtained but only in a special medicament patent (BSM).

The situation in Italy is obviously unfair to nationals of the United States and other countries where pharmaceutical inventions are protected. It puts the Italian manufacturer in a position where, without any research expenditure on his part, he can copy an American pharmaceutical invention and sell the products not only in Italy but also in any other country where the American inventor has been unable to obtain product protection.²

The uncertainty in these rules, at times, may mislead an inventor as to exactly what protection he has. In the pharmaceutical situation, in Italy, an obvious unfair business practice is certain, but permissible by law, notwithstanding a possible patent infringement.

Other important differences in the laws concern the degree of novelty required. In general, an invention is not considered new in a country if it has been known or used before filing of the patent application. Most countries extend this test of novelty to publication, use or exhibition in any country in the world. Others apply this test only to such prior knowledge in their own countries.

Search and examination procedures also vary widely and some countries dispense with examination altogether, except as to matters of form. Fee costs cover a wide range, with renewal fees common to most foreign systems.

U.S. inventors and businessmen can expect to receive national treatment equal to that afforded local citizens in protection of their patent rights in about 90 countries with which the United States has concluded bilateral and multilateral agreements.³ The most important multilateral agreement is that of the International Convention for the Protection of Industrial Property (Paris Union), to which the United States and 64 other signatories adhere. The United States also is a member of the Inter-American Convention of 1910 on Inventions, Patents, Designs and Models, together with 13 Latin American countries. The United States has bilateral agreements in terms of the Treaties of Friendship, Commerce, and Navigation (FCN) with China, France, Germany, Greece, Iran, Ireland, Israel, Japan, Korea, and the Netherlands, although those with France and Iran are not strictly friendly.

² Goldsmith, *Difficulties Facing American Business in Patent Application in Europe*, in *DOING BUSINESS IN THE COMMON MARKET*, CCH COM. MKT. REP., SPEC. REP. 107, 110 (1963).

³ See Lightman & Lee, *supra* note 1.

Most countries specify that a "working" (an actual use) of the patent be achieved in a specified time, otherwise a cancellation is imposed. Some countries require the patentee to license anyone upon request, which amounts to a compulsory licensing arrangement. The Paris Convention indicates a 3-year period after the patent grant before a member country may invoke a compulsory license. Certain bilateral agreements between the United States and Germany, Greece, or Switzerland permit a waiver of the working requirement, if a corresponding U.S. patent is possessed.

The Paris Convention and the Inter-American Convention confer a 12-month "right of priority" period on patent applications. This means that an applicant has 12 months after filing his first patent application in a Convention country to file a corresponding application in any other member country and maintain the priority benefit from the first filing date. Thus, the inventor is protected in these countries from unauthorized filing of the same application during that 12 months, within which publicity will not defeat his application. Some countries such as Korea and the Philippines, although not members of the Convention, have reciprocal agreements with U.S. patent owners for similar priority protection.

The patent term (life of the patent) may range from 5 to 20 years in different countries. Some countries offer an option to the patentee of 5, 10, 15, or 20 years. Latin American countries notably offer what is called "confirmation," "revalidation," and "importation" patents, conferring upon the foreign patentee a term coextensive with his original grant, said grant forming the basis of issue.

Soviet Bloc countries in Eastern Europe issue an inventor's certificate. This certificate vests ownership and exclusive use in the state for which the assignor receives a stipend commensurate with its value to the state.

The U.S. Department of Commerce can render assistance to potential patentees for application abroad, but in all instances it is advisable to seek competent patent counsel to avoid the many vagaries and uncertainties attendant upon the foreign patent laws. This article is concerned with some of the problems encountered by private business enterprises in their attempts to acquire a patent abroad, in the effectuation and enforcement of the patent monopoly once acquired, and the types of problems present when infringement actions are provoked.

I. DOMESTIC AND FOREIGN PATENT SYSTEMS

A. *The United States' Patent System*

The U.S. patent system is quite complex. Only selected sections are presented here to enlighten those unfamiliar with patent law.

Patent laws are sanctioned through the power of the U.S. Constitution,⁴ and specific statutes.⁵ Inventions patentable are covered by a pertinent section stating:

Whosoever invents or discovers any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement thereof, may obtain a patent therefor, subject to the conditions and requirements of this title.⁶

Conditions governing patentability are numerous. The potential patentee must establish novelty or his right to a patent is precluded. The patentee has failed to establish novelty if any of the following are present:

- (1) the invention was known or used by others in the United States or patented or described in a printed publication in the United States or a foreign country prior to the invention of the applicant;
- (2) the invention was patented or described in a printed publication in the United States or a foreign country or in public use or on sale in this country more than one year prior to date of application in the United States;
- (3) the invention was abandoned;
- (4) the invention was first patented by the applicant, his legal representatives, or assignees in a foreign country, with application filed more than 12 months before the application date in the United States;
- (5) the invention was described in a patent already granted;
- (6) the applicant did not himself invent the subject matter disclosed; or
- (7) before applicant's invention thereof the invention was made in this country by another and was not abandoned, suppressed, or cancelled; in instances where priority of invention is uncertain, the examiner will consider not only respective dates of conception and reduction to practice, but also reasonable diligence related to time of conception and last applicant to reduce to practice.⁷

A patent will be granted only if the subject matter is non-obvious.⁸ If the applicant examined the prior art, and it would have been obvious to one with only ordinary skill in the art, that the

⁴ U.S. CONST. art. 1, § 8:

"The Congress shall have power . . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries."

⁵ Patent Act of July 19, 1952, 35 U.S.C. (1964) [hereinafter cited as 35 U.S.C.]

⁶ 35 U.S.C. § 101.

⁷ 35 U.S.C. § 102.

⁸ 35 U.S.C. § 103.

subject matter as a whole would effect invention, then a patent would be denied. The obviousness must be at the time of invention and not thereafter. It is immaterial how the invention was made; a process developed in a series of independent steps (batch process) is just as valid as a continuous process, an integration of steps. If it is obvious to the inventor that a combination of *A* and *B* will yield *C*, and *D* is actually produced, then the invention might be allowed for product *D* but probably not for product *C*.

An applicant domiciled in the United States, but serving abroad on behalf of that country will be accorded treatment identical to that shown any other citizen who conceives of an invention.⁹

Strict statutory conformity is required in patent application.¹⁰ Generally, all applicants must apply in writing to the Commissioner of Patents, U.S. Department of Commerce, Washington, D.C. Each application for a patent must contain a specification,¹¹ a drawing where required,¹² and an oath by the applicant.¹³ The applicant must sign the application and remit the fee as required by law. Each original application, except design cases, must be accompanied by a basic fee of \$65, with additional amounts in some instances dependent upon the form of the claims.¹⁴

The specification is a written description of the invention. It describes the manner and process of making or using the patent in full, clear and concise terms, so as to enable any person skilled in the art to make use of the same in the best mode contemplated by the inventor. The specification contains one or more of the claims with specific reference to exactly what is claimed. Claims may be set forth in dependent or independent form, but, if in dependent form, all those limitations of the claim are read by incorporation by reference into the dependent claim. An element of a claim may be combined with another to express a step or means to carry out a specific function without reciting the structure, material, or acts in support thereof. But the claim is tantamount to the structure, material or acts as described in the specification or their equivalents. Hence, one cannot mention something in a claim that is omitted from the specification.

The Commissioner may construe the subject matter of an application to form the basis of two or more independent and distinct inventions. In such instances, only one patent may be allowed. But any subsequent filing of similar subject matter, referred to as a

⁹ 35 U.S.C. § 104.

¹⁰ The statutory requirements are set forth at 35 U.S.C. § 111.

¹¹ The statutory requirements for a specification are set forth at 35 U.S.C. § 112.

¹² 35 U.S.C. § 113.

¹³ The statutory requirements for the oath are set forth at 35 U.S.C. § 115.

¹⁴ 35 U.S.C. § 41.

divisional application, is filed as if it had the date of the original application in the establishment of priority. If the divisional application pertains directly to the subject matter of the original application, the Commissioner may disallow the second filing. The limitation of the subject matter to one invention, however, in no way invalidates the patent.¹⁵

An interference in patent action may arise, if in the opinion of the Commissioner, an application contains substantially the same subject matter of a pending application or of an unexpired patent.¹⁶ Questions of priority of invention are the dominant concern in interferences. Priority issues are determined by a Board of Patent Interferences comprised of three examiners. A decision of the Board adverse to one applicant constitutes a rejection of his claims and an allowance of claims to the successful applicant. In general, the Patent Office will disallow any claim bearing substantially on the same subject matter of an issued patent unless the claim is made one year prior to the issuance of the patent. Parties to an interference may file an agreement or understanding between themselves prior to the termination of an interference proceeding. These agreements may be kept in a separate file, but available to government agencies, upon request of a party. Filing an agreement after termination of the interference will not abrogate a decision contrary to the agreement unless a showing of good cause is filed within six months subsequent to the termination. Any discretionary action by the Commissioner is reviewable with regard to interference proceedings.

Upon resolving all issues in favor of the applicant, a patent is issued to the patentee, his heirs, or assigns for a term of 17 years.¹⁷ After payment of the necessary fees and issuance of title, the holder has the right to exclude others from making, using or selling the invention throughout the United States. The patent becomes dedicated to the public after the term expires. The government-grantor apparently employs the philosophy that the patentee is entitled to a monopoly for this period in return for fully disclosing his discovery for the benefit of mankind.

Situations may arise whereby a patent is defective. The defect can be cured by a patent reissue, providing the error was not deceptive.¹⁸ Patents are deemed defective, and subject to reissue when the patent is wholly or partly inoperative or invalid by reason of a defective drawing or specification, or by reason of the patentee claiming more or less than that to which he was entitled. Upon

¹⁵ 35 U.S.C. § 121.

¹⁶ 35 U.S.C. § 135.

¹⁷ 35 U.S.C. § 154.

¹⁸ 35 U.S.C. § 251.

reissue of a defective patent, all claims of the new and amended application are valid for the unexpired term of the original patent. No new matter is allowed to be introduced into the application for reissue. The reissued patent will not be granted for enlargement of the scope of the claims of the original patent unless applied for within two years from the date of grant of the original patent.

The holder of the title to Letters Patent of the United States owns personal property. Patents are freely assignable in law by an instrument in writing. The assignment pertains to the patent application or any interest in the patent. The patentee, his assigns, or his legal representatives may grant and convey an exclusive right under the patent for the whole or a specific part of the United States. Any assignment is void as to any subsequent purchaser or mortgagee for valuable consideration, without notice, unless it is recorded in the Patent Office within three months from its date or prior to the date of such subsequent purchase or mortgage.¹⁹ Patents may be held in joint ownership and in the absence of any agreement to the contrary, each of the joint owners of the patent may make, use, or sell the patent without consent of the other owners and without an accounting thereto.²⁰

Patent infringement is appropriately contemplated and protected by rather extensive statutory coverage.²¹ A patent infringer is anyone who makes, uses or sells any patent invention, without authority, in the United States, during the term of the patent. The infringer need not specifically act himself; infringement can easily be found by the inducement of another to do the act. Such inducement is known as contributory infringement.²² A contributory infringer is anyone who sells a component of a patented machine, manufacture, combination or composition, or a material or apparatus for use in practicing a patented process, constituting a material part of the invention, knowing the same to be especially made or especially adapted for use in an infringement of such patent, and not a staple article or commodity of commerce suitable for substantial noninfringing use.²³ The act must constitute a direct or contributory infringement of a valid patent.²⁴ It has been held that unless there is a direct infringement, there is nothing to contribute to, and con-

¹⁹ 35 U.S.C. § 261.

²⁰ 35 U.S.C. § 262.

²¹ 35 U.S.C. § 271.

²² 35 U.S.C. § 271(b).

²³ 35 U.S.C. § 271(c).

²⁴ *Irvin v. Buick Motor Co.*, 88 F. 2d 947 (8th Cir. 1937), *cert. denied*, 301 U.S. 702 (1937). The unauthorized use of an invalid patent is not an infringement. *Hyster Co. v. Hunt Foods, Inc.*, 263 F.2d 130 (7th Cir. 1959); *The Diversey Corp. v. Charles Pfizer & Co.*, 255 F.2d 60 (7th Cir. 1958); *Simmons Co. v. A. Brandwein & Co.*, 250 F.2d 440 (7th Cir. 1957); *Cummings v. Moore*, 202 F.2d 145 (10th Cir. 1953).

sequently, no contributory infringement.²⁵ The legal owner of a patent will not be denied relief for infringement or contributory infringement to his patent nor will he be deemed guilty of misuse or illegal extension of the patent right by virtue of his having done one or more of the following:

- (1) derived revenue from acts which if performed by another without his consent would constitute contributory infringement of the patent;
- (2) licensed or authorized another to perform acts which if performed without his consent would constitute contributory infringement of the patent;
- (3) sought to enforce his patent rights against infringement or contributory infringement.²⁶

Case law is replete with infringement suits and has been epitomized in a number of rather famous cases.²⁷ There is no such thing as an infringement or contributory infringement made in good faith or where the infringer was unaware of the infringement. About the only defenses allowable for contributory infringement are those where the parts furnished by an infringer for use in a patent can be adapted to other lawful uses in addition to the infringing uses, or where the parts furnished are perishable, or used for legitimate purposes of repair, or where the patent is being used to protect an unpatented part or material from competition.²⁸

An infringement of a patent may result upon substitution of similar compounds, steps, or ingredients in a patent, sufficient to invoke the doctrine of equivalents.²⁹ The essence of this doctrine is that one may not perpetrate a fraud on a patent. A patentee may invoke the doctrine to proceed against the producer of a device, if said device performs substantially the same function in substantially the same way to obtain the same result. If two devices do the same thing in substantially the same way, and accomplish substantially the same result, they are the same, even though they differ in name, shape, or form.

A defense to an infringement suit is the so-called "file wrapper estoppel."³⁰ This is a type of estoppel which purports to hold the

²⁵ *Frommberg, Inc. v. Thornhill*, 315 F.2d 407 (5th Cir. 1963); *Angel Research, Inc. v. Photo-Engravers Research*, 223 F. Supp. 673 (N.D. Ill. 1962); *Trico Products Corp. v. Delman Co.*, 199 F. Supp. 231 (S.D. Iowa 1961); *Chicopee Mfg. Corp. v. Columbus Fiber Mills Co.*, 165 F. Supp. 307 (M.D. Ga. 1958).

²⁶ 35 U.S.C. § 271(d).

²⁷ *Heyer v. Duplicator Mfg. Co.*, 263 U.S. 100 (1923); *Peters & Russell, Inc. v. Dorfman*, 188 F.2d 711 (7th Cir. 1951); *Universal Oil Products Co. v. Globe Oil & Refining Co.*, 137 F.2d 3 (7th Cir. 1943), *aff'd*, 322 U.S. 471 (1944); *Laskowitz v. Marie Designer, Inc.*, 119 F. Supp. 541 (S.D. Cal. 1954); *Kraft Foods Co. v. Walther Dairy Products*, 118 F. Supp. 1 (W.D. Wis. 1954).

²⁸ *Freedman v. Friedman*, 242 F.2d 364 (4th Cir. 1957).

²⁹ *Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 339 U.S. 605 (1950).

³⁰ *Lewis v. Avco Mfg. Corp.*, 228 F.2d 919 (7th Cir. 1956); *Keith v. Charles E. Hires Co.*, 116 F.2d 46 (2d Cir. 1940).

patentee to all statements, amendments and rejections in the history of the case file. For example, a patentee cannot draft an amendment narrowing a claim to obtain allowance and later broaden the construction of his narrowed claim to invoke an infringement action.³¹ There is a well known and consistently observed rule of patent construction, stating that a claim in a patent as allowed must be read and interpreted with reference to claims that have been cancelled or rejected, and the claims allowed cannot by construction be read to cover what was eliminated from the patent.³² Once the patentee has agreed to cancellation or narrowing of a claim he cannot resort to the doctrine of equivalents to recoup the loss and invoke infringement. The Supreme Court, in considering the issue of whether the doctrine of file wrapper estoppel supersedes the doctrine of equivalents in *Exhibit Supply Co. v. Ace Patents Corp.*, stated:

Whatever may be the appropriate scope and application of the doctrine of equivalents, where a claim is allowed without a restrictive amendment, it has long been settled that recourse may not be had to that doctrine to recapture claims which the patentee has surrendered by amendment.³³

In order to succeed in an infringement action, the patentee must overcome a number of other defenses available to an alleged infringer.³⁴ In one noteworthy case,³⁵ the defendant claimed the defense of double patenting, in addition to anticipation, indefiniteness in claims, non-invention, and non-infringement. Double patenting arises when the patentee receives two patents for claims that substantially state the same thing in an invention. It is well settled that a patentee may receive two patents for a single disclosure — one for the method and the other for the apparatus, the former often referred to as merely functionality of a machine.³⁶ Double patenting only occurs when claims of two patents issued to one applicant are identical.³⁷ The patentee may then seek a remedy when either of his patents are infringed in double patenting. The defense of different mode of operation is often employed to avoid infringement.³⁸

³¹ *Falkenberg v. Golding*, 195 F.2d 482 (7th Cir. 1952).

³² *Schriber-Schroth Co. v. Cleveland Trust Co.*, 311 U.S. 211 (1940), *amended in* 312 U.S. 654 (1941).

³³ 315 U.S. 126, 136 (1942).

³⁴ *See, e.g., Union Carbide & Carbon Corp. v. Stuart Laboratories, Inc.*, 194 F.2d 823 (3d Cir. 1952) (failure to make full disclosure); *Vitamin Technologists, Inc. v. Wisconsin Alumni Research Foundation*, 146 F.2d 941 (9th Cir. 1944), *cert. denied*, 325 U.S. 876, *rehearing denied*, 326 U.S. 804 (1945) (improper use); *John Waldron Corp. v. Equitable Paper Bag Co.*, 106 F.2d 724 (3d Cir. 1939) (different mode of operation); *General Tire & Rubber Co. v. Fisk Rubber Corp.*, 104 F.2d 740 (6th Cir. 1939) (double patenting); *Waterbury Buckle Co. v. G.E. Prentice Mfg. Co.*, 294 F. 930 (D. Conn. 1923).

³⁵ *General Tire & Rubber Co. v. Fisk Rubber Corp.*, 104 F.2d 740 (6th Cir. 1939). The court disallowed all of these defenses.

³⁶ *Hartford-Empire Co. v. Obear-Nester Glass Co.*, 71 F.2d 539 (8th Cir. 1934).

³⁷ *Scharf v. Weinfeld & Kahn*, 31 F. Supp. 689 (S.D.N.Y. 1940).

³⁸ *See cases cited note 34 supra.*

Thus, if an applicant achieves the same result as found in an issued patent through a different scheme of operation, then non-infringement might be determined. Mr. Justice Day has stated:

If the device of the respondents shows a substantially different mode of operation, even though the result of the operation of the machine remains the same, infringement is avoided.³⁹

The defendant may overcome an infringement suit by the "omission of an element" defense. If two devices perform the same function, but the alleged patent causing infringement contains an element lacking in the prior patent, then there is no infringement. When the accused structure omits an essential element of a patent, without the substitution of an equivalent, operating substantially in the same way to achieve practically the same result, there is no infringement.⁴⁰ The patentee must always make a full disclosure,⁴¹ or the infringer may plead that the patentee filed a description and specification which contained less than the whole truth relative to the invention.⁴² The patentee need only disclose those details to effect invention known to him at the time of application for the patent. The law is quite clear that an addition to a patented process does not avert infringement, even where the addition amounts to an improvement:

A limited use of terms of effect or result, which accurately define the essential qualities of a product to one skilled in the art, may in some instances be permissible and even desirable, but a characteristic essential to novelty may not be distinguished from the old art solely by its tendency to remedy the problems in the art met by the patent.⁴³

Infringement will be found, if the patent is used without authorization, even when the infringer improves the art over and above that disclosed by the patentee. The defense of improper use or anticipation is often cited as a desirable means to obviate an infringement.⁴⁴ In effect, if *A* is practicing a process prior in time to issuance of a patent to *B* for that process, then *A* is not an infringer even though *A* is not aware of the technicalities of that process. There is a well established principle in patent law that if a process is disclosed in a prior art, a patent whose validity is attacked is anticipated even though the prior patent failed to state and the inventor did not know that his invention brought the process into operation. The principle is clearly enunciated in the *Vitamin Technologists, Inc.* case:

We refuse to entertain the absurd proposition that because the farmer and copra grower did not know the photo chemical process involved in their immemorial practice, they may be enjoined as infringers.

³⁹ *Cimiotti Unhairing Co. v. American Fur Ref. Co.*, 198 U.S. 399, 414 (1905).

⁴⁰ *Kay Patents Corp. v. Martin Supply Co.*, 202 F.2d 47 (4th Cir. 1953).

⁴¹ See cases cited note 34 *supra*.

⁴² 35 U.S.C. § 282.

⁴³ *General Electric Co. v. Wabash Appliance Corp.*, 304 U.S. 364, 371-72 (1938).

⁴⁴ See cases cited note 34 *supra*.

Assuming that Dr. Steenbock discovered, as he claims, that the sun's rays coming from millions of miles away could irradiate foods with vitamin D and that this was the reason, unknown to them, why farmers and coconut growers regarded their sun-cured hays and sun-dried copra were good foods, such a discovery does not entitle him to a patent on their processes.⁴⁵

The patentee has his remedy by civil action whenever his valid patent is infringed.⁴⁶ Every patent issued by the United States is presumed to be valid until proven invalid. Each claim in the patent, whether in independent form or dependent form, shall be presumed valid independently of the validity of other claims; dependent claims shall be presumed valid even though dependent upon an invalid claim. The burden of establishing invalidity of a patent or any claim thereof rests on the party asserting it.⁴⁷

Injunctive relief is not uncommon in patent litigation as permitted by statute. Several courts possess concurrent jurisdiction to grant injunctions, in accordance with the principles of equity, to prevent a violation of any patent right.⁴⁸

The successful litigant patentee may be awarded damages adequate to compensate him for the infringement, but in no event shall the award be less than the reasonable royalty due the patentee as a result of the infringer's use, plus interest and court costs. The court may award treble damages in the event damages are found or not found by a jury. In the assessment of damages or in the determination of what constitutes a reasonable royalty, the court may receive expert testimony.⁴⁹ In very exceptional cases the court may also award reasonable attorney's fees to the prevailing party.⁵⁰ The statute of limitations to preclude waiver for infringement suits is six years from the date of filing of the complaint or counterclaim.⁵¹

B. *Contrast of U.S. Patent Laws to Laws of Other Countries*

In some instances the patent laws of other countries are in substantial compliance with U.S. patent laws; in other instances a nuance is observed or there is a marked dissimilarity. The following is an extraction of the patent laws of various countries to demonstrate some differences and similarities.⁵²

In Brazil, a patent is valid for 15 years. Medical and chemical processes are patentable. Compulsory licensing is possible within 2 years after grant, if adequately worked. Revocation, if not worked,

⁴⁵ 146 F.2d at 948. See cases cited note 34 *supra*.

⁴⁶ 35 U.S.C. § 281.

⁴⁷ 35 U.S.C. § 282.

⁴⁸ 35 U.S.C. § 283.

⁴⁹ 35 U.S.C. § 284.

⁵⁰ 35 U.S.C. § 285.

⁵¹ 35 U.S.C. § 286.

⁵² See Lightman & Lee, *supra* note 1, at 5, 6, 9.

is possible within a 3-year period. Importation does not constitute work.

In France patents are valid for 20 years. No novelty examination is required. Special legislation applies to patenting of pharmaceutical products.

German (Federal Republic) patents are valid for 18 years. A novelty examination is required and compulsory licensing may be imposed any time. Patenting in the United States constitutes working in Germany.

A patent in the United Arab Republic is valid for 15 years and renewable for 5 years. No novelty examination is required. Revocation is possible 2 years after the first compulsory license.

United Kingdom inventions are valid for 16 years and renewable for 5 or 10 years where inadequately remunerated. Substances of food or medicine which are mixtures of known ingredients are not patentable. Certain newly-independent members of the British Commonwealth are in the process of developing and promulgating their own national patent codes. In the meantime, they continue to use pre-independence procedures and facilities in providing patent protection within their respective territories. These countries include Cyprus, Ghana, Kenya, Malaysia, Singapore, Sarawak, Nigeria, Sierra Leone and Uganda. Hong Kong conforms to these regulations, but has instituted their own peculiar exceptions. Generally speaking, in these countries the only patent protection available is by means of the registration of a United Kingdom patent which must take place within 3 years of the original British grant.

In Venezuela, invention and improvement patents are valid up to 10 years after the grant; revalidation patents (based on prior foreign filing) are coterminous with the basic patent for 10 years, while introduction patents are granted for 5 years, but do not protect imports. Chemical products are not patentable. Exploitation in Venezuela in lieu of manufacture constitutes working for invention, improvement and revalidation patents. Patent registration must be marked on the product. Though not a member of the Paris Union, Venezuela grants a 1-year priority right on foreign patents.

In India, patent validity extends to 16 years. Prior public knowledge or use in India is prejudicial. Food, medical or chemical products are subject to compulsory licensing at any time regardless of working. Reciprocal priority rights are granted on basis of applications filed in certain Commonwealth countries, but India is not a member of the Paris Union.

The extreme variations in the patent laws of many countries require careful consideration of the inventor or assignee to comply carefully with the laws in order to avoid litigation. In essence, this

demands the acquisition of native counsel, familiar with the patent laws in his country.

II. SELECTION OF PATENT USE

The predicates upon which patent monopolies are granted to natives, in contrast to foreigners, are different. When a patent is granted to a national, the economic assumption derives from the premise that the monopoly is essential to the stimulation of invention and investment. The stimulation afforded by the grant should contribute more to the well-being of the nation than the inherent cost of the monopoly to the grantor. Thus, different products, even competing with each other for the same end use, may tend to encourage competition through the creation of new competitive products. Different motivations are involved in grants to foreigners. A patent grant from a sovereign to a foreigner must be weighed against the factors that might militate against or encourage sociological, political, and economic implications. Specifically, should the granting country allow a patent to a foreigner which stimulates its own industrial growth even though the grantor and grantee may be from not-so-friendly nations? Factors related to these considerations no doubt influence the decision of the grantor. These considerations, coupled with treaties or conventions that might be enforced, are conducive to and exemplify the rationale inducing a country to establish different standards for foreigners and nationals applying for patent protection.

Upon issue of a foreign patent, the patentee may exercise his vested right by various alternatives. It may be satisfactory to manufacture the protected product in his own country, where sufficient facilities and labor force are established, and to export the product to the foreign market where patent protection was acquired. Licensing of the patent right, either exclusively or nonexclusively, is another well-known means of exploitation. Cross-licensing is another alternative, though its effect may be an antitrust interdiction, producing leverage in a foreign market whereby each patentee gains access to the patent rights of each other in his home territory.

A. *Exporting Patentee's Products*

Peculiar patent laws of a country may preclude importation as a working and the patent may become revoked. It seems apparent that public policy is an issue which some laws contemplate. Though products imported may provide commodities essential to the stability of underdeveloped or undersupplied countries, patent laws may tacitly have been effectuated to develop the technological know-how of an underdeveloped country. Therefore, the patent must actually

be worked by physical means in a country to stimulate growth, importation not constituting a working. The patent laws then, may inhere more to development of the national than the foreigner. If the granting country is not underdeveloped, its laws may proscribe imports so as not to dilute the markets of similar products produced by its own citizens.

One reason for disinterest in exportation by Americans is the Webb-Pomerene Act,⁵³ once a protection against the antitrust laws, now of questionable application.⁵⁴ In 1949, *United States v. United States Alkali Export Association* clearly established that international cartels fall within the law.⁵⁵ It is also possible that conspiracy-type behavior by certain export trade associations could easily be reached.⁵⁶ American companies have considered a joint venture with a foreign company as one possible way to obviate the exportation difficulties. In effect, a joint venture serves the purpose of giving a foreigner the status of a quasi-national in the country of interest. Though these types of business nuptials may seem desirable, there are some exceedingly complex problems present.⁵⁷

B. *Licensing Arrangements*

The obvious use of a license to the patentee is the situation wherein the granting country prohibits importation of products or imposes quantitative restrictions. However, licensing to a foreigner is fraught with many potential hazards. The most important consideration is the reliability and trustworthiness of the potential licensee. The licensee must have the financial capability to meet the patentee's royalty requirements. It must be understood that the licensee will not violate any contractual provisions of the license, will limit the use only to the manufacture and sale in a definite area, and will avoid any possible industrial piracy with respect to property. Thus, the licensee should be prohibited from usurping the patentee's good will and know-how, and prevented from sublicensing to others. An excellent summary has been given for the criteria requisite to consideration of a license grant:

In summary, a successful industrial property licensing program calls for a careful business survey of the market in which the licensees will operate and the abilities and prospects of the licensees, a royalty compensation formula based on equity and on the realities of the situation, the taking of maximum precautions for the protection of the licensed industrial property, a careful statement of the nature, scope and duration of the license and of the specific

⁵³ Export Trade Act of 1918, 15 U.S.C. §§ 61-65 (1964).

⁵⁴ Timberg, *Foreign Licensing Programs: Their Planning and Formulation*, 35 U.M.K. C.L. REV. 2 (1967).

⁵⁵ 86 F. Supp. 59 (S.D.N.Y. 1949).

⁵⁶ *United States v. Minnesota Mining & Mfg. Co.*, 92 F. Supp. 947 (D. Mass. 1950).

⁵⁷ See Mr. Ross' treatment of this subject elsewhere in this symposium.

obligations of the licensee and licensor (both as respects the performance and the breach, voluntary or involuntary, of the license agreement), informed and relevant insights into the operation of the national legal system involved in the agreement, and clear but not necessarily over-detailed draftsmanship.⁵⁸

The advantage or disadvantage of a license grant must, by necessity, be predicated upon many factors: the cost advantage, the quantitative restrictions upon imports which may be imposed by tariff laws, the provision in some patent laws that an import is a nonworking, and the worthiness of the licensee.

C. Cross-Licensing Agreements

The express purpose of cross-licensing is that monopoly rights are reshuffled to preclude the rights of one competitor in another's area, notwithstanding the monopoly. Another motivation for this type of licensing is that certain industries may have a monopoly on only a phase of the process or a lack of product patents. The arrangement permits cross-fertilization among the various patentees and is construed as "healthy" in the fostering of competition.

On the other hand the effects have not always been considered to be so benign and constructive. Such agreements have been thought to divide world markets in conflict with the antitrust laws. These undesirable results have been found in a number of product industries, such as acetic acid, activated carbon, alkalis, detergents, aluminum, sulfur, resins, optical goods, radio equipment, rubber and the like. Most cases involve some division of markets within Western Europe: a separation of the German from the French market, the Italian from the German market, or some other compartmentalization. Typically, the British market has been separated from the Continent, and North America from the markets of the Eastern Hemisphere.⁵⁹ This separation, in effect, places an undue burden on the underdeveloped countries because they are subjected to the bargaining power of the limited producers with monopolies.

It is clear that cross-licensing will not be permitted at the expense of division of world-trade. In the *Imperial Chemical Industries* case, the court said:

These agreements, irrespective of their *per se* legality, were instruments designed and intended to accomplish the worldwide allocation of markets; their object was to achieve an unlawful purpose — an illegal restraint of trade prohibited by Section 1 of the Sherman Act. The agreements are unlawful because they provided a means for the accomplishment of this purpose and objective. We have also found that these agreements did, in operation, result in restraints of United States trade.⁶⁰

⁵⁸ See Timberg, *supra* note 54, at 15.

⁵⁹ E. GOLDSTEIN, PATENT, TRADEMARK AND COPYRIGHT LAW 679 (1959).

⁶⁰ United States v. Imperial Chemical Industries, 100 F. Supp. 504, 592 (S.D.N.Y. 1951).

Similarly, territorial allocation and trade suppression was interdicted in the *National Lead* case⁶¹ and the *Carboloy* case.⁶² For a more elaborate discussion of these proscribed acts, the reader is referred elsewhere.⁶³

The opportunities to use a foreign granted patent are not without difficulties. Import-export trade laws may severely limit the use to a per se export attempt and certain types of cross-licensing may place the wrongdoer in the hands of the antitrust laws. The most sacrosanct use, if one as such exists, would be the development of the process or product locally or the use of a simple license.

III. TREATIES AND CONVENTIONS

The international patent system is basically composed of about five different elements: (1) the International Convention for the Protection of Industrial Property (Paris Convention of 1883), (2) the Inter-American Convention of 1910, (3) national patent laws of the sovereign states, (4) international treaties involving patents as subject matter, and (5) those practices which use foreign patents in international trade and investment. Without reservation or qualification, the Paris Convention has had the most pronounced effect on patents in world trade and international development.

A. *The Paris Convention*

The convention was held in Paris in March 1883. The articles were amended and proclaimed⁶⁴ by the United States and 78 other countries in 1931. The Convention reassembled in 1934 and 1957 without significant amendment.

The major achievement of the agreement was the recognition of the principle of reciprocity among the signatories.⁶⁵ A number of

⁶¹ *United States v. National Lead Co.*, 63 F. Supp. 513, 523-24 (S.D.N.Y. 1945).

⁶² *United States v. General Electric Co.*, 80 F. Supp. 989, 1009 (S.D.N.Y. 1948).

⁶³ *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951); see REPORT OF THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS (Mar. 31, 1955).

⁶⁴ 47 Stat. 1789 (1931-1933), T.S. No. 834 (proclaimed Mar. 6, 1931).

⁶⁵ *Id.*:

Article 1. The contracting countries constitute themselves into a union for the protection of industrial property. . . .

Industrial property . . . in the broadest meaning . . . is to be applied not only to industry and commerce . . . but likewise to agricultural industries . . . and extractive industries (minerals, mineral waters, etc.).

The term "patents" includes the various types of industrial patents granted by the laws of the contracting countries such as patents of importation, improvement patents, patents and certificates of addition, etc.

Article 2. Nationals of each of the contracting countries shall, in all other countries of the Union, as regards the protection of industrial property, enjoy the advantages that their respective laws now grant, or may hereafter grant, to their own nationals, without any prejudice of the rights specially provided by the present convention. Consequently they shall have the same protection as the latter, and the same legal remedy against any infringement of their rights, provided they observe the conditions and formalities imposed on subjects or citizens.

other points are worthy of mention.⁶⁶ Any signatory who has filed an application in any signatory country and who is entitled to the Convention's protection has a period of 1 year in which to apply for patent protection in any other convention jurisdiction. In the absence of such a priority provision, the inventor of a process or product in country *A*, having duly made a patent application in his own country, might well find that country *B* is unwilling to consider him entitled to claim a patent in that country. Country *B* might insist, for instance, that the first introducer of the invention into its territory was the eligible patentee, or it might insist that no patent was issuable at all if the invention was already being publicly practiced in country *A*.

The convention even goes further in protecting the patentee's priority. Once a patent is granted on the basis of priority provisions, the subsequent invalidation of the patent by the original granting nation will not of itself affect the validity of patents granted elsewhere on the same invention. The thrust of such an argument would have powerful significance if the granting country rejected the patent on grounds of junior priority or where the subject matter may lack in inventiveness.

Compulsory licensing has also been regulated by the Convention to the extent that the grantors cannot necessarily reward their favorite citizens to stimulate domestic development. Most of the restraint is imposed upon the "working" provisions. This provision prohibits the cancellation of a patent when the action is based simply on the fact that the relevant product had been imported into the jurisdiction. The convention prevents its signatories from taking any steps to compel "working" in the first 3 years after the issue. Also, the convention binds its signatories to resort initially to compulsory licensing at reasonable royalties as a remedy under the "working" provisions or for any other patent abuse under the national's laws, rather than to cancellation of the grant.

The convention confers on the patentee the right to use the foreign patent in international trade and investment. A foreign patentee thus acquires a monopoly in an area far beyond the locus of his operation. The effect of the foreign patent is that the patentee who grants a license for a use is less likely to create direct and immediate competition for his own production than would be the case for patent licenses in his local territory.

The Paris Convention, though 84 years old, has achieved a high degree of satisfaction and workability in world trade, and no doubt

⁶⁶ SUBCOMM. ON PATENTS, TRADEMARKS, AND COPYRIGHTS OF THE SENATE COMM. ON THE JUDICIARY, 85TH CONG., 1ST SESS., THE INTERNATIONAL PATENT SYSTEM AND FOREIGN POLICY 1-4, 6-12 (Comm. Print 1957).

has contributed significantly to the aid of underdeveloped countries.

The Inter-American Convention of 1910 has encouraged the development of international relations between many of the non-signatories in Latin America and the United States along similar guide lines as the Paris Convention.

B. *The Common Market Patent*

Even with benefits of the Paris Convention, the patentee must be confronted with a new application in every country. The design of the common market patent has some desirable characteristics because, if successful, the patentee receives six patents for one, therefore unachievable.

The "Kennedy round" has been regarded by many as a crucial corollary to the Common Market. Formally known as the European Economic Community or EEC, the Common Market was established by the Treaty of Rome in 1957, with France, West Germany, Italy, the Netherlands, Belgium, and Luxembourg as members. The United States speculated that the EEC could become a great vehicle for liberalizing world trade, or it could become an engine of protectionism. To cope with the protectionism doctrine, President Kennedy gave first legislative priority to what became the Trade Expansion Act of 1962. This was a bold, new approach, designed to pierce the Common Market tariff barrier which the EEC nations planned in order to compel concessions by the United States and others. This approach which became known as the Kennedy round, was that, as a customs union, the six countries would progressively lower the tariffs against each other to zero. This would expand trade by promoting greater efficiency, competition and economic rationalization. Expanded trade and more efficient industry would mean increased income. Increased income would produce a larger and more diversified market for American exports. This was the risk the Kennedy round was willing to take to compete with the veil around the six.⁶⁷ Whether or not this will ever come into fruition is not readily predictable. The Common Market patent may remain the mere suggestion it is at present.

The Common Market patent should inure to the benefit of underdeveloped countries. At the present time, Africa and Latin America have a limited supply of educated manpower. Thus, educated people must be employed as teachers, engineers, physicians, and the like. Countries in these areas cannot devote the numbers required to competently man a patent office. Hence, a Common Market of Africa, for example, is a sensible solution, developing

⁶⁷ Porter, *U.S. to Learn EEC Effect Soon*, The Denver Post, May 8, 1967, at 30, col. 4.

the countries by technology and helping that development through patent interchange.

Some of the problems the potential patentee now faces would be avoided by the Common Market patent. This elimination would not necessarily make the patentee immutable to patent laws, but would tend to reduce infringement suits. Only those points significant to this discussion will be pointed out with respect to the requirements for a Common Market patent:⁶⁸

- (1) A novelty search, preferably made by the International Patent Institute at the Hague, will precede any grant (art. 78).
- (2) The grant will be accomplished in two stages:
 - (a) a provisional grant after a successful novelty search;
 - (b) then the *definite patent* upon application to European Patent Office.
- (3) If a definite patent is not applied for after the provisional grant, patents will lapse in 5 years.
- (4) The subject matter must be sufficient to obtain a grant; trivial new matter will not be patentable.
- (5) Invalidity of a patent cannot be pleaded in an infringement suit, but must be brought before a Special Department of the Common Patent Office with appeals to an International Court; this provision will aid in comity considerations and *res judicata* for judgments.
- (6) Infringement suits will be tried in *national courts*, wherein lie difficulties:
 - (a) all litigants will use substantive common law;
 - (b) nationals may use their own procedural rules as to Statute of Frauds, statute of limitations and damages.
- (7) The common patent constitutes an indivisible property right and cannot be assigned by one country only.
- (8) Adequate provisions are made for all types of licensing.

The major problem with the common patent is in determining rights of nonmembers of the EEC. Important questions to be answered are (1) will the non-EEC patentee have access to a common patent; (2) what conflicts are precipitated if rights are denied nonmembers of the EEC; and (3) what rights are in conflict if EEC members also are signatories to the Paris Convention? It seems certain that the EEC will regulate the rights of nonmembers.⁶⁹ However, this right to regulate must not be in conflict with the Paris Convention. It would seem a matter of propriety that even if the

⁶⁸ See G. OUDEMANS, THE DRAFT EUROPEAN PATENT CONVENTION (1963).

⁶⁹ Weiser, *The European Common Market Patent Convention: The Right to Apply for a Common Market Patent*, 6 IDEA 317 (1962).

patentee cannot obtain a Common Market patent, he could still achieve this end by separate application under the articles of the Paris Convention. The most significant advantage of a common patent is that the laws will have some uniformity and the patentee will have an easier time to determine his rights. Thus, the term of the patent and its scope (subject matter) will be uniform throughout the countries involved.

C. *Treaties in General*

The United States and her citizens do a significant amount of business with countries which are not signatories to any multilateral treaty. Bilateral agreements achieve a similar result, but may not possess the force and effect of multilateral agreements. In essence, many of these bilateral treaties are set up for political reasons, but sociological and economic benefits are often included to establish good will and promote better trade relations. One of the incidents of these treaties is often the grant of foreign patents to U.S. patentees.

D. *International Patent System — A Possibility?*

To date there is no unified approach to an international patent system. The source of all international relationships is the Paris Union of 1883. A similar arrangement exists with certain Latin American countries. However, with those countries that are non-members of any international agreements, a working agreement often exists in terms of the "reciprocity principle" through various types of treaties. For the specific types of treaties and their effects on international transactions, various sources of reference should be consulted.⁷⁰ Attempts to give one a patent valid in at least six countries have, at least in fact, been seriously contemplated by the common market countries.⁷¹ Though no one situation covers all the prescriptions and proscriptions of international patent law, industrial property is at least qualifiedly protected, but by laws displaying many variations on the theme. Thus, the specific arrangement that a national of one country has with another should be the primary source of consultation in connection with the initiation of a patent application.

⁷⁰ R. WILSON, *UNITED STATES COMMERCIAL TREATIES AND INTERNATIONAL LAW* (1960); Bayitch, *Conflict Law in United States Treaties*, 8 *MIAMI L.Q.* 501 (1954). With respect to the effects of treaties on private international law, see Nadelmann, *Ignored State Interests: The Federal Government and International Efforts to Unify Rules of Private Law*, 102 *U. PA. L. REV.* 323 (1954). The significance of various multilateral treaties and the Hague Conference on International Private Law is discussed in 1 E. RABEL, *THE CONFLICT OF LAWS: A COMPARATIVE STUDY* (2d ed. Drobnig 1958). See also 5 *AM. J. COMP. L.* 650 (1956), and Nadelmann, *The Hague Conference on Private International Law — Ninth Session*, 9 *AM. J. COMP. L.* 583 (1960).

⁷¹ G. OUDEMANS, *supra* note 68.

In mid-October 1967 delegates from 22 major countries — including the United States, Great Britain, France, West Germany, Japan and the Soviet Union (which countries account for 80% of the world's patent applications) — met at Geneva, Switzerland, and reached preliminary agreement on some long overdue patent reforms.⁷² The first draft of an international treaty was accomplished by a committee of patent experts of the Patent Cooperation Treaty (PCT) from a working group of the United International Bureau for the Protection of Intellectual Property (BIRPI).⁷³

At the present time there are basically three patent systems: the French, the German or American, and the Dutch. Each system provides its peculiar advantages and disadvantages. The French system, without a novelty or priority examination, leads to rapid granting of a patent but affords no security to the patentee. The American system gives security but requires long delays. The Dutch system is a so-called deferred examination system and has been used since January 1, 1964. West Germany deems the deferred examination system desirable and hopefully will adopt it.⁷⁴ This system would no doubt improve the long delays required in examination now experienced (*e.g.*, 2½ years for a patent to issue in the United States, 5 years in Germany, and 7 years in Japan). The deferred examination system works as follows: an application is filed for a novelty search or an examination; the requests could be filed at the same time as the application but no later than 7 years from the date of the original application; the application would be disclosed 18 months after the date of priority (date of application), regardless of the state of the procedure.

The Geneva meeting was in essence a revival of the Paris Convention, but a much more pragmatic goal was sought. If the proposal becomes reality, an applicant would file, through his national office, an international application with BIRPI. A worldwide search would be initiated, either by a national patent office or an international patent institute. If the search is favorable, the applicant could request a full examination and an international certificate of patentability.

The most significant changes recommended in the PCT at the convention were as follows:⁷⁵

- (1) Further simplify the use of the system and reduce its cost.
- (2) Concentrate international transactions as much as possible in individual countries. For example, a U.S. applicant would work primarily through the U.S. Patent Office.

⁷² TIME, Oct. 20, 1967, at 92.

⁷³ CHEMICAL & ENG. NEWS, June 12, 1967, at 37.

⁷⁴ *Id.*, June 19, 1967, at 15.

⁷⁵ *Id.*, Oct. 16, 1967, at 15.

- (3) Give maximum freedom to each country to retain its present concepts and laws. In its current form the treaty would require the United States to switch from the "first-to-invent" to the controversial "first-to-file" system, which was eliminated at the convention.
- (4) The treaty also calls for publishing applications within 18 months from the date of filing, which left a sour taste in the mouths of U.S. industry.

Thus, a single multilingual international patent application may yet become a reality. The treaty must yet be drafted in final form and approved by the Geneva delegates, then submitted to all 79 Paris pact signatories for ratification. With only conservative success, the plan may be in force by 1970.

IV. PROSECUTION OF A VIOLATED PATENT RIGHT

A. *Parties to a Suit*

If a licensee defaults or a patent becomes infringed, the problems usually created fall into one of two classes: actions either between nationals and foreigners, or between foreigners from the same country doing business in another country. The types of situations arising in any patent proceeding must, by their nature, demand consideration of the effects of extraterritoriality, act of state, effect of the judgment, *res judicata*, and antitrust laws.

1. Foreigner v. National

Consider the problem created when a foreign patentee has licensed his patent to 50 different nationals in different areas of the same country. A situation could arise wherein each of the nationals sublicenses, without authority, to another national, in breach of the license contract. If a large segment of the nation's economy has been dependent on this operation, a major problem may arise if the patentee revokes all licenses. One possibility is that the national may be shielded from a suit because the Act of State Doctrine might be invoked. The Act of State Doctrine is an actual taking of the property, to justify the ends of the State with little, if any, rational reason given for the act. A nation employing this doctrine could justify the taking of the property on grounds that poverty might result if the license of the industry responsible for the wrong was revoked. Thus, the effect of the *Sabbatino* case⁷⁶ may be in point for this situation.

⁷⁶ *Banco Nacional de Cuba v. Sabbatino*, 193 F. Supp. 375 (S.D.N.Y. 1961). In this case, even though the action could not be justified on grounds of public policy the Supreme Court reversed stating "that no compensation was required for expropriation of the sugar," apparently to avoid more severe international political ramifications.

Undoubtedly, the foreigner would attempt to thrust the laws of his country upon the violators as an effect of extraterritoriality. However, the United States has been less prone of late to interject its laws into a foreign jurisdiction, fearing adverse political effects.⁷⁷ It seems certain, however, that a national will be protected and a foreigner's property expropriated, if the well-being of a country might be injured. The foreigner, even though he has the protection of multilateral treaties, is always faced with the international implications which might control the outcome.

2. Citizens of the Same Country Doing Business in a Foreign Country

The patentee in this situation is normally not confronted with the problems which result from doing business with a national, or from infringement of a foreign patent by a national. If a United States corporation infringes a foreign patent in Germany, how can the infringer be reached? Should the United States have jurisdiction or should the country which grants the foreign patent obtain jurisdiction? Obviously, the patentee stands in an advantageous position because the United States can extend its laws beyond the United States if a U.S. citizen is involved.⁷⁸ The rationale is that the United States can and will protect her citizens. Litigation between citizens of the same country could be brought in the foreign country on grounds that the proper venue is the locus of the alleged infringement. The apparent drawbacks, of course, would be the proper choice of laws and judgment enforcement. Hence, the patentee would profit by bringing the action in his native country for a number of reasons, including jurisdiction, choice of laws, and enforcement of the judgment.

B. Remedies

Whenever a patentee has been wronged, there are three possible routes to litigation. The suit might be litigated in the United States, it could be litigated abroad, or the device of arbitration might be employed. What are the problems of the foreign forum? The difference of substantive law questions might be reasonably resolved, but if the law of the forum controls procedural matters, then the patentee faces serious obstacles. The availability of witnesses, documentary evidence, and compulsory process must be considered. In some jurisdictions the unsuccessful litigant is required to pay his adversary's

⁷⁷ For a thorough discussion of patents and interposition of acts of the state, see Spiro, *Foreign Acts of State and the Conflict of Laws*, 16 INT'L & COMP. L.Q. 145 (1967).

⁷⁸ *Skiriotes v. Florida*, 313 U.S. 69 (1941). *Skiriotes* was diving for sponges outside the three mile limit and the Supreme Court allowed the Florida statute to be extended.

attorney's fee. Fees are frequently strictly prescribed by a statutory schedule and contingent fees are practically unknown. The nonresident plaintiff may be required to post a security deposit for court costs and attorney's fees.⁷⁹ Added delay and inconvenience of various characteristics of the trial are added detriments.⁸⁰

1. Litigation Abroad

In trying actions abroad it must be remembered that Americans are accustomed to common law and many of the European countries use civil law. Most civil law countries have trial to the court and not by jury, the court often being comprised of lay judges.

Actions are commenced with filing of the complaint. Civil law procedure provides for the pleading of evidentiary matter, and the trial may be interrupted by a hearing. This would preclude admission of all the evidence at one time. This latter effect, however, is similar to transactions in the U.S. Customs Court.⁸¹ Service of process is had after the complaint is filed and is interpreted as a notice rather than a basis for jurisdiction.⁸² Jurisdiction usually is in personam — in rem and quasi-in-rem jurisdiction being virtually unheard of. Jurisdiction is often established, but by no means uniformly, through a choice of laws based on the nationality of the defendant (his domicile); the place of the wrong or where committed (impact rule); or the place of execution or performance of contract. The more modern approaches of weighting of contacts (center of gravity) or "most substantial connection" theories are usually neglected. Service of process upon American citizens is often achieved through the assistance of U.S. Consulates, based upon the United States' refusal to invoke sovereign immunity. However, U.S. courts will refuse assistance of process, if the foreign process conflicts with the domestic procedure.⁸³

The major problem with a foreign judgment is that a patentee may be unable to effect its enforcement in the United States.⁸⁴ American courts employ local rules in their own jurisdiction. While rules are not uniform, they do reflect consideration of the general rules that a judgment, to be enforceable, (1) must be final; (2) must have gone to the merits; and (3) must be based on competent jurisdiction. The reciprocity rule is the ground in many jurisdictions, though judgments are often reviewable on the merits as a matter of

⁷⁹ Hess, *Litigation and Arbitration In International Trade*, 72 CASE & COM., Jan.-Feb. 1967, at 34.

⁸⁰ Rivkin, *International Litigation and Arbitration*, in A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS 963 (W. Surrey & C. Shaw, eds. 1963).

⁸¹ U.S. CUST. CT. R. 3(r), 28 U.S.C. App. (1949).

⁸² M. KATZ & K. BREWSTER, JR., INTERNATIONAL TRANSACTIONS AND RELATIONS, 468-69 (1960).

⁸³ *In re Letters Rogatory Out of First Civil Court of City of Mexico*, 261 F. 652 (S.D.N.Y. 1919).

⁸⁴ 28 U.S.C. § 1696 (1964).

course.⁸⁵ American courts will not grant enforcement to judgments awarded in courts that do not give a similar reciprocal treatment. Thus, in *Hilton v. Guyot* the court said:

[T]here is a distinct and independent ground upon which we are satisfied that the *comity* [emphasis added] of our nation does not require us to give conclusive effect to the judgments of the courts of France; and that ground is, the want of reciprocity, on the part of France, as the effect to be given to the judgments of this and other foreign countries.⁸⁶

In those countries granting Americans favorable reciprocal privileges, a foreign judgment will be enforced.⁸⁷

2. Litigation in the United States

An alternative to a patent suit for an infringement abroad is litigation in the United States. However, jurisdiction over the subject matter and in personam may be unavailable. Any application of local law, such as discovery or production of documents may be likewise unavailable.⁸⁸ One possibility might be the use of the long-arm statutes, if the foreigner is also doing business in the United States. Hence, if the patentee can show that there was at least a minimum of contacts between the infringer and the court concerned, then jurisdiction might be established in view of the *International Shoe* case.⁸⁹ Jurisdiction may be established through the use of foreign consulate service, but the service may not always be made direct in some instances.⁹⁰

With respect to a conflicts of law question, problems are found in the proof of foreign law. Although the United States will not recognize the laws of uncivilized countries, foreign law, if a proper choice was made, can be proven through various statutory means.⁹¹

Once the U.S. citizen has obtained a judgment in the United States, can he enforce it abroad? The reciprocity principle no doubt will apply, but attacks of the judgment may be made on grounds of lack of jurisdiction and *res judicata*. The successful patentee will be perplexed. In some countries he will be able to collect his judgment,⁹²

⁸⁵ Smith, *The Enforcement of Foreign Judgments in American Courts*, 19 *MILITARY L. REV.* 1 (1966).

⁸⁶ 159 U.S. 113, 210 (1895).

⁸⁷ *Ritchie v. McMullen*, 159 U.S. 235 (1895) (decided the same day as *Hilton v. Guyot* but with a different result).

⁸⁸ Rivkin, *International Litigation and Arbitration*, 34 *U.M.K.C.L. REV.* 60, 67 (1966).

⁸⁹ *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

⁹⁰ Miller, *International Cooperation in Litigation Between United States and Switzerland: Unilateral Procedural Accommodation in a Test Tube*, 49 *MINN. L. REV.* 1069, 1076 (1965). Switzerland refused to effectuate the service and invoked sovereign immunity when service upon their citizens did not come through the country.

⁹¹ See UNIFORM JUDICIAL NOTICE OF FOREIGN LAW ACT § 5. See also *FED. R. CIV. P.* 44(a).

⁹² A. NUSSBAUM, *AMERICAN-SWISS PRIVATE INTERNATIONAL LAW* 52-54 (2d ed. 1958) (indicating that Switzerland is willing to cooperate fully).

but it is equally clear that in others the judgment will not be enforced.⁹³

The consensus indicates that an infringed patentee or one whose license agreement has been breached may be in no better position to litigate in the United States than abroad. Each forum will have its own difficulties and some of these may be insurmountable.

C. Arbitration — a Possible Solution

Because of the uncertainty in successful enforcement of a judgment either abroad or in the United States, and because of the most onerous task of litigating a patent claim, the use of arbitration seems highly desirable. Many of the problems inherent in the court situation, *e.g.*, jurisdiction, use of foreign law, conflicts of law choice, enforcement of the judgment, and *res judicata*, might be obviated by an arbitration clause in the contract. However, if a patent is infringed, this remedy would not be available, unless tied to some type of a licensing agreement or an assignment providing for this resource. The application of arbitration could be of paramount importance in patent licensing agreements.

Arbitration is defined as "the submission for determination of disputed matter to private unofficial persons selected in a manner provided by law or agreement."⁹⁴ Arbitration agreements impose several obligations and duties upon the parties. Neither party may seek aid from a tribunal other than the one agreed upon. No party may attempt to interfere with the proceeding, set aside the award, or resist its enforcement. Once the parties select arbitrators and an award is made, the judgment is final. *Res judicata* is presumed, and the judgment must be honored.⁹⁵ The agreement to arbitrate may be effectuated by (1) direct specific enforcement (an order to arbitrate); (2) collateral enforcement (appointment of arbitrators by

⁹³ The Netherlands will not give effect to a foreign judgment notwithstanding the propriety of the reciprocity principle.

⁹⁴ BLACK'S LAW DICTIONARY 134-35 (4th ed. 1951):

Compulsory arbitration is that which occurs when the consent of one of the parties is enforced by statutory provisions. . . .

Voluntary arbitration is by mutual and free consent of the parties.

The *submission* is an agreement by which parties agree to submit their differences to the decision of a referee or arbitrators. It is sometimes termed a reference. . . . In a wide sense, "arbitration" may embrace the whole method of thus settling controversies, and include all the various steps. But in a more strict use, the term denotes only the submission and hearing, the decision being separately spoken of, and called an "award." An award is the judgment or decision of arbitrators or referees on a matter submitted to them. It is also the writing containing such judgment. . . .

As distinguished from appraisal, an arbitration presupposes a controversy or a difference to be tried and decided. On the other hand, an appraisal or valuation is generally a mere auxiliary feature, as of a contract of sale, the purpose of which is *not to adjudicate a controversy but to avoid one*. [Emphasis supplied.]

⁹⁵ See cases collected in E. CHEATHAM, E. GRISWOLD, W. REESE, & M. ROSENBERG, CONFLICT OF LAWS ch. 6 (5th ed. 1964).

court order); and (3) indirect specific enforcement (the staying of an action brought in violation of an agreement to arbitrate).⁹⁶

The use of arbitration in foreign patent licensing agreements has been suggested⁹⁷ to avoid high court costs, conflicts of laws and enforcement difficulties. But arbitration is not without risk. The arbitration clause should be adequately drafted to show with exactness and clarity what the parties intended, since these types of proceedings function as plenary actions. Rules employed should be those that have been well tested. Reputable organizations such as the American Arbitration Association or International Chamber of Commerce should be the tribunal if the arbitration is to be in the United States or elsewhere. Availability of a qualified arbitrator should be determined prior to the inclusion of an arbitration clause.⁹⁸ It should be made clear whether the clause pertains to antecedent proceedings or applies only to those in the future.⁹⁹ Under the Federal Arbitration Act,¹⁰⁰ the laws of 19 states,¹⁰¹ and in many foreign jurisdictions,¹⁰² agreements to arbitrate future disputes are valid, enforceable and irrevocable. Treaties (bilateral and multilateral) often give effect to arbitration awards.

Experience has shown that arbitration should not be contemplated unless honest disputes actually exist, and the parties intend to deal with each other amiably subsequent to the award. Once parties have endured litigation, they may wish to consider some other means of settlement in the future; comparative costs, speed of the determination, enforceability of the awards, and the nature of the issues involved are all criteria in this consideration.

Arbitration might be desirable in Communist bloc countries who not infrequently invoke sovereign immunity to protect their citizens in international relations. However, more recently this doctrine has been waived and some resort to arbitration has been employed to establish an interest in the principles of "fair play" in anticipated future dealings.¹⁰³

Thus, the settlement of foreign patent claims by arbitration might turn out to be *sui generis* when other methods are notoriously

⁹⁶ Phillips, *Arbitration and Conflicts of Laws: A Study of Benevolent Compulsion*, 19 CORNELL L.Q. 197, 199 (1934).

⁹⁷ Knopp, *Licensing and Related Patent Problems Within the EEC*, in DOING BUSINESS IN THE COMMON MARKET, CCH COMM. MKT. REP., SPEC. REP. 114 (1963).

⁹⁸ L. ECKSTROM, LICENSING IN DOMESTIC AND FOREIGN OPERATIONS 434 (3d ed. 1964).

⁹⁹ See Hess, *supra* note 79. Some foreign countries and 31 jurisdictions in the United States preclude future disputes to be settled by arbitration.

¹⁰⁰ 9 U.S.C. §§ 1-14 (1964).

¹⁰¹ See Rivkin, *supra* note 80, at 984.

¹⁰² See L. ECKSTROM, *supra* note 98.

¹⁰³ K. GRZYBOWSKI, THE SOCIALIST COMMONWEALTH OF NATIONS, ORGANIZATIONS, AND INSTITUTIONS 215-41 (1964).

fraught with uncertainty as to the outcome and the efficacy of enforcement.

It is well established that submission of a controversy to arbitration by prior agreement confers jurisdiction on the forum notwithstanding the absence of a defendant. In *Gilbert v. Burnstine*,¹⁰⁴ the defendants agreed to sell and deliver goods to the plaintiff in the United States. An arbitration clause provided that the parties would submit any difference to an arbitration forum in London using the Arbitration Law of England. The defendant left England to avoid jurisdiction. An arbitration award of £46,000 was made to the plaintiff. The court held that the defendant had consented in advance to submit to the jurisdiction of English courts and their processes. This consent was irrevocable without approval of the opposite party. Neither party could defeat jurisdiction by remaining outside England and the plaintiff was allowed to show that the terms of the agreement were substantially fulfilled. The defendant was given actual notice of the proceeding, consistent with the requirement of due process. This case exemplifies the efficacy of conferring jurisdiction upon a tribunal in advance of a controversy and obviates any difficulties that normally are encountered when the forum lacks this grace. Though extraterritoriality is frowned upon in most foreign jurisdictions, it becomes part of the procedure in arbitration.

It is also clear that an arbitration clause merges into the contract and a defendant cannot attempt to avoid arbitration, even if the agreement states Russia as the situs. In *Amtorg Trading Corp. v. Camden Fibre Mills*,¹⁰⁵ a Pennsylvania corporation agreed to do business with Amtorg, an agency of the Soviet Government. The contract provided that any disputes would be tried before the U.S.S.R. Chamber of Commerce Foreign Trade Arbitration Commission in Moscow. Camden brought suit in New York against Amtorg, but the latter moved to stay the suit pending arbitration. The per curiam opinion held that

Camden chose to do business with Amtorg and to accept, as one of the conditions imposed, arbitration in Russia; it may not now ask the courts to relieve it of the contractual obligation it assumed.¹⁰⁶

Thus, the use of arbitration in international trade seems to be a very desirable device to avoid many of the uncertainties resulting from expanded or attenuated differences of opinion. Jurisdiction, choice of laws and their conflicts are seasonably avoided. Foreign awards under arbitration will, in most instances, be enforced in contrast to non-arbitral awards. *Res judicata* is a conclusive presumption in arbitra-

¹⁰⁴ 255 N.Y. 348, 174 N.E. 706 (1931).

¹⁰⁵ 304 N.Y. 519, 109 N.E.2d 606 (1952).

¹⁰⁶ *Id.* at 607.

tion. Agreements to submit disputes to a foreign tribunal are tantamount to a similar submission of the controversy exclusively to the courts of a sister state.¹⁰⁷ There is nothing novel about arbitration in international business.¹⁰⁸ However, the use of arbitration in patent litigation seems to have certain novel attributes, not heretofore contemplated.

CONCLUSION

Patent infringement suits and licensing agreements on an international scale are fraught with many potential hazards. Patent laws of foreign countries contain many vagaries and esoteric implications, in many instances understood only by native counsel. Multilateral and bilateral treaties provide a means of protecting property in a foreign country. Litigation that may ensue presents the patentee with an undue burden to enforce his award either internally or externally. The patentee always must overcome the sometimes insurmountable problems of jurisdiction, conflicts and choice of laws, enforcement of foreign judgments, and *res judicata*. Enforcement in the United States of judgments awarded abroad may be as difficult to obtain as foreign enforcement of U.S. judgments. Arbitration is suggested as a salutary means to obviate some of the inherent difficulties of enforcing a patent monopoly abroad. However, arbitration would be limited to those situations involving a contractual arrangement or licensing agreements, and inapplicable to patent infringement suits.

¹⁰⁷ See *Parker v. Krauss Co.*, 157 Misc. 667, 284 N.Y.S. 478 (Sup. Ct. 1935).

¹⁰⁸ INTERNATIONAL TRADE ARBITRATION (M. Domke ed. 1958); Bayitch, *Treaty Law of Private Arbitration*, 10 *ARB. J.* 188 (1955); Lorenzen, *Commercial Arbitration — International and Interstate Aspects*, 43 *YALE L.J.* 716 (1934); Nussbaum, *Treaties on Commercial Arbitration, a Test of International Private-Law Legislation*, 56 *HARV. L. REV.* 219 (1942); Pisar, *The Law Governing Arbitration*, *J. BUS. L.* 342 (1959); Czyzak & Sullivan, *American Arbitration Law and the U.N. Convention*, 13 *ARB. J.* 197 (1958). See especially on arbitration and conflicts of law several scholarly articles, e.g., W. STURGES, *COMMERCIAL ARBITRATIONS AND AWARDS* ch. 17 (1930); Stern, *The Conflict of Laws in Commercial Arbitration*, 17 *LAW & CONTEMP. PROB.* 567 (1952); Note, *Commercial Arbitration and the Conflict of Laws*, 56 *COLUM. L. REV.* 902 (1956).

NOTE

COLORADO'S OMBUDSMAN OFFICE

INTRODUCTION

IN 1605 Don Quixote de la Mancha rode forth from the pages of Cervantes' classic book to do battle against all wrong. He fancied himself a grand knight in shining armor whose self-appointed quest was to seek out the destroyer, end tyranny, and bring justice to the weak and the oppressed. His thirst to conquer the foe soon set him tilting at a giant knight who proved to be a windmill and then pitted his prowess against a great army which was only a flock of sheep. His goals may have been admirable, but his lack of contact with reality doomed him to defeat from the start.

Today a new knight is setting out on much the same mission. This present day defender of the public, the ombudsman, has not cast himself in the ancient quixotic mold. He is a concept which citizens throughout the world¹ have conjured up from enthusiastic reports from Scandinavia.² The people would dub the ombudsman their champion and send him forth to battle every official wrong. They want him as a means of satisfying their need for a sense of personal importance in the vastness and the facelessness of bureaucracy. They have romanticized the ideals inherent in the office into a fantasy that does not exist;³ the ombudsman they see is a panacea for most of the shortcomings of the modern administrative system.⁴ As agency control over the lives of people grows more pervasive, their demand for relief from governmental red tape becomes more audible and their infatuation for this hero becomes more clear. In response, a bevy of nations, including the United States and its state and local governments, have recently begun considering transplanting

¹ Bainbridge, *A Civilized Thing*, NEW YORKER, Feb. 13, 1965, at 136, reprinted in *Hearings on S. Res. 190 Before the Subcomm. on Administrative Practice and Procedure of the Senate Comm. on the Judiciary*, 89th Cong., 2d Sess. 106 (1966) [hereinafter cited as 1966 *Hearings*]; Kastari, *Finland's Guardians of the Law*, in *THE OMBUDSMAN* 58 (D. Rowat ed. 1965).

² W. GELLHORN, *OMBUDSMEN AND OTHERS* 5-6, 239 (1967); Krislov, *A Restrained View*, in *THE OMBUDSMAN* 246, 247 (D. Rowat ed. 1965); e.g., Asher, *Ombudsman (Mr. Fixit) Here to Explain Unique System*, Washington Post, Mar. 7, 1966, reprinted in 1966 *Hearings* 28; see Anderman, *The Swedish Justitieombudsman*, 11 *AM. J. COMP. L.* 225 (1962), reprinted in 1966 *Hearings* 96.

³ See W. GELLHORN, *OMBUDSMEN AND OTHERS* 195 (1967). This development has been referred to affectionately as "ombudsmania." Marshall, *The United Kingdom*, in *THE OMBUDSMAN* 173 (D. Rowat ed. 1965).

⁴ A Pattern of Executive Protection: The Ombudsman, address by Hans Blix, at Howard University School of Law, Feb. 21, 1965, reprinted in 1966 *Hearings* 90.

this ancient Nordic institution to their shores.⁵ At least two American governments, Hawaii⁶ and Nassau County, New York,⁷ have adopted the idea, and others seem destined to follow suit. Whether this American experiment will fulfill the public's high expectations or whether it will prove to be only a quixotic exercise remains to be seen.

Colorado, having docketed an ombudsman bill in both houses during the 1967 legislative session and having an unofficial and voluntary ombudsman in the person of Lieutenant Governor Mark Hogan, may count itself in the forefront of the American governments which have seriously considered the ombudsman idea. The Lieutenant Governor has done more than anyone else to spark interest among the people of the state. Shortly after taking office in January 1967, Mr. Hogan announced that he intended to assume the role of ombudsman for Colorado.⁸ The public has taken advantage of his offer, and requests for his aid are increasing as publicity about his work mounts. The local newspapers have added to the interest by carrying on a lively debate over the merits of the concept. The question which this situation presents to Coloradans is whether the institution should be given formal status by the enactment of an ombudsman bill at some future date.

Intelligent consideration whether this foreign institution has any value for Colorado must be founded on a good understanding of what the institution involves. The theory is simple: an ombudsman is a government official appointed to receive and investigate complaints made by individuals against abusive or capricious acts of public officials. If he finds the complaint is justified, he tries to correct the action. He cannot reverse the official decision, but he does try to persuade the agency to change its ways. He can often influence a reluctant agency to adopt his recommendation by publishing his own opinion in the news media to bring public pressure to bear.

Although the theory is simple, the ramifications are complex. A good deal of information should be considered before any conclusions are reached about Lieutenant Governor Hogan's ombudsman work or about the ombudsman bills proposed for Colorado. The Colorado situation can be better evaluated after viewing the ombudsman institution in its historical setting and after analyzing

⁵ Anderman, *supra* note 2; Krislov, *supra* note 2, at 246-47.

⁶ 10 STATE GOVERNMENT NEWS, July 1967, at 7.

⁷ County Executive of Nassau County, N.Y., Press Release, May 31, 1966. See also N.Y. Times, Nov. 20, 1966, § 1, at 53, col. 1. The County Executive presented a proposed local law to the Board of Supervisors which would create the office of Public Protector. On the same day he appointed the Commissioner of Accounts to assume the powers and duties detailed in the proposal. The Board has not yet submitted the bill to the people on referendum.

⁸ Rocky Mountain News, Jan. 12, 1967, at 23, col. 1.

its strengths and weaknesses as revealed by the existing ombudsman systems in other countries. Then this institution which developed within a parliamentary, civil law form of government must be measured against the unique aspects of our congressional, common law system.

Reports of the detailed workings of most of the present ombudsman offices have been published by competent authors. That material will not be repeated here except to the extent necessary to give a glimpse of how the office has traditionally functioned and to show what results have been achieved. The parts of this article which deal with specific facts and statistics recorded in the ombudsman countries are drawn in large part from the first hand reports written by Professor Walter Gellhorn and collected in his excellent book, *Ombudsmen and Others*.⁹

I. THE SWEDISH INSTITUTION

The ombudsman concept is a product of monarchical Sweden.¹⁰ The direct predecessor of the present Ombudsman¹¹ came onto being in 1713 during Sweden's war with Russia under Czar Peter I. After twelve years of absence from the country as Commander-in-Chief of his army, Sweden's King Charles XII found himself unable to dispense enlightened justice or to assure himself that his servants were faithfully carrying out the law. Therefore, he made a decision which was to prove fateful for modern administrative government. He appointed the King's Supreme Ombudsman to oversee the tax collectors, the judges, and the handful of public servants who administered the law in his name.¹² The Swedish of today have praised his decision,¹³ but it is likely he was motivated more by a desire to insure himself against embezzlement than by a desire to protect his people against oppression.¹⁴

The temporary appointment became a permanent part of the

⁹ W. GELLHORN, *OMBUDSMEN AND OTHERS* (1967) [hereinafter cited as GELLHORN].

¹⁰ It is noteworthy that the office was created by an absolute monarch, since American critics have attacked the idea as part and parcel of "creeping socialism." Unruh, *The Need for an Ombudsman in California*, 53 CALIF. L. REV. 1212, 1213 (1965).

¹¹ "Ombudsman" is an early Swedish term composed of three syllables. "Om" translates as about, "bud" means message, and "man" is person. Thus the literal translation is "man with a message about something." Fowle, *Two Ombudsmen Report on Roles—Civic Control Described by Swede and New Zealander*, N.Y. Times, Feb. 20, 1966, § 1, at 20, col. 1, reprinted in 1966 Hearings 380. In Swedish idiom the term more accurately means a "person who represents someone." Address by Blix, *supra* note 4, at 93.

¹² GELLHORN, *supra* note 9, at 194-95; Bexelius, *The Swedish Institution of the Justitieombudsman*, 27 INT'L REV. AD. SCI. 243 (1961), reprinted in 1966 Hearings 77-78; address by Blix, *supra* note 4, at 93; Rudholm, *The Chancellor of Justice*, in THE OMBUDSMAN 17-18 (D. Rowat ed. 1965).

¹³ See, e.g., Bexelius, *The Ombudsman for Civil Affairs*, in THE OMBUDSMAN 22, 25 (D. Rowat ed. 1965).

¹⁴ GELLHORN, *supra* note 9, at 2.

royal government. After the death of Charles XII the officer became known as the Chancellor of Justice. In 1766 when Sweden's Parliament, the Riksdag, had gained the balance of power, it appropriated the right to appoint the Chancellor. Later when the winds of political fortune reversed, the new King reasserted the monarchical authority and made the Chancellor the Crown's officer once more. Then in 1809 while the nation was again at war with Russia and engulfed in national and international crises, the Riksdag led Sweden away from royal government toward representative democracy. The Constitution which was drafted and adopted by the Riksdag gave it many new powers to offset the great authority of the King. One brief clause created the office of Justitieombudsman as a safeguard against disregard of the law by royal officers. The King had his Chancellor of Justice to watch the civil service; now the Riksdag had its own inspector of courts and administrative agencies, the Ombudsman.¹⁵

A. Results in Sweden

These developments in Sweden in 1809 launched the revolutionary idea of an official critic of government. The institution has flourished there, and after more than one hundred and fifty years the tradition permeates the thinking of the Swedish people.¹⁶

With only a few assistants and a present annual budget of \$120,000,¹⁷ the Ombudsman has carved a permanent niche in Swedish life and has exerted a definitely beneficial influence on the quality of its government.¹⁸ The Ombudsman has been particularly effective in protecting the civil rights of citizens, *e.g.*, the rights of peaceful assembly, free speech, and access to all official documents. The liberties of the citizens have been safeguarded against encroachment by the judiciary, the prosecutors, the police, and the penal institutions. While success in checking administrative agency derelictions has been less noteworthy,¹⁹ the results have been impressive,

¹⁵ Authorities cited note 12 *supra*.

¹⁶ Anderman, *supra* note 2, at 237-38, 1966 *Hearings* at 105-06.

¹⁷ Bainbridge, *supra* note 1, at 142, 1966 *Hearings* at 108. The staff consists of nine lawyers and three secretaries.

¹⁸ Anderman, *supra* note 2, at 234-35, 1966 *Hearings* at 102-03. "[F]ew would deny that the Ombudsman institution has in its various forms achieved much good in those countries where it exists." Mitchell, *The Irrelevance of the Ombudsman Proposals*, in *THE OMBUDSMAN* 273 (D. Rowat ed. 1965).

¹⁹ Anderman, *supra* note 2, at 235-37, 1966 *Hearings* at 103-05. There are special factors which have hindered progress in this field. The administrative branch of government is expanding rapidly without an increase in the staff available, or a decrease in other responsibilities. The agencies usually do not explain their decisions. There is no administrative procedure act, and furthermore, neither the courts nor the Ombudsman can easily determine their jurisdiction over administrative decisions. The institution is presently shifting focus from supervision of the judiciary to supervision of administration, and the transition is not complete. It has been suggested that a country with a more highly developed system of judicial review would not experience these difficulties because jurisdiction could be more clearly defined. *Id.*

especially in achieving uniformity of procedure and uniformity of interpretation.²⁰ It is as legislative reformer that the Ombudsman has made little progress. His proposals to Parliament for statutory change have largely been ignored although his annual reports to Parliament and his petitions to the executive branch continue to repeat his advice on matters in the expectation that his suggestions will eventually prevail.²¹

The influence of the Ombudsman does not result from the few constitutional powers he is given. It stems from his position as the trustee of Parliament, and from the tremendous prestige the office has accumulated over the century and a half of its existence. His carefully reasoned arguments made from this respected position are usually sufficient to persuade an official, if not the Parliament, to accept his suggestion. These factors are the source of his influence, and the press is the means by which it is maintained and disseminated.²²

The Swedish would be the first to admit that their Ombudsman is not a single handed miracle worker. There have been no sensational disclosures of scandal on a national level. In fact, very few of the cases have been remarkable, but that has not detracted from their importance to the individuals involved.²³

The first Ombudsman corrected the most spectacular abuses which have been discovered. On one inspection in 1825 of a debtors' prison at Stockholm, the Ombudsman found an unfortunate brewer who had been imprisoned for twenty-two years waiting for the Supreme Court to decide his appeal. The Court had mislaid his file! The executive branch was moved to release the man without any further penalty.²⁴

A more typical example of recent years resulted in standardization of agency procedure. Swedish law authorizes county administrators to revoke driving licenses on evidence that the holder does not meet the standards of skill, responsibility or reliability required of a driver. The Ombudsman's investigation into revocation procedures showed that various administrations employed widely different standards. Some revoked the driving licenses of persons for

²⁰ GELLHORN, *supra* note 9, at 240.

²¹ *Id.* at 244-46.

²² See Bexelius, *supra* note 13, at 25; Anderman, *supra* note 2, at 225, 1966 *Hearings* at 96; Bainbridge, *supra* note 1, at 138, 142, 1966 *Hearings* at 107-08. "[T]he Ombudsman's finding fault causes some temporary pain and perhaps some loss of self-esteem in most instances, but . . . it rarely leaves permanent scars if the offense was not willful. . . . A headline saying the Ombudsman has criticized the police is almost the equivalent of a prosecution." GELLHORN, *supra* note 9, at 249-50. The individual's career is not lost because his superiors may choose to ignore the incident in favor of the rest of his record when promotions are considered.

²³ Bexelius, *supra* note 13, at 36-37.

²⁴ *Id.* at 38.

drunkenness even though they had not been driving. Other administrations only revoked licenses after two or three cases of drunkenness. The Ombudsman's remarks were sufficient to cause each administration to adopt the same revocation procedure.²⁵

An examination of 400 cases involving driving under the influence of alcohol revealed that some courts had used incorrect formulas to determine the alcohol content of the blood. Two outstanding scientists were called upon to define a valid calculation. Their information was passed along to the courts which were able to increase accuracy and administer better justice.²⁶

A man in a mental hospital wrote a letter complaining that one of the doctors was opening his mail. The Ombudsman could only reply that the doctor was authorized by law to do so.²⁷

In another case, a band of gypsies set up camp on a beach in a town. They were located on a public camping site so they refused to leave when the local chief of police requested them to move on. The next day the gypsies and their belongings were loaded onto a police bus and dumped off in a desolate area. They asked the Ombudsman to investigate. Since the gypsies had violated no law, the police chief had acted illegally. The police chief was prosecuted by the Ombudsman under the rarely used constitutional authorization to prosecute officials who commit unlawful acts or who neglect to perform their duties in the proper manner. The court found the police chief guilty of the charge and assessed a fine.²⁸

The Ombudsman once read in a Stockholm newspaper of an alcoholic who had killed his wife in a drunken rage. Four days earlier she had asked the police for protection, insisting that her husband was a dangerous alcoholic. The Ombudsman wrote to the police and asked why they gave the lady no protection. They replied that they had taken the man into custody at once, but had to release him since the law did not allow detention of an alcoholic for more than one day. During that day the police had not been able to gather sufficient evidence to have him committed to an institution for alcoholics. The police were exonerated, but the government was moved to amend the law so as to authorize detention of a person charged as a dangerous alcoholic for enough time to complete the investigation.²⁹

A statistical examination of the Swedish Ombudsman's efforts gives another perspective of the work he and other ombudsmen do. In 1964 the Ombudsman received 1,429 new cases. Of those, 1,239

²⁵ 1966 *Hearings* at 35-36.

²⁶ *Id.* at 36.

²⁷ Bainbridge, *supra* note 1, at 142, 1966 *Hearings* at 109.

²⁸ 1966 *Hearings* at 33.

²⁹ *Id.* at 30.

were citizens' complaints, 179 were the result of his inspections or other information, and eleven were initiated on his own motion on the basis of newspaper reports.³⁰ Although they comprise only thirteen percent of his caseload, the Ombudsman thinks his inspections produce the most significant leads to administrative shortcomings.³¹ About twenty percent of the private complaints come from inmates of mental hospitals and penal institutions.³² About thirty percent of the personal complaints are dismissed without an inquiry. Approximately ninety percent of all investigated complaints are dismissed after an examination of the relevant documents. All complainants whose cases are dismissed receive a written explanation of the dismissal.³³ Only about ten percent of all complaints are determined by the Ombudsman to be justified.³⁴

B. *Adoption of the Swedish Institution Elsewhere*

In spite of its longstanding acclaim in Sweden, it is only within the last two decades that the ombudsman institution has gained much recognition elsewhere.³⁵ Finland is the one exception; her historical links with Sweden caused Finland to create an Ombudsman office in 1919.³⁶

Denmark generated the current worldwide interest by installing an ombudsman for civil and military affairs in 1954.³⁷ The office was adopted by West Germany in 1957,³⁸ and then, in quickening succession, by Norway and New Zealand in 1962.³⁹

Guyana, a newly emerged nation state, created an ombudsman office by its new constitution.⁴⁰ Laval, Canada, a suburb of Quebec City, became the first North American government to establish the office by adopting its own version in January 1966.⁴¹ Nassau County, New York, was the first United States government to have an ombudsman. However, the office created there in May 1966 was instituted by executive order rather than by legislative enactment or by

³⁰ GELLHORN, *supra* note 9, Table XII at 208.

³¹ *Id.* at 208.

³² Bainbridge, *supra* note 1, at 142, 1966 *Hearings* at 109.

³³ GELLHORN, *supra* note 9, Table XIV at 214; address by Blix, *supra* note 4, at 94.

³⁴ GELLHORN, *supra* note 9, at 213.

³⁵ GELLHORN, *supra* note 9, at 5; Bainbridge, *supra* note 1, at 136, 1966 *Hearings* at 106.

³⁶ GELLHORN, *supra* note 9, at 48-50; Anderman, *supra* note 2, at 225, 1966 *Hearings* at 96.

³⁷ See generally GELLHORN, *supra* note 9, at 5-8; Northey, *New Zealand's Parliamentary Commissioner*, in *THE OMBUDSMAN* 127, 131 (D. Rowat ed. 1965).

³⁸ Anderman, *supra* note 2, at 225, 1966 *Hearings* at 96-97.

³⁹ GELLHORN, *supra* note 9, at 154-59 (Norway); Northey, *supra* note 37, at 127 (New Zealand).

⁴⁰ Gellhorn, *Ombudsman in America?*, *TRIAL*, Apr.-May 1967, at 38.

⁴¹ Cloward & Elman, *Poverty, Injustice and the Welfare State, An Ombudsman for the Poor?*, *THE NATION*, Feb. 28, 1966, at 230, 233.

referendum of the people.⁴² Hawaii, in June 1967, became the first of the states to enact an ombudsman bill. But that legislation remains on the books, unconsummated, because the legislature did not fill the office or provide a fund for its operation.⁴³

II. ANALYSIS OF THE EXISTING OMBUDSMAN OFFICES

Each government which has transplanted the institution has built on the original foundation, making adaptations to fit the special needs of the adopting country. An examination of the strengths and weaknesses which have been highlighted by the variations from Scandinavia to New Zealand reveals much about the form the office should take. At the same time, the comparison gives some indication of the success which could be expected in Colorado.

A. Qualifications

It may not be essential that an ombudsman be an attorney, but legal training would be an important asset.⁴⁴ While a good portion of his work primarily requires common sense and an overall view of the administrative system, there remains a substantial part of the program which only an attorney is trained to handle. For example, the ombudsman must provide expert investigation involving questions of law if the public, the agencies and the legislature are to be influenced.⁴⁵ The officer must be capable of demanding certain standards of conduct from an agency and be capable of persuading officials that the law requires no less.⁴⁶ As another example, it is highly unlikely that anyone other than an experienced attorney could successfully argue that the case of *SEC v. Chenery Corp.*⁴⁷ requires

⁴² Authorities and material cited note 7, *supra*.

⁴³ 10 STATE GOVERNMENT NEWS, July 1967, at 7. See also Rocky Mountain News, June 15, 1967, at 55, col. 1.

⁴⁴ See GELLHORN, *supra* note 9, at 422-23; cf. Aaron, *Utah Ombudsman: The American Proposals*, 1967 UTAH L. REV. 32, 44.

⁴⁵ Abrahamson, *Ireland*, in THE OMBUDSMAN 201, 204 (D. Rowat ed. 1965).

⁴⁶ See Abraham, *The Need for an Ombudsman in the United States*, in THE OMBUDSMAN 234, 236 (D. Rowat ed. 1965).

⁴⁷ 332 U.S. 194 (1947). Many experienced attorneys will find this reading of the second *Chenery* case startling. It is, however, an interpretation which has been made by the respected Administrative Law Section of the American Bar Association.

[T]he *Chenery* case is uniformly cited or miss-cited [*sic*] to support an agency's election to proceed by *ad hoc* adjudication rather than by rule making. Occasionally, as in the *E & B Brewing* case [NLRB v. E & B Brewing Co., 276 F.2d 594 (6th Cir. 1960)], it is cited as establishing limitations upon retroactive application of standards established in such adjudications. It has not been cited as establishing or suggesting, as it does, standards for finding abuse of discretion in the persistent failure or refusal of agencies to promulgate as rules those "rules of decision" which have become hoary as "well established" precedents, sometimes followed with *stare decisis* faithfulness.

Recommendations of Vice Chairman Smalley to the Committee on Agency Rule Making, 12 AD. L. BULL. 190 (1960).

the agency in a given situation to establish policy by published rules rather than by ad hoc adjudication. It is doubtful that a non-legally trained person could convincingly argue that an agency's denial of an application for a license without following announced criteria violates due process as defined in *Hornsby v. Allen*.⁴⁸ Moreover, it is unlikely that case law arguments would even occur to someone outside the legal profession.

The constitutional guarantees of the first eight amendments as well as those of procedural and substantive due process have become familiar terms to large numbers of the public. But whether they have been violated is a question requiring legal skill, and safeguarding these guarantees has traditionally been treated as a legal concern.

A large number of complaints force the investigator to construe statutes, rules and opinions of courts and agencies. He must be able to analyze legislative history when that is necessary to statutory interpretation. He must be capable of suggesting reorganization and delineation of responsibility among the various agencies. His work as a legislative reformer means he must be adept at many phases of law, from determining what reforms are necessary to perhaps drafting the legislative revision.

The ombudsman's effectiveness can be bolstered if his opinion, based on hindsight and expertise in administrative law, is convincing on its merits.⁴⁹ He cannot satisfy the complainant unless the individual is assured the investigation was thorough and accurate. He cannot effectively urge the legislature to revise without presenting solid reasons for the change. He cannot persuade the agency to adopt a new procedure without convincing it that the proffered method is more sound administratively. In the final analysis, he cannot be wrong often or he will not be able to influence anyone that his opinions are reliable.

All these requirements do not mean, however, that legal training is an indispensable prerequisite to effectiveness as an ombudsman. It is commonplace for administrators and executives without legal backgrounds to succeed. They must make many decisions involving legal considerations, but they rely on advice from attorneys. An ombudsman could do the same by making an attorney a member of his staff. Nevertheless, legal training would relieve an ombudsman of the necessity of relying on another person's advice in many matters. An ombudsman with a legal background would undoubtedly

⁴⁸ 326 F.2d 605 (5th Cir. 1964).

⁴⁹ W. GELLHORN, *WHEN AMERICANS COMPLAIN* 229-30 (1966).

have a valuable advantage; without it his efforts could be seriously hampered.

The Scandinavian countries explicitly make legal education a prerequisite, and Norway even requires that the ombudsman meet the qualifications of a judge of its highest court.⁵⁰ New Zealand sets out no qualifications for its ombudsman,⁵¹ evidently trusting the House of Representatives to select a suitable individual. The only man appointed so far has been considered eminently qualified; he was a successful lawyer before becoming an administrator and diplomat.⁵²

Personal characteristics are probably the most important criteria in the selection of an ombudsman.⁵³ His effectiveness rests upon several highly significant but intangible characteristics: his personality, his public image, his ability to communicate, his tenacity.⁵⁴ His own integrity and objectivity must be beyond doubt; if they are not, there is little that his criticism can do to effect changes or little that his opinion can do to placate complainants.⁵⁵ He must be self-sufficient if he is to carry out his task in the face of the criticisms that are sure to be made. He must be strong enough to criticize high ranking officials when necessary, and courageous enough to take an unpopular position. Above all, he must remain apart from partisan politics to retain the confidence indispensable to his work.⁵⁶

The Danish Ombudsman, without trying, is the only official critic around whom a personality cult has developed.⁵⁷ While this gives him great prestige and ability to persuade, it tends to transform criticism of the man into criticism of the office. This development is probably due to the selection of a highly popular and prominent individual, and it is certainly fostered by what Professor Gellhorn describes as colorful and able performance.⁵⁸

Most countries have tended to select someone who is relatively unknown, perhaps to avoid choosing a political partisan. The Swedish like to say, as one parliamentary leader expressed it, "The man we select does not lend distinction to the office; the office distinguishes him."⁵⁹ The Norwegians chose a judge from their Supreme

⁵⁰ GELLHORN, *supra* note 9, at 158.

⁵¹ Ombudsman Act § 2 (1962) (New Zealand), *reprinted in 1966 Hearings* 132.

⁵² GELLHORN, *supra* note 9, at 92.

⁵³ *Id.* at 423.

⁵⁴ See Abraham, *supra* note 46, at 237.

⁵⁵ W. GELLHORN, WHEN AMERICANS COMPLAIN 47 (1966).

⁵⁶ Anderman, *The Swedish Justitieombudsman*, 11 AM. J. COMP. L. 225, 226 (1962), *reprinted in 1966 Hearings* 96, 97.

⁵⁷ GELLHORN, *supra* note 9, at 33-34.

⁵⁸ *Id.* at 5 & n.1. Mr. Hurwitz was a law professor on the faculty of the University of Copenhagen.

⁵⁹ *Id.* at 203.

Court to be their first Ombudsman.⁶⁰ He has been described as a modest and shy man who does not receive widespread press coverage. Even without news reports, his work has been effective due mainly to dissemination of his opinions through specialized publications.⁶¹

On the other hand, the mildness of Finland's Ombudsman has meant that the potentialities of the office have been only partly realized. For example, while the Ombudsman agreed that local officials had no authority to intrude into the private life of one complainant, he did no more than that. He did not come to the defense of each citizen's right to privacy by issuing a rebuke and giving it widespread publicity. If he had, he might have been responsible for strengthening this right throughout the country.⁶²

Mr. Bexelius, the Swedish Ombudsman, furnishes a good example of the attitude required. He has said:

[M]any of my friends have been angry with me. Often when I criticize a judge, he is a man with whom I have worked in court and know very, very well. Naturally, I don't like to criticize him, but I must. The ombudsman cannot be concerned about his popularity. It is no secret that high officials in Sweden — all of them — dislike the ombudsman. They say that he is always interfering in things he doesn't know anything about, and that they could do their jobs better if he would stop meddling, and so on. But all their grumbling doesn't mean a thing. Everybody knows that it is necessary to have an ombudsman.⁶³

B. *Method of Selection*

The Swedish procedure of a non-partisan selection by the legislative body has been widely followed. Since the ombudsman has been conceived everywhere as the legislature's agent, that body naturally exercises the prerogative of selection. Realizing that the ombudsman's whole power depends upon his objectivity, most legislatures have not succumbed to the temptation to make a partisan choice.⁶⁴

The Swedish Parliament chooses a body of forty-eight electors and empowers it to elect the Ombudsman. Seats on the electoral body are proportionate to party representation in the Riksdag, twenty-four members being chosen from each house. Since World War I the elections have been unanimous. Pending elections have not received much attention by the public or the press which presumably leaves the electors free to choose a well qualified individual rather

⁶⁰ *Id.* at 158.

⁶¹ *Id.* at 189-90.

⁶² *Id.* at 88-89.

⁶³ Bainbridge, *A Civilized Thing*, *NEW YORKER*, Feb. 13, 1965, at 136, 151, *reprinted in 1966 Hearings* 106, 112.

⁶⁴ GELLHORN, *supra* note 9, at 424.

than a spokesman for the majority party. The tradition in Sweden of selecting a jurist strengthens the absence of a choice based on partisan considerations because the judiciary is removed from political elections.⁶⁵ The ombudsmen of Denmark, Finland and Norway are elected directly by their parliaments.⁶⁶

New Zealand's method of selection is unique. The Ombudsman is appointed by the executive branch, but only upon the recommendation of each Parliament. It is possible that the Government can dictate the choice since it nominally controls the votes of its supporters. This has not happened; New Zealand's election has followed the non-partisan tradition firmly established in most of the Scandinavian countries.⁶⁷ It should be noted that the institution was established in Sweden in an era when party politics in the modern sense did not exist.⁶⁸ The recent experience in Denmark and New Zealand,⁶⁹ however, is a strong indication that the office can be transplanted into today's political atmosphere without loss of neutrality.

Finland is the exception to the tradition. Perhaps the injection of partisan considerations into the selection accounts for the fact that this ombudsman has less influence than those of other countries. Each party nominates a candidate and the nominee of the majority party is routinely elected. At least the procedure of voting by secret ballot without discussion⁷⁰ avoids what otherwise could be irreparable damage to the prestige of the individual and to his ability to fulfill the task.

If the premise asserted here that the ombudsman must function independently is accepted, then most considerations favor a non-partisan selection, and little valid reason exists for a political choice. Playing politics here is a two-edged sword. A sophisticated citizenry might soon realize that the controlling party had not acted to help and protect the public but rather to advance its own fortune by entrenching a political hack in a powerful position to heap abuse on the opposition and to make excuses for his own party. The tactic could well cause an adverse reaction at the polls. Appreciation of this possibility probably accounts for the fact that few legislatures make a partisan choice.

⁶⁵ See Lundvik, *Comments on the Ombudsman for Civil Affairs*, in THE OMBUDSMAN 44-45 (D. Rowat ed. 1965); GELLHORN, *supra* note 9, at 202-03.

⁶⁶ GELLHORN, *supra* note 9, at 424. The Finnish Parliament elects its Ombudsman by a simple majority vote. *Id.* at 51.

⁶⁷ *Id.* at 103-04.

⁶⁸ Holmgren, *The Need for an Ombudsman Too*, in THE OMBUDSMAN 225, 230 (D. Rowat ed. 1965).

⁶⁹ GELLHORN, *supra* note 9, at 103-04.

⁷⁰ See generally *id.* at 424.

C. Tenure, Salary and Staff

Sweden's experimentation with the most advantageous length of term has provided a touchstone for others. Before 1941 Sweden's Ombudsmen were elected for a one year term. Even though many were re-elected the changeovers proved to be too frequent. At present the Swedish Ombudsman serves a four year term, and his salary is equal to that of a judge of the Supreme Court. He may be re-elected indefinitely although indications are that Parliament considers twelve years service the maximum. It deems a new officer with a fresh outlook desirable. Parliament is also aware that the strain of the responsibility might take its toll on any person's devotion and initiative after many years in the office.

Although Parliament retains the power to remove the Ombudsman during the term for exceptional reasons, it has never done so.⁷¹ Even failing at re-election the officer is not without security; he may choose to resume his previous career or to retire on a full pension.⁷² The other Scandinavian countries allow each new parliament to elect an ombudsman or to re-elect the incumbent. The New Zealand Ombudsman serves until his successor has been appointed by a succeeding Parliament.

Removal from office during the term is more difficult in New Zealand than in most of the Scandinavian countries, although removal has seldom occurred anywhere. The New Zealand Ombudsman can be removed or suspended only for disability, bankruptcy, neglect of duty or misconduct.⁷³ The Nordic parliaments can remove their appointee when a simple lack of confidence occurs.

A term of at least three or four years is necessary for the individual to master the demands of the office, to establish rapport with those he serves and for the public to realize full benefits. The notion applied to the judiciary in some jurisdictions of insuring autonomy by means of an appointment for life might unduly rigidify the institution while gaining an independence that most legislative bodies are already willing to grant. An individual could lose both his initiative and his flexibility after holding the office for a long time. Further, there must be a hedge against loss of confidence by the legislature, the agencies or the people. An ombudsman without influence would be a lameduck appointee without effectiveness.⁷⁴

If lengthy tenure is not a desirable feature, other aspects must make the job appealing to attract highly qualified individuals to

⁷¹ See generally Lundvik, *supra* note 65, at 45. See also Bainbridge, *supra* note 63, at 140-42, 1966 *Hearings* at 108.

⁷² GELLHORN, *supra* note 9, at 203; Lundvik, *supra* note 65, at 45.

⁷³ Ombudsman Act § 5 (1962) (New Zealand), *reprinted in* 1966 *Hearings* 132, 149.

⁷⁴ GELLHORN, *supra* note 9, at 425.

this formidable task. The possibilities of future advancement in public office are no longer much of an inducement. Even in Sweden it is the practice to choose an older individual and to refrain from appointing him to another office at the end of eight or twelve years of service. He is then relieved of the economic need to curry favor rather than criticizing forthrightly.⁷⁵ This philosophy in altered form has appeared in some of the ombudsmen bills proposed in the United States. Most of the proposals bar any member of the state legislature from holding the office within two years after leaving the legislature.⁷⁶ At the same time the proposals bar the ombudsman from holding any state position for either two or three years after he relinquishes that office.⁷⁷

While these restrictions will be helpful in preventing the office from being used as a reward for the faithful, but losing, political candidate, or from being turned into a patronage post for a career civil servant, they will also tend to limit the number of interested applicants. To be barred from a public position for several years after serving as ombudsman would seem to eliminate the career civil servant. It could well eliminate judges, the class which has most frequently filled the office elsewhere. There would be no guarantee that these people could ever resume their careers in public service after their terms as ombudsmen.

The American proposals would prevent the incumbent from holding any position for remuneration during his tenure,⁷⁸ but he should be able to take a leave of absence from many vocations. The latter factor should broaden the field of selection somewhat, even if legal training is made a requisite. In that case, attorneys engaged in private practice and law professors would be likely classes to provide the ombudsman. However, the right individual could come from the bench or the district attorney's office, or from any legal background if he expected to retire at the end of his service. In that event the restriction on employment after service would be no hindrance.

Two factors which might cause a qualified individual to accept the position are an adequate salary and a competent staff. An additional reason to set a high salary is to enhance its public image by giving material recognition to the importance of the office. The Scandinavian countries have fixed the salary at a level commensurate with that of a judge on the highest court, or equal to the chief judge's compensation. Only in New Zealand is the salary left to

⁷⁵ Bainbridge, *supra* note 63, at 140, 1966 *Hearings* at 108.

⁷⁶ Aaron, *Utah Ombudsman: The American Proposals*, 1967 *UTAH L. REV.* 32, 44.

⁷⁷ *Id.*

⁷⁸ *Id.*

the discretion of the chief executive. The salary there has been fixed below that of most of the higher judges and other ranking officials.⁷⁹

The power to determine salary level can be important as a control over the independence of the ombudsman. It can mean an executive official, a legislative committee, or a legislature itself with power to reduce the flow of funds during the ombudsman's term can influence his work. The Scandinavian procedure which establishes the salary at a par with that of the judges of the supreme courts is one solution to this problem.

It seems highly likely that the recurring governmental problem of competing poorly with private business salaries will appear here. The individuals who are qualified will likely be receiving compensation at a rate well over what the government will pay. These factors may be unimportant, however, since no country has experienced difficulty in attracting able men to the post. The chance to make a real contribution to a better life and the attendant prestige are probably persuasive enough to cause many to accept the challenge in spite of the hardship it entails.

An ombudsman's work is invariably viewed as highly personal since his own integrity and objectivity are the factors which make his judgments effective. His effectiveness can be hampered if he is not allowed to choose his own staff. It is essential that the assistants who will do much of his research have his confidence. All of the countries which have an ombudsman allow him to select his own assistants. Several of them, however, select a deputy ombudsman in the same manner as his superior is chosen to assist and to fill a vacancy.⁸⁰

One engaging feature of the institution is the small staff with which it has traditionally functioned. The Danish staff consists of seven lawyers and five clerical employees. Most of them work only part time because their services as attorneys are in great demand in private practice. Yet they consider working with the Ombudsman desirable employment because many have been able to advance to good positions after their broad exposure to governmental activities.⁸¹

Sweden's Ombudsman operates with a staff of nine attorneys and three secretaries.⁸² The New Zealand staff consists of a lawyer, an administrator, an investigating officer and two clerical employees. Another attorney and another typist also work part time.⁸³

⁷⁹ GELLHORN, *supra* note 9, at 425.

⁸⁰ *Id.* at 425-26.

⁸¹ *Id.* at 29.

⁸² Bainbridge, *supra* note 63, at 142, 1966 *Hearings* at 108.

⁸³ GELLHORN, *supra* note 9, at 116 & n.56.

These staffs are not large considering the populations they serve. Sweden, the most populous of the Scandinavian countries, counts eight million people.⁸⁴ New Zealand has a population of three million people.⁸⁵ It is encouraging to note that no ombudsman has been denied the staff he needs, nor has had difficulty in recruiting qualified persons.⁸⁶

D. *Jurisdictional Powers*

Limiting the jurisdictional reach of the ombudsman has been one of the most difficult problems encountered. An ombudsman cannot revise the entire governmental framework let alone function as a superior administrative authority for each agency. He cannot be made competent to examine every public problem, but the difficulty lies in where and how to draw the line. No matter how jurisdiction has been defined, it is characteristic of each ombudsman office that much time and effort has been required to determine whether a particular matter falls within its scope.⁸⁷

No ombudsman has been empowered to supervise the work of the legislature which, after all, created the office to assist it and not to govern it. Yet the responsibility to criticize inadequate laws and to recommend revision amounts to an indirect supervision of the legislature. Still, an ombudsman has no formal sanctions to compel the adoption of his suggestions for legislative reform, just as he is given no formal power to effect his other suggestions.

The Danish Ombudsman is authorized to supervise some local matters and every phase of national administration, military and civil, excluding the courts. His jurisdiction encompasses "ministers, civil servants and all other persons acting in the service of the State" except those who work in judicial administration.⁸⁸ Even with this wide jurisdiction the Ombudsman has sought to enlarge his jurisdiction. In 1964 he took cognizance of complaints against lawyers appointed by the national government whose indigent clients were dissatisfied. He felt these attorneys were within his reach as "persons acting in the service of the State." In fact, he astounded the entire profession by intimating that lawyers should be within his jurisdiction because they perform a public function and can only serve when duly licensed by the state. The issue has not been finally settled

⁸⁴ The Swedish government estimated the population at 7,773,000 in 1966. *THE WORLD ALMANAC AND BOOK OF FACTS FOR 1967*, at 258.

⁸⁵ The New Zealand government officially estimated the population at 2,647,282 in 1965. *Id.* at 258.

⁸⁶ GELLHORN, *supra* note 9, at 426. But the rapidly increasing backlog of cases in the Swedish office indicates that this ombudsman staff is reaching the limit of its capability to handle the increasing volume of cases. Text accompanying note 106 *infra*.

⁸⁷ See generally *id.* at 426-27.

⁸⁸ *Id.* at 10-11.

although the bar association persuaded him to disclaim a present competence.⁸⁹

New Zealand's experience is informative. Its statute states that the principal function of the Ombudsmen is to "investigate any decision or recommendation made . . . or any act done or omitted, relating to any matter of administration and affecting any person or body of persons in his or its personal capacity."⁹⁰ A schedule lists those departments which are placed by statute within the Ombudsman's jurisdiction, but that does not solve the problem. The Ombudsman has the difficult task of deciding whether an act relates to what the statute terms a "matter of administration" over which he has jurisdiction or to a matter of policy over which he does not. The Ombudsman has not been able to devise any general principles which resolve the problem so he is forced to decide his jurisdiction case by case. His decisions have sometimes been strongly criticized, his detractors fearing that he is extending his jurisdictional reach into policy decisions.⁹¹ The New Zealand Ombudsman has stated that a quarter of his working time is taken in resolving his own doubts about jurisdiction.⁹²

1. Review of Discretion

The Swedish institution was originally charged with the responsibility of insuring compliance by public officials with laws and regulations. It gradually assumed the additional duty of reviewing administrative decisions, not so much to change the result of the case at hand but to insure other cases are properly considered.⁹³ Traditionally an ombudsman does not criticize simply because he would have reached a different decision but only if the action under review is so clearly erroneous as to be illegal. Discretion is only abused where there are no valid reasons for the way it is exercised, that is, where the controlling reasons are arbitrary or capricious. Yet this distinction is notoriously difficult for the courts or the ombudsman to draw in practice.

The New Zealand statute allows the widest latitude for ignoring the distinction. The Ombudsman may review an administrative decision not only for illegality, but to determine whether it is "un-

⁸⁹ *Id.* at 43. The Scandinavian countries do not have a declaratory judgment procedure which could provide a definite answer to disputes such as this. *E.g.*, Lundvik, *Comments on the Ombudsman for Civil Affairs*, in *THE OMBUDSMAN* 44, 46-47 (D. Rowat ed. 1965). This article also includes a discussion of the difficulties caused by this lack.

⁹⁰ Ombudsman Act § 11 (1962) (New Zealand), *reprinted in 1966 Hearings* 132, 136.

⁹¹ *See generally* GELLHORN, *supra* note 9, at 107, 110.

⁹² *Id.* at 118.

⁹³ The Office of Ombudsman in New Zealand — Its Origin and Operation, address by Sir Guy Powles, before the Canadian Bar Association, *reprinted in 1966 Hearings* 207, 208.

reasonable, unjust, oppressive, or improperly discriminatory," or "was based . . . on a mistake of law or fact," or "was wrong."⁹⁴ The statute in effect opens the door to review of all decisions, discretionary or otherwise, and the present Ombudsman has seized the opportunity to do so.⁹⁵

Other countries try to restrain their critic more closely. Norway allows review and criticism when the decision is "found to be clearly unreasonable or otherwise clearly in conflict with fair administrative practice."⁹⁶ Yet the Ombudsman has found it proper to consider more and more of the borderline cases, and Professor Gellhorn concludes he has acted on many complaints which are outside his jurisdiction since there was no clear abuse of discretion.⁹⁷

The Danish statute provides that the Ombudsman is to "keep himself informed" whether those subject to his supervision "commit mistakes or acts of negligence in the performance of their duties." The Parliament's general directives expand on this by directing criticism of "arbitrary or unreasonable decisions."⁹⁸

The actual practice of ombudsmen to assume wide jurisdiction over matters of discretion is clearly apparent.⁹⁹ The statutory definitions may be different semantically, but in practice there is no distinction between an "unreasonable" decision and a "clearly unreasonable" decision. Language will probably never be adequate to control the extent of an ombudsman's assertion of his jurisdiction. It seems that the only effective check will be supervision by the legislative committee which is commonly charged with responsibility to oversee the ombudsman's work.¹⁰⁰

2. Exhaustion of Remedies

One of the controversial issues is whether the doctrine of exhaustion of remedies should be applied to the ombudsman. Theoretically, the citizen has enough protection if he has a right of appeal to any court or administrative tribunal. There should be no need for a second review by the ombudsman; a fully adjudicated decision is supposed to be better justice than that which the om-

⁹⁴ Ombudsman Act § 19 (1962) (New Zealand), *reprinted in 1966 Hearings* 132, 143.

⁹⁵ GELLHORN, *supra* note 9, at 433-34.

⁹⁶ *Id.* at 168.

⁹⁷ *Id.* at 169-70.

⁹⁸ *Id.* at 13 & n.15.

⁹⁹ *Id.* at 434.

¹⁰⁰ Sweden's system of parliamentary supervision of the ombudsman is typical of that used by other countries. The First Law Committee of the Riksdag is charged with maintaining a working relationship between the Riksdag and the Ombudsman. The Ombudsman's required annual report of his work is addressed to that committee. The committee receives any complaints made about his activities, and its members may criticize his past decisions or suggest he concentrate his energies in a different area. Bexelius, *The Ombudsman for Civil Affairs*, in *THE OMBUDSMAN* 22, 25 (D. Rowat ed. 1965).

budsman can offer. If the issue is the substantive soundness of a decision affecting a private interest, the tribunal is probably best qualified to consider the merits. But if the complaint relates to procedure, arbitrariness, behavior or issues other than the merits, the ombudsman is better equipped to give a decision.¹⁰¹

Ideally the ombudsman should be free to cut across the bureaucratic structure to get at the crux of the complaint. If he is able to do so, however, many complainants will come directly to him rather than pursue the elaborate and expensive review structure that is available. The advantage to the individual is that the ombudsman will take the case upon himself without any further effort or expense of the individual. On the other hand, the ombudsman has no power to change a decision even though his suggestions or criticisms often achieve that result for the individual.

Furthermore, if the doctrine is applicable many meritorious complaints will never be appealed to the administrative tribunal much less reach the courts. The citizen is often thoroughly exhausted in finances and patience before he has exhausted the administrative remedies which stand between him and court review. Even if direct access to the court were granted, many individuals could not afford it, nor would they choose to accept it. The right to appeal is frequently not exercised.

There are arguments to be made for or against applying the exhaustion doctrine. Seeking the middle ground by leaving the matter to the discretion of the ombudsman affords no clear solution. Norway's Ombudsman is instructed by Parliament to require that a complainant pursue the administrative relief available unless "particular reasons" exist for assuming jurisdiction at once. Where administrative review remains open he has dealt with the merits in only two situations. One is when the complaint is clearly unjustified so that no good purpose could be served by requiring appeal before giving his opinion. The second is when the matter is too urgent to insist on following the appeal available. But even this Ombudsman is an example of the trend among official critics to assume jurisdiction even if other avenues remain open to the complainant. The Norwegian Ombudsman has managed to exert his influence without taking actual jurisdiction. For instance, he advised a prisoner to complain through channels, but at the same time he communicated informally with the Ministry of Justice to ask about some of the points of the complaint. This technique gives the department a clear indication of the Ombudsman's opinion even when he technically has not acted on the case.¹⁰²

¹⁰¹ See generally GELLHORN, *supra* note 9, at 110-11.

¹⁰² *Id.* at 172 & n.36.

The Swedish Ombudsman, whose jurisdiction is not limited by the exhaustion doctrine, affords another example of the tendency to assume jurisdiction rather than to turn a complainant away. On occasion a case has been appealed to the ministerial body and simultaneously filed with the Ombudsman. In that situation the ministers have tended to wait for the Ombudsman to act, and he has waited for the ministers to act. But the Ombudsman admits that he has usually given in first and assumed jurisdiction.¹⁰³

Other countries have resolved the question by statute in favor of a flat requirement of exhaustion of remedies.¹⁰⁴ The decisive factor is probably that, with any other rule, the ombudsman and his small staff would be inundated with more than he could handle. Even the Swedish Ombudsman has suggested that the doctrine be made applicable to him.¹⁰⁵ His backlog of cases almost doubled from 240 in 1961 to 447 in 1965, and this no doubt accounts for his recommendation.¹⁰⁶

3. Statute of Limitations

Complaints are almost always filed when the matter is current, but exceptions do occur, necessitating a statute of limitations to establish a time limit after which an ombudsman no longer has jurisdiction. A complaint is considered valid in Sweden even if it is lodged ten years after the event. Other countries draw the line at one year to avoid airing ancient grudges and to limit complaints to those suitable for investigation.¹⁰⁷

The shorter period has most of the arguments on its side. There is some reason to give the ombudsman authority to bypass the one year statute of limitations to pursue a meritorious case, but in the instances already discussed where an ombudsman has been given discretion, he has tended to expand his jurisdiction. Unlimited jurisdiction can create an unworkable situation, and it would seem best to foreclose that possibility with a mandatory statute of limitations.

E. *Source and Processing of the Ombudsman's Work*

The manner in which the ombudsman institution is called into operation is important to its effectiveness. Matters are brought to an ombudsman's attention in several ways. Any citizen may write to lodge a complaint.¹⁰⁸ In addition, ombudsmen often investigate

¹⁰³ *Id.* at 207 & n.23.

¹⁰⁴ *See generally id.* at 428.

¹⁰⁵ *Id.* at 207 & n.23.

¹⁰⁶ *Id.* at 213.

¹⁰⁷ *Id.* at 427.

¹⁰⁸ *See generally id.* at 210-17; Bexelius, *supra* note 13, at 28; address by Blix, *supra* note 4, at 93.

questionable decisions or practices brought to their attention by the news media.¹⁰⁹ They may also seek out administrative abuse through inspections of agencies.¹¹⁰ The real value of the institution as far as the public is concerned is direct and easy access to the service by means of a personal complaint.¹¹¹ The complainant need do no more. The ombudsman will decide whether to pursue the matter and he will conduct any investigation. While the Swedish Ombudsman feels that matters which he takes up on his own motion as a result of a news item or his inspection result in the most productive work,¹¹² other ombudsmen have ignored their inspection and self-initiated powers and have concentrated on individual complaints.¹¹³ The authority to act by any of the three methods is a power which each ombudsman should be allowed to develop as he chooses.

1. Complaints

Complaints filed by letter with the ombudsman, either from an individual or an organization, constitute the bulk of his work. He is not obligated to leap into action but has broad discretion to dismiss complaints. Little formality is required other than a signed letter stating the facts, and these requirements are not strictly enforced. An individual may walk into the ombudsman's office and someone on the staff will assist him in drafting his complaint. No attorney is required although they have been known to draft complaints for their client's signature.¹¹⁴ Anonymous complaints need not be considered but ombudsmen have investigated some anyway.

Only New Zealand requires a filing fee, equivalent to \$2.80, to discourage frivolous complaints. Experience shows, however, that the theory fails in practice. New Zealand has had its share of trivial letters, but only a few are complaints from prison inmates who usually comprise a large share of the clientele elsewhere. This is some indication that the fee has not discouraged the maladjusted but instead has disadvantaged the impecunious.¹¹⁵

The Swedish processing procedure emphasizes the personal control of the Ombudsman. He frequently reads the complaint as it arrives, sometimes scribbling instructions in the margin for a staff assistant, or choosing to handle the case himself. The complaint is then noted in a log. Most cases are assigned to a staff member who

¹⁰⁹ Bexelius, *supra* note 13, at 29; address by Blix, *supra* note 4, at 93.

¹¹⁰ See generally GELLHORN, *supra* note 9, at 218-27; Bexelius, *supra* note 100, at 29; address by Blix, *supra* note 4, at 93.

¹¹¹ Note, in THE OMBUDSMAN at 184 (D. Rowat ed. 1965).

¹¹² GELLHORN, *supra* note 9, at 218; see Bexelius, *supra* note 100, at 42-44.

¹¹³ GELLHORN, *supra* note 9, at 426-31.

¹¹⁴ See, e.g., GELLHORN, *supra* note 9, at 122.

¹¹⁵ *Id.*

takes the next step whether it be drafting a letter stating the reasons for its dismissal or requesting more information from the complainant. If an investigation is undertaken, the assistant contacts the agency and asks for the official file. The law requires public servants to provide documents and to give information, and they cooperate. The great majority of the cases are disposed of quickly after the file is received. A letter to the complainant explaining the finding is drafted for the Ombudsman, and the case is closed. No opinion is published unless the case is one of those the Ombudsman considers important enough to publish in his annual report to Parliament. This publication procedure has produced a body of administrative agency precedents which the Swedish agencies and Ombudsmen have followed.¹¹⁶

Other countries use a less cumbersome procedure. A complaint which is not dismissed at once is sent to the agency for its explanation. The ombudsman then forwards the comment to the individual. Most are satisfied at that point; if not, the ombudsman will investigate the official file, or take other necessary steps.¹¹⁷

2. Inspection

A viable inspection system does not exist even in Sweden where tradition and publicity cause citizens to feel and to act as if one were imminent. The Swedish Ombudsman, however, inspects as much as he can, making deft utilization of the spot check by examining files at random in the agency under scrutiny.¹¹⁸

Field inspection seems to be an essential element of any efficient and effective governmental organization. While the ombudsman can undoubtedly perform a valuable service here, especially by unifying procedure, the task is beyond his capability as the institution is usually constituted. The public may have to rely on internal audits by superiors in the structure to safeguard its interest. In addition any individual subjected to administrative abuse always has the option of filing a complaint with the ombudsman.

The plain facts are that no individual or small staff can adequately inspect all the agencies in a modern government. Further, the inspection may emphasize paperwork at the expense of training of agency personnel, internal audits or reorganization planning.¹¹⁹ The extra documentation is just as apt to be that which exonerates the official as that which adds comprehensiveness to the file or assurance that safeguards were met. The Swedish Ombudsman has

¹¹⁶ See generally *id.* at 210-12. The annual report is discussed *id.* at 251-54. See also Bainbridge, *supra* note 63, at 20, 1966 *Hearings* 109.

¹¹⁷ GELLHORN, *supra* note 9, at 213.

¹¹⁸ *Id.* at 218.

¹¹⁹ *Id.* at 223.

recognized the futility of his attempt to reach each unit even as seldom as once a decade, and he has pleaded for permission to delegate routine complaints to the agency so as to free himself for exceptional complaints and more investigations.¹²⁰

3. News Coverage

The news media play a large role in policing administrative agencies. They usually do not tackle a technical problem but are superb at exacting every drop of emotion out of a human interest story. While the ombudsman avoids being drawn into the personalities of the situation, his trained eye may spot a procedural deficiency or an inadequate law when others do not. He is free to delve into the question on his own initiative.

F. Privileges and Immunities

The ombudsman's proceedings and decisions have been made immune from judicial review except for the subpoena power which he must enforce through the courts. A declaratory judgment, however, may be obtained in some countries when a party alleges the ombudsman has contravened the provisions of the act creating the office. Except in Sweden the ombudsman has control over whether the press shall have access to his work. The ombudsman has been accorded the same immunity from civil and criminal actions as judges, and he and his staff are privileged not to testify about their work.¹²¹

G. Investigative and Procedural Powers

The ombudsman could be hamstrung without sufficient means to carry out his task. The institution has been given the subpoena power to compel any official to produce documents or to give testimony relating to an investigation.¹²² The ombudsman usually has authority to establish his own rules of procedure for handling complaints, except for the jurisdictional restrictions already discussed. He has authority to initiate investigations, usually without notice.¹²³ He may recommend a change in statute to Parliament or to the

¹²⁰ Bexelius, *supra* note 100, at 43.

¹²¹ See generally Bexelius, *The Ombudsman for Civil Affairs*, in *THE OMBUDSMAN* 22, 24-25 (D. Rowat ed. 1965) (Sweden); Kastari, *The Chancellor of Justice and the Ombudsman*, *id.* 58, at 62-63 (Finland); Northey, *New Zealand's Parliamentary Commissioner*, *id.* 127, at 135-37 (New Zealand); Os, *The Ombudsman for Civil Affairs*, *id.* 95, at 105 (Norway); Pedersen, *Denmark's Ombudsman*, *id.* 75, at 81 (Denmark). See also Aaron, *Utah Ombudsman: The American Proposals*, 1967 *UTAH L. REV.* 57-58, for a collection of the privileges and immunities afforded by the bills proposed in the United States.

¹²² See GELLHORN, *supra* note 9, at 431; e.g., Ombudsman Act § 16 (1962) (New Zealand), reprinted in 1966 *Hearings* 132-49.

¹²³ See GELLHORN, *supra* note 9, at 430.

executive branch, or he may petition the agency for a change in its procedures.¹²⁴

Countries which have adopted the institution have not given their ombudsmen sanctions as severe as those authorized in Sweden. Only the Swedish and Finnish Ombudsmen have authority to require any civil servant to aid in investigating any matter, or to prosecute a public servant for the crime of dereliction of official duty.

Probably the most persuasive power an ombudsman has at his command is publicity. Each existing ombudsman is required to file an annual report with the parliament. The Swedish Ombudsman's report, running up to 500 pages, outlines the work he has done and contains a fully reasoned opinion for each important case. While most officials never see it because it is printed in only 3,400 copies, they appear to be aware of its contents through secondary sources, *i.e.*, the press and specialized publications. There is a determined effort by officials to avoid the stigma of being named critically in the report.¹²⁵

Even more influential than the annual report is the daily press coverage given an ombudsman's opinions. It is through this medium that his criticisms and suggestions gain wide circulation. The Swedish public believes it has excellent civil servants so it expects high quality performance from them. When a serious shortcoming is brought to light, the public treats it as a scandal. Civil servants on the sharp end of the news story react quickly to avoid a recurrence. Usually the news media does not identify the official's name or title, but his haste to make corrections is no less because his identity will be revealed in the annual report.¹²⁶

Experience has shown that an ombudsman seldom has any need to invoke his procedural powers. The power of publicity and the existence of the formal powers are subtle threats which have been persuasive enough to assure the ombudsman cooperation and to gain the information his work requires.¹²⁷

The ombudsman's primary powers, the right to investigate and to recommend, are not insignificant assets because of the very nature of the institution. Since he has no formalized authority to impose his opinion on the agency, he must resort to the persuasive tools of logic and reason augmented by the weight of his personal influence. If the agency rejects his suggestion without a good reason,

¹²⁴ See generally GELLHORN, *supra* note 9, at 205-08; Anderman, *The Swedish Justice-ombudsman*, 11 AM. J. COMP. L. 225-31 (1962), reprinted in 1966 *Hearings* 96-100; Bexelius, *supra* note 121, at 78-79.

¹²⁵ GELLHORN, *supra* note 9, at 251-54; Bainbridge, *A Civilized Thing*, NEW YORKER, Feb. 13, 1965, reprinted in 1966 *Hearings* 107-08.

¹²⁶ See generally Lundvik, *Comments on the Ombudsmen for Civil Affairs*, in THE OMBUDSMAN 44, 49-50 (D. Rowat ed. 1965).

¹²⁷ See generally GELLHORN, *supra* note 9, at 436-37.

he can resort to publicity to roast the agency in the wrath of public opinion. Publicity may not be the power to command, but it comes close to compulsion. Again, this power has not been used frequently, nor have personal attacks been indulged.

H. *Common Results*

The ombudsman development outside Sweden and Finland is relatively young, too new to evaluate with certainty that it will remain as effective as it now appears. Even so, its success in these adoptive countries is generally recognized after the five to fifteen years of trial it has undergone. The remarkable similarity of results reached from Scandinavia to New Zealand to Nassau County, New York, affords some assurance that the established pattern is stable. Crank letters have comprised only a small percentage of the complaints. Most cases have been dismissed immediately or after a brief investigation, and only ten to fifteen percent of the complaints have been judged meritorious.¹²⁸ The variations in results appear to be due more to differences in classifying cases because of differing jurisdictional limits and standards of judgment than to variations in personality characteristics among the nationalities.¹²⁹

The small number of complaints found to be deserving is not an indication the value of the office has been negligible; its mere existence has considerable effect. Knowledge that its aid may be invoked serves as an incentive to agency officials to give good service.¹³⁰ Public confidence in public administration is increased by the mere fact that anyone has the possibility of presenting his case to the ombudsman.

If the public is to have faith in the integrity of its government, accusations of scandal or other abuse should not go unanswered. The governing officials can hardly assuage the public's suspicion because they obviously have an interest in whitewashing a deficiency. The ombudsman, however, can heal the sore before it becomes an open wound.¹³¹ It is his responsibility to investigate these matters in depth and to publicize his findings. If he is objective enough to do that unhesitatingly, he will do much to restore faith in government. Sometimes he will be responsible for a great shakeup,¹³² but

¹²⁸ At the end of the first year of his work, Judge Samuel Greason, Public Protector of Nassau County, felt that 20% of his cases were well founded. County Executive of Nassau County, N.Y., Press Release, July 12, 1967.

¹²⁹ GELLHORN, *supra* note 9, at 118-19.

¹³⁰ Bexelius, *supra* note 121, at 41.

¹³¹ *Id.* at 42.

¹³² See, e.g., GELLHORN, *supra* note 9, at 57. The Finnish Ombudsman demanded the indictment of two cabinet members and two former Ministers for improper use of government funds. The cabinet members resigned immediately, and the two Ministers were convicted.

more frequently he will exonerate faithful government servants. The ombudsman office is a safety valve to those who invoke its aid as well as to the great majority who know they could call on it for help if their particular impasse with government grows worse. It vindicates directly the rights of only a small number whose complaint succeeds, but at the same time it serves others indirectly.

The great strength of the concept has been the flexibility with which it has adapted to the differing demands made in each new home. Most observers credit the individuals who have served as ombudsmen with its successes. The ombudsmen's skills have molded the office to their countries while their stature has bolstered its effectiveness.

This emphasis on personalism casts some doubt about the future capability of a single ombudsman assisted by a small staff. Many governmental units have populations which already could produce more complaints than one key individual can effectively process. Some proponents of an official critic have suggested installing more than one ombudsman so there would be enough to handle the volume of complaints.¹³³ But there is some question whether a committee can establish and maintain the rapport and identity with the people which has seemed necessary to public confidence. Some observers feel those characteristics would not be lost, but there is little proof.¹³⁴ The best approach for Colorado is to avoid experimenting with a plural ombudsman since the relatively small population makes it appear unnecessary here.

III. IS THERE A NEED IN COLORADO?

A. *Government by Administrative Agencies*

Governmental responsibility to regulate is increasingly falling to the administrative agencies. Major issues in the lives of uncounted citizens are routinely settled by the administrative process. Observers have estimated that three to four times as many decisions are handed down by the agencies as by the courts.¹³⁵ With all this governmental activity closely touching so many people, it was inevitable that irritations, suspicion and hostility would develop.

This is not to say that those who enter the public payroll automatically become "power-crazed, obtuse, venal, ill-mannered, and

¹³³ E.g., Reuss and Munsey, *The United States*, in *THE OMBUDSMAN* 194-200 (D. Rowat ed. 1965); testimony of Dr. William Winter before the Colorado House State Affairs Committee, Feb. 28, 1967. *Denver Post*, Mar. 1, 1967, at 32, col. 1.

¹³⁴ Professor Gellhorn discounts the necessity of the personalism which has usually been an obvious factor in ombudsman institutions. He cites the fact that Sweden actually has three ombudsmen, the Chancellor of Justice, the Military Ombudsman, and the Ombudsman for Civil Affairs, without any loss of public identity caused by this multiplicity. GELLHORN, *supra* note 9, at 255.

¹³⁵ *THE POLITICS OF REGULATION* 2 (S. Krislov & L. Musolf ed. 1964).

inefficient."¹³⁶ Criticism of the agency process is not necessarily criticism of the individuals who comprise it. Human error will always be present, and American public servants are no different than other citizens. It is doubtful that their governmental career works any metamorphosis of their character, as many believe. Approximately one out of six employed Americans is paid from the public treasury at some level of government.¹³⁷ It is contrary to logic and daily experience to assert that so large a number is unfit to serve the public faithfully and well.

If all agency personnel are not guilty of deliberate wrongdoing or careless mistake, all are not innocent either. A Senate judiciary subcommittee recently concluded that "'undue influence,' 'illegal *ex parte* communications between private individuals and government agencies' and a record of 'inaction, endless delays, favoritism and arbitrary actions' . . . have created a 'wide-spread lack of public confidence in the fairness of agency decisions.'" ¹³⁸

The great increase in the number and size of regulatory agencies widens the opportunity for improper use of governmental power. Modern administration is both complex and powerful. The immensity of its responsibilities accounts for a serious conflict in its own goals: the merits and circumstances of each case should be weighed carefully, but the public obligation to fulfill all its tasks forces the agency to largely ignore individual differences. It can only operate efficiently by standardizing its procedures to fit the average case which cannot exist. Furthermore, the agency becomes so entangled in its own efforts that it is in no position to objectively evaluate the quality of the service it provides.

It is common parlance to label this burgeoning governmental phenomenon, "bureaucracy," and to saddle it with all the unsavory connotations that the term implies. The citizen increasingly views himself as living at the mercy of an ever growing and inaccessible administrative structure. A reasonably high level of public confidence in government is vital to a democracy. While America has not reached a danger point, it is no exaggeration to say that dissatisfaction continually mounts as the opportunity for friction increases. The belief that governmental decisions are made frequently by resort to influence peddling or outright graft is common.¹³⁹ If nothing worse, everyone is sure the public's best interest takes secondary consideration to the official's best interest. This type of suspicion has branded every politician's pronouncements suspect; it has

¹³⁶ W. GELLHORN, *WHEN AMERICANS COMPLAIN* 1 (1966).

¹³⁷ *Id.* at 43.

¹³⁸ Westin, *Inquiry Into Our Watchdog Agencies*, in *THE POLITICS OF REGULATION* 13 (S. Krislov & L. Musolf ed. 1964) (referring to federal agencies).

¹³⁹ See W. GELLHORN, *WHEN AMERICANS COMPLAIN* 139 (1966).

kept many of the best qualified from entering public service; it has encouraged cynicism and apathy.¹⁴⁰ The problem is one which no modern government can ignore.

American governments have more elaborate safeguards against governmental abuse than any other country in the world.¹⁴¹ The safeguards are, ironically, so systematized, inflexible and misunderstood that they are themselves cited as evidence of red tape.¹⁴² Furthermore, there is no right to review of administrative determinations beyond the strictly legal issues.¹⁴³ The individual is not interested in the legal technicalities; the sum total of his grievance may be that he does not understand why the decision was adverse to his interests. He may suspect the important facts were ignored, that procedure was prejudicial, or that somehow he was the victim of foul play. He wants a full review, far more than the terse technical response the appellate process can provide.¹⁴⁴ The highly vaunted right of appeal is too frequently illusory, if only because economics exerts a tremendous pressure to accept the administrative determination.

A good indication of the inadequacy of the present system is the current level of discontent reflected in the heavy volume of congressional complaints at the national level. No one knows just how large it is, but each House and Senate member receives several hundred to several thousand constituent letters each week. Most of these are requests for favors or aid and comfort of some sort rather than a complaint about administrative abuse. Still, the latter comprise substantial numbers.¹⁴⁵

While the criticisms against the national administrative process are best documented, the same indictment is applicable to state and local levels of government.¹⁴⁶ Probably the need is greater at the state level because the quality of government performance is all too frequently lower.¹⁴⁷

B. *Colorado Administrative Government*

There are good reasons to doubt that the ombudsman institution can be transplanted with success into the American federal

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 212; see Abraham, *The Need for an Ombudsman in the United States*, in *THE OMBUDSMAN* 234, 235 (D. Rowat ed. 1965).

¹⁴² W. GELLHORN, *WHEN AMERICANS COMPLAIN* 1 (1966).

¹⁴³ Marx, *The Importation of Foreign Institutions*, in *THE OMBUDSMAN* 255, 258 (D. Rowat ed. 1965).

¹⁴⁴ *Id.* at 257-58.

¹⁴⁵ See generally W. GELLHORN, *WHEN AMERICANS COMPLAIN* 58-66 (1966).

¹⁴⁶ Abraham, *supra* note 141, at 236; see Krislov, *A Restrained View*, in *THE OMBUDSMAN* 246, 254 (D. Rowat ed. 1965).

¹⁴⁷ Authorities cited note 146 *supra*.

government.¹⁴⁸ The staggering size and diversity of the population are foremost. The sheer volume of complaints would make anything like personal review totally impossible. The ombudsman, faced with a heterogeneous citizenry and keen competition for publicity, could not develop the nationwide rapport which is essential. The complex and delicate system of checks and balances which are unique to America also militate against the proposal. The executive branch would look askance at a legislative agent probing into its administrative processes. The doctrine of separation of powers which gives rise to the executive privilege to conceal information would interfere with the ombudsman's investigation. The necessity of running for re-election is a strong incentive for national legislators to deal directly with their constituents. Therefore, congressmen have not welcomed a national ombudsman who could receive complaints and who would thus stand between them and their best chance of re-election.¹⁴⁹

The same objections are not so strong when a Colorado ombudsman is considered.¹⁵⁰ The problems of unwieldy geographic size, population and diversity do not exist in Colorado. The institution has been found workable in Sweden with eight million people, and Colorado's present population is estimated at two million.¹⁵¹ An ombudsman in the traditional, personalistic sense would be

¹⁴⁸ See generally Abraham, *supra* note 141, at 237-38; Krislov, *supra* note 146, at 245-54; Marx, *supra* note 143, at 258-63.

¹⁴⁹ Representative Henry S. Reuss believes that the congressman's role as a mediator between citizens and bureaucracy is an unshakeable part of American government because the legislators feel the breadth and quality of their direct contact with their constituents is the difference between re-election and defeat. Therefore, he proposes creation of an Administrative Counsel of the Congress. Congressmen could refer their constituents' complaints to the Administrative Counsel whose expert staff would investigate and report to the Congressman. The legislator could use the information to urge the agency to change an error, and he could reply to the constituent so he would not lose credit for the good deed. Reuss & Munsey, *The United States*, in *THE OMBUDSMAN* 194-98 (D. Rowat ed. 1965). Representative Reuss' bill was introduced in the House in 1963, but so far he has been unsuccessful in gaining support for his plan. Abraham, *supra* note 141, at 237.

The supposition that congressmen depend on constituent service for re-election, as well as several other points applicable to this article, is made vividly apparent in a recent letter to *The Denver Post*:

There is no mystery about why Byron Rogers is returned to office every two years, and will continue to be just as long as he chooses to serve. He takes care of his constituents!

A phone call to his Denver office last week got right through to Congressman Rogers himself. He listened attentively to my tale of woe about government red tape gone wild, took notes, promised to look into the matter and called back the very next day to report.

It happens he was unable to remedy the situation, but how comforting to know that somebody cares.

Big government does not have to be impersonal.

Denver Post, July 24, 1967, at 19, col. 2.

¹⁵⁰ Abraham, *supra* note 141, at 238.

¹⁵¹ The Census Bureau estimated the population at 1,975,000 as of July 1, 1967. Rocky Mountain News, Sept. 6, 1967, at 1, col. 4. It was placed at slightly over two million as of December 31, 1966, by a business group based on the volume of retail sales. SALES MANAGEMENT, June 10, 1967, Table B-1.

possible because the volume of complaints would be manageable by one official critic aided by a small staff. The ombudsman should be able to command the attention of his public. He would not be faced with the tremendous competition for publicity that would block this development on a national level. Accounts of his work would be assured of a statewide audience through the local newspapers and the local radio and television stations which extend their influence throughout the state.

The problems created by the separation of powers are not so easily dismissed. The Governor may have overshadowed the legislature in actual powers¹⁵² as the President has surpassed Congress. But the personal influence of the Governor is less pervasive and less jealously guarded than that of the President, and it is likely that competition for prestige would be proportionally less at the state level. The legislature's agent could thus expect to be met with less hostility by the executive branch, so the Governor's people might less adamantly assert executive privilege to deny access to information. The legislature could no doubt resolve this problem by bestowing upon the ombudsman the authority to subpoena documents and to compel testimony as has been done in the countries with the institution.¹⁵³ The constitutionality of such powers has been upheld against a due process challenge on the ground that purely investigative proceedings do not require all the safeguards of rule making or adjudicatory functions.¹⁵⁴ As long as the ombudsman can only investigate without having authority to issue orders, the separation of powers doctrine will not be violated.¹⁵⁵

Granting that an ombudsman could be constitutionally fitted into the governmental structure of the state, what does the future

¹⁵² Nader, *Ombudsmen for State Governments*, in *THE OMBUDSMAN* 240, 241 (D. Rowat ed. 1965).

¹⁵³ Text accompanying note 122 *supra*.

¹⁵⁴ *Hannah v. Larche*, 363 U.S. 420 (1960).

¹⁵⁵ Cf. 1 E. COOPER, *STATE ADMINISTRATIVE LAW* 21-25 (1965); *Stockman v. Leddy*, 55 Colo. 24, 129 P. 220 (1912) (legislature may not assume an executive function reserved to governor by the state constitution). Colorado has long adhered to a strict separation of powers doctrine. COLO. LEG. RESEARCH COUNCIL, *REPORT TO THE COLORADO GENERAL ASSEMBLY: SIMPLIFICATION OF STATE GOVERNMENT ORGANIZATION* pt. IV, at 6 (1964). The agencies have been known to assert a right to refuse the general assembly certain information. In 1950 the Regents of the University of Colorado investigated their faculty for subversives after one professor testified before the House Un-American Activities Committee that he had been a member of the Communist Party from 1938 to 1943. The Regents undertook self-investigation to quiet the great public furor which arose and also to head off a legislative investigation. The report was kept confidential by the Regents. In 1951 members of the assembly demanded it be made public. This was not done, so the assembly then demanded that it be turned over to the legislature in executive session. The Regents again refused the demand for disclosure, but finally caucused with the governor and legislative leaders to give them a summary. Other than this, the report was never disclosed, although there was no court determination of the agency's right to refuse. R. MACIVER, *ACADEMIC FREEDOM IN OUR TIME*, Appendix B: *The University of Colorado Investigates* 290-304 (1955).

in Colorado hold for an ombudsman? Several questions for which there are no ready answers should be examined before any bold prediction is made.

C. *The Need in Colorado*

The crucial issue is whether an ombudsman is needed. There can be no clear cut statistical answer because there are no figures by which to calculate the level of citizen dissatisfaction with administrative agencies. Random sampling could easily provide an answer, but even if statistics were available there is no assurance they would be useful. We need to know something about the intensity of dissatisfaction. Everyone could say they disliked their prior experience with administration, but more pertinent is whether that affects their faith in government.

We need to know whether the present complaints are meritorious, but even this information would provide no definite answer to whether a Colorado ombudsman is needed. Even if complaints are unfounded, they should be met head on as long as they are made in good faith so that trust in government can be maintained. If they are not justified the individual should be given an explanation, and if they are justified a remedy should be sought.

Approaching the question of need from a different perspective may be helpful. Colorado is not among the most populous of the fifty states. Even so, a vast administrative network has been developed to carry out state functions. There are departments, boards, divisions, commissions and other units in great number — 212 by one count, and more if some closely related units are counted separately.¹⁵⁶

This bewildering array has properly been called "the headless fourth branch of government."¹⁵⁷ The state constitution neatly categorized government into the legislative, executive, and judicial branches,¹⁵⁸ but in recent years administrative agencies which are neither one nor the other have been created without clear thought where they fit. They have authority to promulgate rules which have the effect of laws, they enforce the laws, and they adjudicate matters of great importance. They thus have characteristics of each of the three branches, but they are not effectively supervised by any of them. The judiciary has no jurisdiction except over the few cases which reach its appellate courts, so it cannot affect the administra-

¹⁵⁶ State Management Analysis Office, *Organization of State Government in Colorado* (Jan. 1967) (organizational chart based on the state statutes and budget groupings).

¹⁵⁷ *TIME*, July 31, 1964, at 57 (Senator Everett Dirksen referring to the federal regulatory agencies).

¹⁵⁸ COLO. CONST. art. III.

tive agencies except in a tangential, sporadic fashion. The general assembly meets for only four months in the long session and for only three months in the biennial short session.¹⁵⁹ It maintains no permanent legislative oversight committee to keep an eye on the agencies.¹⁶⁰ The only supervision forthcoming from this branch is the highly superficial review the general assembly can give an agency when it passes on the annual budget.

The executive branch should be in the best position to check administrative abuse. The Governor's singularity has placed him in a bright spotlight of publicity which focuses on him the year around rather than briefly during sessions of the assembly. He can call for expert advice upon his legislation proposals, exercise party discipline in the assembly, and prevail upon pressure groups to aid his legislative program.¹⁶¹ But the Governor of Colorado is practically powerless to control actual administration of state functions. Several of the most powerful department heads are elected directly.¹⁶² The Governor is placed in a much weaker position in relation to the administrative agencies than in many other states by virtue of an extremely strong state civil service program. He may appoint to fill a vacancy, but he cannot remove a civil service official. They serve almost indefinitely and can be removed only in accordance with the civil service rules¹⁶³ which strongly protect the public servant.

The Governor's 1966 attempt to discipline the commissioner of insurance is a case in point. The Governor took the commissioner to task before the public for what he considered unlawful acceptance of "any valuable thing" from the regulated insurance interests, and he recommended removal from office. The Civil Service Commission, possibly feeling the heat of public opinion, fired the commissioner, but a Colorado district court ordered him reinstated because the strict technicalities of the civil service laws had not

¹⁵⁹ COLO. CONST. art. V, § 7. The general assembly is limited during the short session to acting on the state budget and those subjects placed on the governor's call. *Id.*

¹⁶⁰ The Legislative Council on June 22, 1964, authorized the Clerk of the House of Representatives to review the rules and regulations adopted by Colorado administrative agencies. Mr. Donald H. Henderson's report contained graphic evidence of the need for some sort of permanent review of agency rule making. Rules of nine of the twenty-three licensing agencies were studied, and all or part of the rules of seven were found invalid. The shortcoming was failure to comply with the requirement of notice established by the Administrative Procedure Act, COLO. REV. STAT. ANN. §§ 3-16-1 to -6 (1963). COLO. LEG. RESEARCH COUNCIL, *supra* note 155.

¹⁶¹ *Cf.* Nader, *supra* note 152.

¹⁶² Secretary of state, attorney general, state treasurer. COLO. CONST. art. IV, § 3; Regents of the University of Colorado. *Id.* art. IX, § 12.

¹⁶³ State Civil Service Act, COLO. REV. STAT. ANN. §§ 26-5-1 to -32 (1963). See particularly § 26-5-23 for dismissal procedure. COLO. CONST. art. XII, § 13 provides that appointments to positions classified as civil service employment must be based on competitive tests of competence.

been met.¹⁶⁴ The commissioner remained in office, but the Governor's actions probably were an effective reminder to him and others in similar positions. The problem with leaving this sort of supervision to the Governor is one of logistics. He simply does not have the time nor the facilities to take on this additional task and to devote the necessary time to it.¹⁶⁵

In the present situation the Colorado agencies are relatively free to interpret and apply the law as they see fit without effective control from any source. The delegations of power to them are necessarily broad and vague. They must use their judgment to determine what the law is. The problem is that their biases, although inherent in any exercise of judgment, may not be what the assembly contemplated or what the standards expressed by the legislature would mean to a court.¹⁶⁶ The individuals whose interests are adversely affected may protest, but that probably will not be persuasive. The agency interpretation gains significance as a precedent, and furthermore it is characteristic of human nature to resist change.¹⁶⁷

An example of a common administrative abuse is that the licensing agencies all too frequently have been used by the regulated industry or profession to close the door to competition rather than

¹⁶⁴ Denver Post, Mar. 11, 1967, at 1, col. 1. The district court ruled that there had been no compliance with the statute requiring filing of written charges that the employee failed to comply with commission standards.

Another example of the Governor's lack of effective control over civil service officials was cited by the Colorado Legislature's Committee on Government Reorganization as the committee was attempting on November 11, 1967, to define the Governor's role vis-a-vis the heads of state departments:

[The] dispute [was] between former Gov. Steve McNichols and William M. Williams, head of the old Planning Division. When Williams refused to follow McNichols' orders, the governor had to bypass Williams to get certain jobs done. But Williams kept his job because he was protected by the Civil Service system.

The committee proposed the following statute for enactment by the legislature as part of the reorganization plan:

The governor, in accordance with Article IV, Section 2 of the Constitution, shall be the chief executive officer of the state. Subject to the Constitution and the laws of this state, the governor shall be responsible for formulating and administering the policies of the executive branch of the state government.

In the execution of these policies, the governor shall have full powers of supervision, approval, direction and appointment over all principal departments. . . .

Where a conflict arises between the head of a principal department and the governor or between the heads of principal departments as to the administration of such policies, such conflicts shall be resolved by the governor and the decision of the governor shall be final.

Denver Post, Nov. 12, 1967, at 28, col. 1.

¹⁶⁵ It should be noted that an ombudsman could have done no more in this situation than the Governor. But the Governor's attempt to remove the insurance commissioner was certainly fruitful in the long run, and the ombudsman cannot be criticized because he could have done the same thing.

¹⁶⁶ *Contra*, Byse, *A Modest Proposal*, in *THE POLITICS OF REGULATION* 58-59 (S. Kristol & L. Musolf ed. 1964).

¹⁶⁷ See, e.g., statement of Senator Edward V. Long, 1966 *Hearings* 2.

to protect the public interest by admitting qualified applicants.¹⁶⁸ Another common fault is that the agencies have not usually exercised their powers to promulgate rules, preferring instead to decide each case on the basis of standards which remain unrevealed to the public. Colorado's Administrative Procedure Act offers little help in correcting this shortcoming because it does not require promulgation of rules.¹⁶⁹

Agency abuses in administering the law continue unchecked largely because there is no one unit charged with supervision of the agencies. This fact makes them virtually independent; this is the strongest single argument for adopting an ombudsman. Many of the most constructive changes for which he could work are the sort of thing which no individual citizen would have standing to contest. The serious problem of agency operation by secret law could be attacked by an individual affected by it in a particular case, but only an official critic could systematically review its use in each administrative unit and issue a single opinion applicable to all agencies.

Ralph Nader has compiled an impressive list of some of the administrative abuses which a state ombudsman could attack:

preferential treatment and influence peddling, inadequate and unpublished regulations, wrongful detention, state police overzealousness or laxity, unjust procedures in agency hearings, arbitrary censorship or secrecy, agency reluctance or refusal to give explicit reasons for decisions, patronage excesses, inefficiencies and delays by state personnel, undesirable conditions in prisons and mental institutions, payoffs and kickbacks in state contracts, and discriminatory enforcement or flagrant non-enforcement of state laws.¹⁷⁰

IV. THE PRESENT COLORADO SITUATION

A. *Colorado's Proposed Legislation for an Ombudsman*

An ombudsman bill was introduced in each house of the general assembly in 1967.¹⁷¹ While neither bill was enacted,¹⁷² they are important indicators of the type of institution their proponents would transplant to Colorado. It is probable that another ombudsman bill will be introduced at some future date in this state, and that it

¹⁶⁸ Hamilton, *How to Turn Regulation into License*, in *THE POLITICS OF REGULATION* 63 (S. Krislov & L. Musolf ed. 1964) (federal agencies); Nader, *supra* note 152, at 242.

¹⁶⁹ COLO. REV. STAT. ANN. § 3-16-2 (1963).

¹⁷⁰ Nader, *supra* note 152, at 246.

¹⁷¹ S.B. 192, 46th Gen. Assembly, 1st Reg. Sess. (1967), was introduced in the senate by Democratic Senator Anthony Volland and Democratic Representative Tom Bastien on Feb. 10, 1967. H.B. 1223, 46th Gen. Assembly, 1st Reg. Sess. (1967), was introduced in the house by Republican Representative Tom Grimshaw on the same day.

¹⁷² The house bill was reported favorably by the Committee on State Affairs, but it was killed in the powerful Rules Committee. The senate bill died in the Judiciary Committee without having had a hearing.

will embody the same basic features as the original models. This is the pattern that ombudsman proposals have taken in the nine other states which have considered such legislation.¹⁷³ Therefore, it will be useful to consider these bills.

Both bills would create a strong ombudsman in the traditional sense. They are alike in many features, but there are some important differences.¹⁷⁴ Both bills would make the ombudsman an agent of the legislature. The senate bill would establish an eight member ombudsman committee to nominate candidates for the office, to supervise the ombudsman's work, and to receive the annual report. The house bill would create a committee, but only to nominate candidates, not to supervise and not to receive an annual report. In fact, it does not require a report. The ombudsman would simply be authorized to report to the general assembly or governor as he deems advisable.

The house bill would give the ombudsman broad authority to investigate any administrative action. There is no limit on the authority to examine discretionary acts, and no requirement that administrative remedies be exhausted. The senate bill attempts to articulate some limits on jurisdiction. It allows the ombudsman to recommend corrective action to the agency if he finds any decision was "unreasonable, unjust, oppressive, or discriminatory, or was based upon a mistake of law or fact," or that a discretionary power was exercised arbitrarily or for an improper purpose. The ombudsman has wide discretion to refuse to investigate a complaint if there is an adequate remedy elsewhere or if the matter is more than one year old.

These broad grants of jurisdiction, without a requirement that other remedies be exhausted or that stale complaints be rejected, would no doubt lead to an ever expanding assumption of jurisdiction as it has in other countries. The senate provision allowing the ombudsman discretion on these two points is desirable, but there must be some check or that limitation could become no more than a mild exhortation. Certainly the language granting such broad jurisdiction could be seized upon to legitimate recommendations on any agency action. Experience abroad shows that it could and would happen. Committee review would be necessary to keep this power in proper bounds.

The ombudsman would have full investigative powers by either proposal, including subpoena power for testimony and documents whether the person is a state employee or not and whether the docu-

¹⁷³ Aaron, *Utah Ombudsman: The American Proposals*, 1967 UTAH L. REV. 32, 34 n.13.

¹⁷⁴ The house bill was patterned after an Illinois bill, and the senate bill was based on a proposal introduced in California.

ment is within the control of a state agency or not. Persons who mislead or obstruct the ombudsman could be found guilty of a misdemeanor and fined up to \$1,000.

One disturbing aspect of both bills is that they would prevent the ombudsman from disclosing any information obtained "except for the purpose of giving effect to this act."¹⁷⁵ He could thus make facts public when such action might be conducive to bringing about a procedural change. There is grave doubt, however, that this language would allow him to engage in the educational campaign which other ombudsmen have undertaken. The public must have a keen awareness of the type of work being done, and possibly such public education qualifies as furthering the purposes of the act. But surely the scholarly articles which other governments find so helpful would be precluded. There is no need for this severe restriction; those reports should be allowed as long as they do not divulge names or other personal information.

The House Committee on State Affairs favorably recommended its bill, and the amendments it made offer striking information about the aspects with which the legislators were most concerned. The amendments are encouraging. Instead of election by two-thirds of each house, the ombudsman would be elected by a majority of each party in each house, *i.e.*, four separate votes would be necessary. This is a strong and definite move to place the ombudsman above partisan considerations. On the other hand, it may be difficult to find someone whom all four groups would support. By another change, the ombudsman would be restricted to two full terms of six years each rather than being eligible for three full terms. The amendment means the committee appreciated the possibility of stagnation in office.

The committee struck the requirement that the ombudsman be a lawyer and retained the prerequisite of being learned in the processes of law and government.¹⁷⁶ An ombudsman without legal training would be forced to turn frequently for advice to an attorney, creating a real danger that his judgments would not be his own. It would inevitably slow his work by requiring him to take more time to learn the applicable law or to confer with his adviser. The provision defeats three of the most important aspects of the institution: speed, personalism, and expertise. Quick action is necessary or else another bureaucracy with complex procedural rules

¹⁷⁵ H.B. 1223, 46th Gen. Assembly, 1st Reg. Sess. § 3 (4) (1967). A similar restriction is expressed in S.B. 192, 46th Gen. Assembly, 1st Reg. Sess. § 11 (8) (1967).

¹⁷⁶ Testimony of Professor Donald Seney of the Political Science Department of the University of Denver before the State Affairs Committee on Feb. 28, 1967. *See also* text accompanying notes 44-52 for a discussion of legal training as a prerequisite. Lt. Governor Hogan does not have a legal background, and he considers that no disadvantage.

for giving service will be created. Personalism is important to public confidence. The ombudsman must believe in his opinions and be able to argue them persuasively in his daily contacts without reading from a staff memorandum. Personal expertise is essential to convincing a reluctant agency there is another way. The whole tenor of the office calls less for institutional expertise than for personal ability. In short, the ombudsman must above all be his own man. The amendment would severely restrict his ability to so establish himself.

The committee added a provision requiring that someone on the staff have administrative agency experience. Sweden has recently found it necessary to appoint specialists from the various administrative fields to the staff,¹⁷⁷ and it seems as important in Colorado as there. This assistant may be appointed from the state government without loss of tenure or retirement benefits, an idea which could well be extended to the ombudsman too. The house bill would have allocated \$60,000 for the first year's budget. The ombudsman's salary would be set on a par with that of a judge of the Colorado Supreme Court. The ombudsman could select his own staff and set their salaries as he might choose out of the budget. On the other hand, the senate bill made no appropriation and empowered the committee to establish salaries, powers which could well destroy the independence of the office.

Both bills would explicitly make the ombudsman an agency in the legislative branch. This in itself frees him of the requirements of the state Administrative Procedure Act which requires due process in rule making and adjudication by agencies in the executive branch.¹⁷⁸ A requirement to proceed by elaborate APA rules would stifle his efforts and go far to make the institution just another bureaucracy.

Each bill alone is woefully inadequate, but taken together their parts arrive at a facsimile of the traditional ombudsman. They would create a surprisingly strong ombudsman, place him above politics, and leave him with virtually no supervision. The weakness of the proposals lies primarily in their lack of limits on jurisdiction over stale complaints, over discretionary actions, and over complaints for which other remedies exist. The drafters drew on some of the strong points of bills proposed in other states, *e.g.*, giving the ombudsman power to apply to a court for a declaratory judgment to determine his authority to conduct an investigation or to issue a report when either is disputed. And the bills go to great length to assure the

¹⁷⁷ Anderman, *The Swedish Justitieombudsman*, 11 AM. J. COMP. L. 225, 237 (1962), reprinted in 1966 *Hearings* 96, 105.

¹⁷⁸ COLO. REV. STAT. ANN. §§ 3-16-1 to -6 (1963).

investigated agency a chance to correct a deficiency before it is criticized publicly.

The bills present a potpourri of ideas rather than a comprehensive plan. The legislature would be well advised to substitute most of the model bill prepared by the Harvard Student Legislative Research Bureau¹⁷⁹ if and when another proposal is considered. The model bill is impressive for the comprehensive scheme it presents, and for its limitation on jurisdiction. However, the Harvard idea for gubernatorial appointment with the advice and consent of the senate should be rejected in favor of the State Affairs Committee amendment. The latter assures bipartisan selection by the general assembly, consistent with the theory that the ombudsman is the agent of the legislature.

B. *The Lieutenant Governor as Ombudsman*

Colorado has an unprecedented opportunity to shed valuable light on the entire question of transplanting an ombudsman to America since Lieutenant Governor Mark Hogan voluntarily assumed that role for the state. Mr. Hogan announced that he proposed to act as intermediary for people who have problems "in their relations with that massive, bureaucratic maze called government. . . . The people of Colorado need this service. For the average citizen who has business to transact in government, the complex agencies sometimes are not only baffling but also forbidding."¹⁸⁰ The public has responded. After the first ten months, Mr. Hogan reports receiving approximately 1,325 cases.¹⁸¹

The voluntary assumption of the official critic's role by the Lieutenant Governor means several things. He can compile solid, statistical evidence of Colorado's need for an ombudsman. For the first time the number of complaints as well as their merits can be made amenable to logical discussion rather than based on emotional and intuitive assumptions. The capacity of an official critic to get results and to stimulate change in statutes or procedure can be tested. The ability of the people to understand the institution, and the willingness of the news media to support its efforts can be analyzed. Perhaps even the traditional value of the institution as an advocate of better government and a means of increasing the public's confidence in its government can be evaluated.

Not only is this opportunity to evaluate based on solid data important to Colorado, but it should reveal important facts for the

¹⁷⁹ 2 HARV. J. LEGIS. 213, 221-26 (1965).

¹⁸⁰ Colorado Springs Gazette Telegraph, Jan. 15, 1967, at 6-D, col. 1.

¹⁸¹ Interview with Mark Hogan, Lieutenant Governor of Colorado, in Denver, Nov. 2, 1967. The following statements attributed to Mr. Hogan were made during this interview unless another source is indicated.

rest of the United States. It is a unique undertaking. While Hawaii has enacted an ombudsman bill it has not funded the operation and there is no present intent to do so.¹⁸² Michigan has, so far as is known, the only other functioning ombudsman office outside Colorado. The secretary of state of Michigan appointed an administrative assistant to receive citizen complaints in 1966,¹⁸³ but this appointee can be no more than an aide to a state officer. Many state elected officials have received complaints in the past, but those efforts cannot be considered ombudsman institutions by any fair definition.

Colorado's experience should be more valuable because the present Lieutenant Governor has a remarkably independent position. He is a Democrat holding high office under a Republican governor, and working with an assembly controlled by Republicans. Whatever else can be said about the political implications, it is clear that Mr. Hogan is not functioning as an administrative assistant for an elected official of the majority party. He holds a virtually autonomous position with no need to act as the majority party's chief of whitewash.

A public protector was appointed along party lines last year in Nassau County, New York.¹⁸⁴ His work in a metropolitan county government will be instructive for the states, but Colorado's experience at the state level should surpass it in value.

The only other ombudsman office in operation handles complaints against the federal government and is closer to congressional constituent casework than the functions of an ombudsman. This last individual was appointed by Congressman Henry S. Reuss to his staff to collect data in what will be the congressman's renewed effort to establish a national ombudsman counsel. The work will be confined to Congressman Reuss's Fifth Congressional District in Wisconsin. The appointment was effective in February 1967, and the purpose is to collect data for only a few months after which the office apparently will be abandoned and the results published.¹⁸⁵

Despite its great potential, much of what Colorado's experience could show will not be realized, or at least not until the present operation is conducted on a more systematic basis. Mr. Hogan has stated that he and his staff are making no efforts to collect or to record data. The reasons are understandable: he has not been allocated state funds for a staff, which forces him to rely on volunteer assistance; he has no intention to create another bureaucracy with

¹⁸² 10 STATE GOVERNMENT NEWS, July 1967, at 7. See also Rocky Mountain News, June 15, 1967, at 55, col. 1.

¹⁸³ Secretary of State of Michigan, Press Release, Aug. 31, 1966.

¹⁸⁴ Authorities and material cited note 7 *supra*.

¹⁸⁵ N.Y. Times, Feb. 5, 1967 § 1, at 67, col. 1.

elaborate rules of operating procedure; and lastly he does not wish to abuse the confidence of citizens by recording personal matters.

These factors seem insignificant, however, when they are measured against the potential importance of what Mr. Hogan has undertaken. They are obstacles which could be overcome. For instance, since much of the work is first received, then investigated, and perhaps resolved over the telephone, it seems feasible that certain information concerning the complaint could be recorded in a daily log. Not much recordation is necessary to provide good statistical information. A few simple notations of basic facts should provide enough data on which to properly evaluate the institution. Foremost is an accurate counting of the volume. The agency against which the complaint is lodged is important, and the disposition of cases is essential to a valid study. Statistics could then be readily compiled at periodic intervals. The following information would be sufficient:

1. Volume of Cases
 - Complaints
 - Referrals from Legislators
 - Undertaken on Own Initiative
2. Agency Complained Against
3. Type of Complaint
 - Administrative Procedure
 - Adequacy of Opinions
 - Factual Consideration
 - Inadequacy in Present Law
 - Misconduct of Officials
4. Disposition of Cases
 - Requests for Information
 - Dismissed Without Investigation
 - Declined for Want of Jurisdiction
 - Recommended Consultation with Attorney
 - Lacked Merit
 - Investigated
 - Dismissed as Unjustified
 - Dismissed — No Direct Action Possible
 - Criticisms or Recommendation Issued

Time is probably the critical factor in the Lieutenant Governor's ability to collect this data. Mr. Hogan should not be saddled with great burdens, but by assuming the duty on his own initiative he takes on some responsibility to the public to provide the means by which to rationally evaluate the institution. His primary concern, he states, is to serve the public's need for an official critic. The

public's need for reliable information about an official ombudsman for Colorado is hardly less.

Recording these facts would not result in the creation of another bureaucracy. Those complaints received or answered by letter are already filed. Use of the telephone has proven beneficial so its use should be continued in this particular office. But the receipt of a case and its disposition should be logged in a docket whether it is handled by letter, personal interview or telephone.

The Colorado proposals for an ombudsman would have required that complaints be made by a signed letter as is the rule elsewhere. At the hearing before the house committee, Professor Seney of the Political Science Department of the University of Denver, criticized this requirement. He said, "A person ought to be able to come into the ombudsman's office and, in a sense, pour his heart out. In many cases individuals might hesitate to complain if a written statement were required."¹⁸⁶

Evidently in response, the committee amended the house bill to allow receipt of a verbal complaint if it is put in writing, presumably by the staff, and signed by the complainant. This is the procedure which has been workable in Sweden, but almost all complaints have been received there in writing. Mr. Hogan's experience already shows that Colorado and probably the rest of the United States differs from Sweden. Many individuals bring complaints to Colorado's Ombudsman by personal visit, and large numbers lodge complaints by placing a telephone call. This is an indication that the next assembly to consider an ombudsman bill should have data from Mr. Hogan so it can intelligently decide whether to require that a complaint be written. Mr. Hogan's initial evaluation is that some of the most meritorious cases come to him by the telephone.

Identity of the individuals involved with a complaint need not be revealed by a recordation of the work being done. Ombudsmen in other countries log a case by a numerical or alphabetical designation so that the annual report does not disclose confidences. Of course, the agency criticized or exonerated is listed, but usually there is no need to reveal the identity of the agency personnel involved.

The present Ombudsman's work has provided enough information to make a preliminary and cautious evaluation. Mr. Hogan states that about 1,325 cases have been received in the first ten months of the undertaking, from January through October 1967. The volume of complaints did not decrease when the assembly adjourned, as Mr. Hogan had expected. He anticipates that it will double next year as awareness of the service spreads.

¹⁸⁶ Testimony before the State Affairs Committee on Feb. 28, 1967. Denver Post, Mar. 1, 1967, at 32, col. 1.

Mr. Hogan's evaluation of these cases is revealing. About forty percent have come from citizens who have private legal problems, and whom he has referred to their attorney or to a legal aid society. These are the cases over which an official ombudsman would have no jurisdiction because they do not involve complaints against governmental agencies. Rather than refusing to recommend the applicable source of assistance, Mr. Hogan has not hesitated to advise the individual to seek legal assistance. His inclination not to turn a deaf ear follows the pattern of the ombudsmen in other countries.¹⁸⁷ Still they handle less requests for information and legal advice than this¹⁸⁸ because their public is better educated about the ombudsman function. Mr. Hogan does not consider these cases to be requests for information, but bona fide complaints which the individual does not understand present a private legal question. He considers only ten percent of his cases to have been requests for information.

The Colorado experience does reflect the widespread demand for some sort of governmental information service; however, it is doubtful whether that need can be met by an ombudsman. It seems clear that information services could not be provided within the traditional ombudsman scheme. To do so would expand the activity of the office greatly, making a small staff and a personalistic system unworkable.¹⁸⁹ Mr. Hogan no doubt receives more than his share of information requests because, being self-appointed, he has been in no position to undertake a public education program. He also feels that once one individual in need of advice is steered in the proper direction, others become aware of this service, want it for themselves when the need arises, and therefore request information from his office. He is undoubtedly correct when he says that his unofficial operation allows him wider jurisdiction than an ombudsman working in accordance with a statute would have.

Another forty percent of the cases received have been quickly resolved by a few telephone calls. These involve situations concerning some governmental branch, although not necessarily the state government. Many citizens have demonstrated a marked lack of knowledge about the responsibilities of the different levels of government. Those complaints involving the federal government

¹⁸⁷ *E.g.*, the Danish Parliamentary Directives instruct the Ombudsman to take no action on a complaint beyond his jurisdiction other than to refer it to the appropriate authority and to give the complainant reasonable guidance. GELLHORN, *supra* note 9, at 21-22.

¹⁸⁸ *Cf.* GELLHORN, *supra* note 9, at 134.

¹⁸⁹ The need by the public for better information about administrative agency functions has been a major criticism made by the New Zealand Ombudsman. *Id.* Japan has over 9,000 Civil Liberties Commissioners who give advice to hundreds of thousands of citizens annually about "nearly everything under the sun." *Id.* at 411. At least one writer feels that an ombudsman should dispense general information about governmental agencies as one of his primary duties. Aaron, *supra* note 173, at 59.

have been referred to the appropriate federal agency, and those involving the local government have been referred to the appropriate local office. This service is an important function of the institution, and it should become a part of any official ombudsman program in Colorado.

That portion of this forty percent which involves state agencies varies widely in its scope. Many complaints arise because there has been a lack of communication between the agency and the individual. A large share of the complainants have been given inadequate information or no explanation at all. Even though they have negotiated, the agency is sometimes unable or unwilling to understand the individual's position. In some cases the Lieutenant Governor or his staff have mediated by locating the problem, drawing out the pertinent facts from the citizen and providing them to the agency, or arranging for the agency to meet again with the individual.

In one case a young couple decided to move from California to Denver. They flew to Denver to purchase a home and returned to California to move their personal property. They bought a motorcycle in California, paid a sales tax and listed their new Denver address on the registration papers. When they brought it to Colorado and applied for a Colorado certificate of title, the revenue department insisted on collecting a sales tax for what it thought had to be a taxable sale within the state. The two sides could not make the other see their point. Someone told the couple that the Lieutenant Governor was serving as an ombudsman so they contacted him. He intervened, explained the situation to the department, and the new Coloradans got their title without paying a double sales tax.

Another case involved a simple failure by the agency to meet its obligations. The state brand commissioner is required to inspect the brands of cattle shipped out of the state, and to collect a tax for each animal as well as an additional fee for the promotion of Colorado beef sales. The livestock owner is entitled to a refund of the promotional fee if he chooses, but he must apply within ten days on vouchers to be furnished by the beef board.¹⁹⁰ One cattleman did not receive the necessary application forms from the agency until after the deadline had passed. He was then refused the refund. After intervention by the Lieutenant Governor the agency supplied the forms and paid the rancher his refund.

Other cases in this category have involved situations where the individual went to an agency and was informed by it that they were not the unit responsible for his problem. The agency personnel either could not or did not refer the citizen to the proper agency. The

¹⁹⁰ Ch. 69, §§ 15, 17, [1965] Colo. Laws 253, 254.

Lieutenant Governor has located the department and given the individual the information.

Mr. Hogan estimates that twenty percent of the cases have been investigated at some depth. Of these, he feels a large share have been meritorious complaints. His efforts as an ombudsman have usually resulted in some gain for the individual. Even in those few cases in which he has had to tell the complainant that nothing could be done, he feels confident they have been appreciative because they are at least satisfied everything possible under the present state of the law has been done. They are perhaps able to understand and accept a decision they had previously resisted. As Mr. Hogan expressed it, they appreciate the fact that, "Passing the buck has stopped," and that someone has told them frankly and convincingly that nothing else can be done.

Professor Seney, speaking for the ombudsman bill before the State Affairs Committee, said an ombudsman office inevitably would "be a sounding board for chronic complainers," but he doubted that such activity would "take over the office."¹⁹¹ Lieutenant Governor Hogan's experience offers solid encouragement on this point. He had expected a good many querulous complaints. After ten months he could classify only three instances as "crackpot" cases of the type where "someone tells me they have been visited by little, green men from outer space and no governmental agency will pay any attention." His experience supports that of other ombudsmen who rarely receive complaints indicating derangement, or complaints that are frivolous, vexatious or made in bad faith.¹⁹²

C. *Public Reaction to Colorado's Ombudsman*

Lieutenant Governor Hogan has mapped a very precarious route for himself. It weaves through the ins and outs of Colorado politics and between the public's desire for service in government and its strong distaste for increased state taxation. The Denver voters, for instance, have emphatically rejected every proposed salary increase for elected city officials since 1951.¹⁹³ The Colorado General Assembly, no doubt reflecting a general and sharply felt abhorrence of increases in state spending, has almost as consistently refused to raise the pay of elected state officials.¹⁹⁴

¹⁹¹ Testimony, note 186 *supra*.

¹⁹² *E.g.*, GELLHORN, *supra* note 9, Table VII, n.a. at 119 (New Zealand).

¹⁹³ Denver Post, July 10, 1967, at 14, col. 1 (editorial). This refusal to increase salaries is all the more significant in light of the fact that salary rates average 30% to 50% lower than most of the salary scales of U.S. cities of comparable size. Report of Charter Salary Committee, Denver, Colorado, Mar. 14, 1966, on file in the mayor's office.

¹⁹⁴ Salaries of Colorado's top-ranking elected and appointed officials have been raised substantially, effective in 1970. Ch. 318, §§ 1-2, [1967] Colo. Laws 594-95. These salaries have remained at low levels since 1958, ch. 42, §§ 1-2, [1958] Colo. Laws 236-37, and the general assembly had refused repeatedly until 1967 to increase them.

An editorial in the *Colorado Springs Gazette Telegraph* mirrors this public opinion opposing increased spending, but surely its almost reactionary viewpoints will not be accepted by the majority of an intelligent electorate once it has an understanding of the ombudsman office:

"Watch it! You are in the process of being softened up for the creation of another tax-supported, politically motivated and controlled bureaucratic agency to eat out your substance." . . . [It] would provide for "ombudsmen" — that is, more bureaucrats — to stand between the already put upon taxpayers and the bureaucracy itself.

. . . .
[I]f, as is certainly true, "the bureaucratic maze called government" has grown complex, baffling and forbidding, the answer, as should be obvious to anyone of even average intelligence, is to reduce the size, power and expense of the bureaucracy, rather than adding to it with more full time stenographers and full time administrative assistants.

The people of Colorado need "ombudsmen" and more bureaucratic "special pleaders" like they need more holes in their heads.

. . . "Let the Swedes and Russians and other socialistic countries keep their obudsmen. We have enough troubles (and taxes) as it is without adopting more old world socialistic ideas."¹⁹⁵

Even political science professors, who should perhaps be better informed than emotional editorialists of the history and traditions of the institution, are not immune from misunderstanding. Also testifying on behalf of the bill before the State Affairs Committee, Dr. William Winter, Chairman of the Political Science Department at the University of Colorado, suggested that a commission rather than an individual should assume the duties of an ombudsman. His reasons were that a commission "'could represent several types of professional orientation' and would lessen the risk that a single ombudsman 'might go out chasing administrators just for the sake of knocking off a few administrators.'"¹⁹⁶ The professor's obvious distrust ignores the strong tradition of integrity and objectivity which ombudsmen have established everywhere they hold office. In all the years of their service, not one ombudsman has been implicated in scandal or any similar misuse of office. There is no reason to believe Colorado will have a different experience.¹⁹⁷

With vitriolic and misleading statements emanating from influential and eminent sources in Colorado, one would expect the

¹⁹⁵ Colorado Springs Gazette Telegraph, Jan. 15, 1967, at 6-D, col. 1.

¹⁹⁶ Testimony before the State Affairs Committee of the Colorado House of Representatives on Feb. 28, 1967. Denver Post, Mar. 1, 1967, at 3, col. 1. See text at note 134 *supra* for an argument against a plural ombudsman for Colorado.

¹⁹⁷ Professor Winter's apprehension is similar to that expressed in an editorial in the *Denver Post* entitled, "Who'll Watch the Watcher." It suggests, perhaps facetiously, that "we might within a decade be hearing that we need some ombudsman-watchers." Denver Post, Feb. 9, 1967, at 14, col. 8.

Lieutenant Governor to tread warily. He has done just that. He has not sought the publicity which the public must have to understand and to support the institution. He has not advocated that the legislature accept the ombudsman bills. Right now his ombudsman experience leaves him convinced that his work is essential. "One hundred percent of these cases present work which ought to be done. But how it should be done, who should do it, where the office should fit in, and whether it can be done economically are questions about which I'm no longer so sure." Mr. Hogan gives the impression that he still feels an ombudsman could effectively work out of the lieutenant governor's office, and that it would have the advantage of not requiring another officer on the public payroll, nor requiring another office and equipment. It probably would necessitate funds for a full time secretary and an administrative assistant.

If constitutional amendment number one on the 1968 ballot is approved by the people of Colorado, the offices of governor and lieutenant governor will be unified politically. Each party's choices for the top two seats will either stand or fall together at the polls. Then the lieutenant governor would not be a stranger in his own administration. While Mr. Hogan realizes that a lieutenant governor might under those circumstances become a full working partner of the governor, he entertains some belief that the additional duties of an ombudsman could also be assumed.

With political traps lying all about him, the Lieutenant Governor is in no position to advocate that Colorado create an ombudsman in its traditional sense. "If the choice was between spending \$50,000 for an ombudsman," he said, "or for education, I would not have to hesitate to choose education." Still he is convinced that the work must be done by someone, and he is determined to fulfill that responsibility for the remaining three years of his term.

The lesson seems clear. The ombudsman institution must remain above party politics or it cannot perform its functions. Inter-meshed with politics, it would not be able to retain the trust of the people, the news media or the legislature. Mr. Hogan is not naive; he says his primary concern is in improving government for the people, but he admits that doing this work well can help him in his political career. However, it would not be accurate or fair to say that his work so far has involved partisan politics. For instance, he has not tried to exert his influence to gain favors for his clientele. He has made it a practice to approach an agency with respect for its own expertise and procedures. He asks what the criteria are and whether the individual has met those standards. Then he evaluates the worth of the procedure or the law as he evaluates the facts of the complaint.

In at least one case he was able to bring about a change in statute. A Canadian driving a diesel equipped Mercedes-Benz stopped in northeastern Colorado to fill his tank with fuel. The gasoline station could not sell him diesel fuel because he had not purchased the tax stamps from the state police. He could not understand why the stations could not sell the stamps directly so the station manager referred him to the Lieutenant Governor. Mr. Hogan agreed. After discovering that the state police saw no merit in having to leave their patrol to collect taxes, he persuaded the assembly to tack an amendment on to a pending road bill. The bill was enacted and the change was made within the week. By then the Canadian was out of state, probably never to return. The incident is also some indication that the work so far has not been politically oriented¹⁹⁸ because a Canadian has no vote in Colorado.

Mr. Hogan has received some constituent casework from the legislature. The members have no personal staff, and they are not in session long enough to handle many constituent complaints. Mr. Hogan does what he can to resolve problems and then replies directly to the individual citizen, being careful to mention the legislator's name.

There are some disturbing features of Mr. Hogan's ombudsman function. First, no matter how earnestly any elected official serving as an ombudsman tries to prevent it, his very party affiliation injects some degree of politics into the institution. This is precisely what must be avoided if the office is to succeed as it should.

Secondly, a crippled mutation of the ombudsman institution is being presented to the public. Colorado now has a blend of the traditional ombudsman and the traditional caseworking politician. The present unofficial function cannot receive the widespread educational publicity an official ombudsman should have. Therefore, misconceptions about the office are no doubt gaining currency, and increasingly so because the volume of complaints is growing as awareness of the office spreads.

Third, the present ombudsman perhaps conceives of his function too narrowly. He has concentrated more on getting results in a particular case rather than in improving procedure statewide because his unofficial status does not authorize him to supervise statewide. The latter function has not been ignored, however. One case serves as a good example. A lady complained that the instructions on the cosmetology licensing examination were so unclear as to prevent a fair test. While Mr. Hogan was investigating he discovered that two tests were kept on file. One battery was for Cau-

¹⁹⁸ Mr. Hogan discounted political motivations in an earlier account of his work. *Denver Post*, Mar. 27, 1967, at 13, col. 1.

casians and the other was reserved for minority groups. He referred the matter to the Colorado Civil Rights Commission which had no difficulty in ending the discrimination.¹⁹⁹

Fourth, the lack of a staff and the demands of his other duties require Mr. Hogan to forego personal supervision of many cases. While difficult or important cases get his attention, his administrative assistant and his volunteer workers frequently handle all aspects of a complaint. This situation raises the possibility that no one person will notice complaints which present a recurring problem, all of which could be resolved by correcting the root of the trouble.

Fifth, the present investigation procedure cannot be thorough enough to command universal respect for its accuracy. Usually the official file is not examined, because there is no power to compel its submission and because Mr. Hogan fully appreciates his unofficial status. It is too easy for an agency in possession of all the facts to explain away the complaint when there is no independent and unbiased examination.

There are some heartening aspects at the same time. The Colorado institution has not slipped measurably into partisan politics. The ombudsman bill had bipartisan support; the house bill was offered by a Republican and the senate bill was proposed by two Democrats.

The Lieutenant Governor's assumption of the role has clothed the institution with the aura of high office which it must have. If the second ranking official in the state has served the people well, the office benefits from a tradition of prestige which should carry over to an official ombudsman. Mr. Hogan and his staff have demonstrated a real personal interest in the citizens who come to the ombudsman. Mr. Hogan reports that it is not easy day after day to hear complaints with sympathetic understanding, but realizing that it is essential, he has done so. He is thus doing much to establish the traditions and the public trust in the office that it will need in any official form.

D. Predictions

Many of the arguments which can be made against establishing an official ombudsman office in Colorado have already taken form. The most extreme reaction has come from the *Colorado Springs Gazette Telegraph* which decried the concept as socialistic.²⁰⁰ It described the office as politically motivated and politically controlled,

¹⁹⁹ Interview with J. David Penwell, Assistant Attorney General and Legal Counsel, Colorado Civil Rights Commission, in Denver, Oct. 25, 1967.

²⁰⁰ Colorado Springs Gazette Telegraph, Jan. 3, 1967, at 7-B, col. 1; *id.*, Jan. 15, 1967, at 6-D, col. 1.

an intolerable appendage to big government which would only make it bigger and more arrogant, and an inexcusable tax burden.

The *Denver Post* doubted the need for "a whole new . . . layer of government" since "state administration has been relatively responsive to the needs of the people . . ." ²⁰¹ It suggested that an effective press and an alert minority party leadership could adequately safeguard the public's interest in good government. Another *Post* editorial expressed fear that an ombudsman would only become a "partisan fault-finder." ²⁰² Besides, it argued, Americans are chronic grippers, so no individual could handle the volume of unnecessary complaints which would inevitably flow once the floodgates were opened.

Other arguments against adopting an ombudsman office could be made. It probably will be said that one man and a small staff cannot do enough to affect the totality of administrative government. It could be argued that there should be no "one man law-giver," and the courts or administrative tribunals should interpret all statutes and rules. The majority of the public probably could be persuaded that administrative problems only plague the poor who do not know how to deal effectively with agencies, and that the indigent can go to a legal aid society for help. It could be said that, all other arguments aside, the effort would not be worthwhile because the complaints are simply too minor and petty to present a real problem.

Most of these arguments have already been answered in the preceding material, and that discussion need not be repeated. The unanswered doubts deserve comment. Colorado administration admittedly has been relatively responsive to the public need. Mr. Hogan feels strongly that Colorado has a good administrative service, ²⁰³ but even a conscientious public administration contains problems and red tape as his present workload shows.

The press has long since been unable to uncover administrative abuse, ²⁰⁴ and the legislature's inability to do so has already been discussed. ²⁰⁵ Mr. Hogan's examples show that serious shortcomings have been corrected through his complaint system. Those same prob-

²⁰¹ *Denver Post*, Feb. 9, 1967, at 14, col. 8.

²⁰² *Denver Post*, Mar. 4, 1966, at 24, col. 1.

²⁰³ Interview, *supra* note 181. The institution could not be successful unless the state was already reasonably well administered. Criticism would have no good effect where the government was riddled with corruption or where officials did not worry about public chastisement. See Rowat & Liambias, *Canada*, in *THE OMBUDSMAN* 186, 188 (D. Rowat ed. 1965); Northey, *New Zealand's Parliamentary Commissioner*, *id.* 127 at 142-43.

²⁰⁴ Abrahamson, *Ireland*, in *THE OMBUDSMAN* 201, 203 (D. Rowat ed. 1965); Nader, *Ombudsmen for State Governments*, in *THE OMBUDSMAN* 240, 244 (D. Rowat ed. 1965).

²⁰⁵ See note 160 *supra* and accompanying text.

lems had existed long before his program began, yet the press and the legislators were not aware of them. Even the individuals affected by the discriminatory cosmetology examination did not realize their rights were being violated. Only an independent investigator will be able to uncover this sort of abuse.

The General Assembly of Colorado has shown its determination to avoid partisanship in any ombudsman office it creates. With that sort of backing, it is hard to believe a Colorado ombudsman would overthrow all the traditions established elsewhere and here to become a partisan fault-finder. By the same token, Mr. Hogan's experience in Colorado shows that Americans are not chronic complainers of the type who would flood the ombudsman with petty complaints.

No one has as yet attacked the ombudsman idea as an enemy of the civil service, but that will be forthcoming. It is an accusation which has been leveled in every country which has recently adopted the institution. Yet the public employees have invariably found the ombudsman their friend. Statistics already presented show he has exonerated them from charges in the great majority of cases rather than casting blame and disrepute upon them.²⁰⁶

Funding the office is a real problem. On one hand, \$50,000 or \$60,000 is a small part of the state budget; it is insignificant compared to the cost of operating Colorado's court system. On the other hand, any allocation of state funds should not be made lightly. Colorado can rely on Mr. Hogan's ombudsman work to provide the answer to whether or not this expenditure should be made. It could be that the office would save the state as much as it would cost by decreasing the number of cases litigated in the courts and before the administrative agencies.

If the unofficial ombudsman's work continues to produce favorable results it will generate a widespread public expectation in Colorado that the service be continued after Mr. Hogan's four years in office are ended.²⁰⁷ There will no doubt still be strong opposition so that a governor is likely at first to appoint his second in command or an administrative aide to fulfill the function. But before too long the need for a Colorado ombudsman will be documented from the

²⁰⁶ The New Zealand public service reacted strongly against the proposal for an ombudsman, fearing that it would be victimized as his scapegoat. A few years of experience with the Ombudsman has persuaded the public service that he has been an impartial friend and defender rather than an enemy. GELLHORN, *supra* note 9, at 91-93. See also Os, *The Ombudsman for Civil Affairs*, in *THE OMBUDSMAN* 95, 96 (D. Rowat ed. 1965). Pedersen, *Denmark's Ombudsman*, in *THE OMBUDSMAN* 75, 77 (D. Rowat ed. 1965).

²⁰⁷ The public's overt response to the ombudsman proposals has been favorable without exception. For citizen reactions, see these letters to the editor printed in the *Denver Post*, Feb. 21, 1967, at 27, col. 1; *id.*, Apr. 16, 1967 ("Perspective" section), at 5, col. 2; *id.*, July 20, 1967, at 19, col. 2.

data which should be collected, and eventually a traditional ombudsman will be instituted.²⁰⁸ We can only hope that the present conception of the office will not prejudice that possibility by becoming a political gimmick or by accustoming the people to a heavily diluted perversion of the concept. In the final analysis the view adopted by the *Denver Post* will no doubt prove accurate:

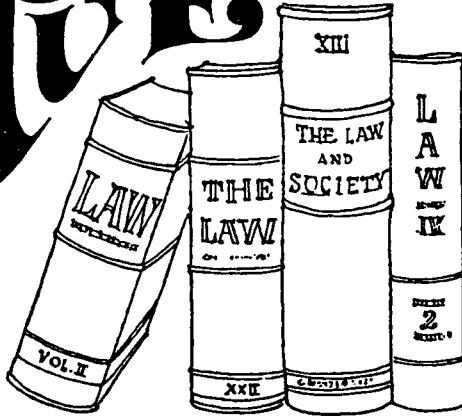
Undoubtedly there will be great lethargy and some resistance, perhaps years of delay. But this idea eventually will prevail and then, after a few years, the people of Colorado will ask themselves how they got along all that time without an ombudsman.²⁰⁹

Loren L. Mall

²⁰⁸ It is probable that Denver will create an ombudsman office before the state does. Mayor Tom Currigan said in his second inaugural address on July 3, 1967, that he would propose soon to the Denver City Council that it establish the post for city and county government. *Denver Post*, July 3, 1967, at 4, col. 1.

²⁰⁹ *Denver Post*, Feb. 7, 1967, at 14, col. 1 (editorial).

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