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Protecting Intellectual Property Rights Abroad: New Uses for Political Risk Insurance and Standby Letters of Credit

by
P. Georgia Bullitt†
and Laura I. Lagomarsino*

INTRODUCTION

During the past twenty-five years, United States companies have become increasingly involved in the transfer of technology¹ to less-developed countries [hereinafter LDCs].² Licensing³ income generated by U.S. companies through trade with LDCs rose more than eighty percent between 1977 and 1984.⁴ Direct investment in high technology projects abroad has also

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1. In this Article, "technology transfer" is used generally to refer to the release of technology from a source to a recipient. See Frame, *Political Risk in International Technology Transfer*, 10(2) J. TECH. TRANS. 1, 2-3 (1986). Technology may be transferred in a variety of ways. Licensing, direct investments, agreements on scientific and technical cooperation, international contracts for research and development and technical assistance agreements may be used separately or in combination to transfer know-how or proprietary interest. ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, NORTH/SOUTH TECHNOLOGY TRANSFER: THE ADJUSTMENTS AHEAD 10-11 (1981).

2. Developing countries are especially eager recipients of technology transfer because they generally lack a sophisticated research and development base from which to industrialize. Janiszewski, *Technology-Importing National Perspectives*, in CONTROLLING INTERNATIONAL TECHNOLOGY TRANSFER 306, 307 (T. Sagafi-nejad, R. Moxon & H. Perlmutter eds. 1981).

3. "Licensing" refers to an agreement whereby the owner of an intellectual property right (licensor) permits another person (licensee) to make a specified use of the intellectual property right and of the tangible or intangible property to which it attaches. WORLD INTELLECTUAL PROPERTY ORGANIZATION (WIPO), LICENSING GUIDE FOR DEVELOPING COUNTRIES, WIPO Publication No. 620 (E) 27 (1977). A typical licensing "package" includes the conveyance of patent, trademark and other property rights and the provision of technical and managerial assistance ("know-how") to a licensee. F.J. CONTRACTOR, INTERNATIONAL TECHNOLOGY LICENSING 13 (1981).

4. Commerce Department Statistics indicate that licensing income generated from agreements between U.S. companies and LDCs rose 84.6% between 1977 and 1984; by comparison, U.S. foreign direct investment in LDCs rose only 69.6% during the same period. The total volume of payments for licensing and related activities was more than \$6.5 billion in 1984; of

increased dramatically in recent years;⁵ from 1966 to 1975, direct investment by the United States in LDCs rose one hundred and fifty-one percent, a large portion of which involved the transfer of U.S. advanced technology.⁶

This growth in technological trade has increased the vulnerability of U.S. companies to the risks of expropriation of property rights in technology and of loss of market share through pirating and reverse engineering.⁷ The risk of loss is greatest in technology transfers to LDCs.⁸ LDCs generally emphasize the acquisition of technology in their development plans,⁹ and many LDCs have promulgated laws that establish and protect intellectual property rights held by foreign entities. In practice, however, the countries often do not enforce these rights.¹⁰ Instead, they espouse a "common

this, approximately 20% resulted from trade with LDCs. U.S. DEPARTMENT OF COMMERCE SURVEY OF CURRENT BUSINESS 34 (August 1985).

5. The computer industry provides a concrete example of this phenomenon. Overseas subsidiaries have become a critical component in the expansion of the U.S. computer manufacturing and software industry. Eckelmann, *A Study of the Competitive Position of the United States Computer Industry in HIGH TECHNOLOGY INDUSTRIES: PROFILES AND OUTLOOKS — THE COMPUTER INDUSTRY* 9, 13 (U.S. Dept. of Commerce, International Trade Administration ed. 1983). A small but increasing amount of software sold in the U.S. has been developed abroad. Wall St. J. September 7, 1984, at 29, col. 1. The U.S. computer industry currently holds a substantial proportion of the worldwide market. According to Department of Commerce estimates, in 1987, U.S. companies could hold three-quarters of a \$55 billion world market for software. Miller, *U.S. Software Firms Try to Curb Foreign Privates to Protect Big American Share of World Market*, WALL ST. J. Mar. 18, 1985, at 34, col. 1. Similarly, in 1986, the U.S. computer industry was expected to gross a total of \$108.3 billion from the worldwide market. U.S. DEPARTMENT OF COMMERCE COMPUTER INDUSTRY STUDY 15. Table 1 (1983).

6. D. HAENDEL, *FOREIGN INVESTMENTS AND THE MANAGEMENT OF POLITICAL RISK* 2, 29 (1979).

7. See generally, Frame, *supra* note 1, at 1, 2, 5, 10.

8. Relations between LDCs and the technology transferors, usually multinational corporations, are often strained in light of their conflicting interests. LDCs struggle to maintain greater control over the transferors for fear that they will regress back to the previously disadvantaged positions they held under colonial dominance; the multinationals seek to ensure owner-control over the investment for fear that they will not be compensated for the years of Research and Development expended to develop the technology. Joelson, *Licensing of Intellectual Property Rights*, 14 GA. J. INT'L & COMP. L. 479 (1984). One authority has described the Third World attitudes toward foreign technology as "a militant posture . . . , demanding an end to restrictive licensing practices, calling for a restructuring of the international patent system, and occasionally treating advanced technology as if it were the 'common heritage of mankind.'" See Frame, *supra* note 1, at 1. LDC's "control" over technology transfer initially took the form of foreign exchange restrictions, designed to ease balance-of-payment considerations. P. Batista, Remarks at a Seminar on the Conditions for Absorption of Advanced Technologies in Developing and Developed Countries, sponsored by the Centre for Applied Studies in International Negotiations 3 (Nov. 7, 1985) (Available in the offices of *The International Tax & Business Lawyer*), *Trade and Transfer of Advanced Technologies: The International Regulatory Framework (GATT/UNCTAD)*. Controls spread to regulation of the practices which restricted use of and access to foreign technology. *Id.*

9. See J. D. Frame, *INTERNATIONAL BUSINESS AND GLOBAL TECHNOLOGY*, ch. 10 (1983).

10. See, e.g., Proposal of the Group of Developing Countries, art. I, para. 2(b), *reprinted in Note, Paris Union: Basic Proposals for the Diplomatic Conference on the Revision of the Paris Convention*, 18 INDUS. PROP. 244 (1979) ("[P]atents are . . . depending on the national law, either the exclusive right, for a limited period of time, to exploit the inventions patented or the right to prevent others, for a limited time, from the exploitation of the inventions patented.")

heritage of mankind" approach that allows free access to knowledge and ideas.¹¹ This practice, whether or not the result of a deliberate policy decision, exposes technology transferors to the risk of loss through uncompensable infringement of proprietary interests in technology by foreign nationals or governments.

A technology transferor risks two major types of loss. The first category of risk stems from government acts (state action) and is generally referred to as "political risk." Political risks are those that "arise from the actions of national governments which interfere with or prevent business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially-owned business property."¹² This category encompasses not only those losses arising from direct proprietary action by a sovereign,¹³ but also those losses incurred as a result of indirect expropriatory action¹⁴ referred to as "creeping expropriation."¹⁵

The second general category of risk is referred to as "commercial risk" and stems from actions by private parties. Acts typically falling within this

11. Frame, *supra* note 1, at 3 (indicating that the "common heritage of mankind" concept originally stemmed from debates regarding the mining of deep seabeds). See also OECD Technology Transfer, *supra* note 1, at 9 ("Common Heritage" is merely a variation of the demand for a "Marshall Plan" for science which has been viewed as a solution for an existing technology gap during the 1960s).

12. Political risks are those that "arise from the actions of national governments which interfere with or prevent business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially-owned business property." F. WESTON & B. SORGE, INTERNATIONAL MANAGEMENT FINANCE 60 (1970), cited in S. KOBRIN, MANAGING POLITICAL RISK ASSESSMENT: STRATEGIC RESPONSE TO ENVIRONMENTAL CHANGE 32 (1982); See also Tyler, *Political Risk: Is Private Cover Here to Stay?*, THE BANKER, April 1984, at 39. ("Political risk is normally defined as an eventuality, economic or political, other than a buyer's insolvency, bankruptcy, or repudiation of contract.")

13. Except as otherwise provided, for the purposes of this article, "expropriation" includes both expropriation and confiscation. These terms are traditionally distinguished as follows: "Expropriation" refers to a lawful interference with property as opposed to "confiscation" which is an international tort. See G. SCHWARZENBERGER, DER SCHUTZ VON AUSLANDSINVESTITIONEN MULTILATERALE KODIFIKATIONSVERSUCH 28 (1969), cited in Henry, *Protection Against Noncommercial Risks in Patent Licensing*, 10 J. WORLD TRADE 421, 423 n.8 (1976).

14. Indirect expropriatory action includes such governmental measures as reducing permissible ownership percentages, increasing mandatory reinvestment requirements, curtailing the amount of profits that can be repatriated, harassing key employees or blocking access to a plant site, cancelling government concessions or changing favorable pricing policies, and imposing strict tax and regulatory burdens. See, e.g., Fearn International, Inc., Contract Nos. 5969 and 6159, Memorandum of Determination at 3 (OPIC Oct. 26, 1973) (creeping expropriation by sundry acts of harassment); Northern Indiana Brass Co., Contract No. 6369, Action Memorandum (OPIC Jan. 22, 1973) (creeping expropriation by government enactment of severe operating restrictions and labor controls); Georgia Pacific International Corp., Contract No. 6293, Action Memorandum (OPIC Aug. 2, 1973) (cancellation by government of lumbering concession prompted OPIC to find expropriation).

15. See Note, *Overseas Private Investment Corporation*, 10 LAW & POL'Y. INT'L BUS. 287, 303 (1978) (creeping expropriation refers to an "erosion of the investors' equity or contract rights falling short of total expropriation").

category include piracy¹⁶ and failure to remit the contractually-agreed upon compensation.¹⁷ When these private acts are encouraged by governmental policies or practices, they are deemed to fall within the purview of political risk.¹⁸ This categorization of private acts as state action reflects a growing recognition by the United States of the close interaction between private corporations and the central governments in many foreign, and particularly less-developed, countries.¹⁹

Political and commercial risks often require different risk management by the transferors.²⁰ Commercial risk must be hedged through the use of private contractual provisions²¹ and various risk planning techniques.²² However, because a transferor's ability to rely upon these private mechanisms depends upon the strength of his bargaining position vis-à-vis the transferee,²³ risk management through private agreement is available only to transferors with substantial ability to demand specific contractual terms and conditions.

In cases where a transferor is unable to provide for a remedy *ex ante* by a contract term or condition, a transferring company may be forced to seek redress for a loss after the fact through the courts. A party often has no

16. Technology pirating is pure theft. The proliferation of international piracy of a broad range of technological products has focused Congressional attention on the problem. See *Hearings on Unfair Foreign Trade Practices (Part 2), before the Subcomm. on Oversight and Investigations, of the House Comm. on Energy and Commerce*, 98th Cong., 1st Sess. 183 (1983) (statement of James E. Tunnell, Consultant).

17. In addition to express breach of contract, licensees sometimes underpay a licensor by tying royalty payments to sales and, then, purposefully lowering sales levels. Frame, *supra* note 1, at 18. Such a plan often involves sales by the licensee to a distributor at artificially low prices. Although the licensee pays the licensor at reduced royalty levels, it arranges to recapture its profits from the distributor. *Id.*

18. OVERSEAS PRIVATE INVESTMENT CORPORATION, PUBLIC POLICY IMPLICATIONS OF OPIC'S PROMOTION OF PROPRIETARY TECHNOLOGY TRANSFER 4 (unofficial, unpublished study by OPIC personnel from OPIC internal files).

19. *Id.*

20. Risk Management entails "identifying risks, assigning a value to them, anticipating losses, and making objective decisions about steps to take before losses occur so that they have the least impact on the operation of the enterprise. It also includes a loss control program in order to help prevent or reduce the incidence or severity of losses." D. HAENDEL, *supra* note 6, at 135. See also Gordon, *The Overseas Private Investment Corporation: Risk Management Principles*, 48 TUL. L. REV. 480, 495 (1974). The traditional tools of risk management are: "1) avoidance, 2) transfer, 3) diversification, 4) loss prevention, 5) insurance, and 6) retention." D. HAENDEL, *supra* note 6, at 139.

21. See, e.g., Sample License Agreement Between Mammon Manufacturing Co. & An Eldorado Co., Materials for Panel Session "Going International—Phase II;" conducted by the International Law Committee of the ABA's Section on Corporation Banking and Business Law 5 (J. Combs & R. Radway moderators) (unpublished material from the ABA Annual meeting, New Orleans, 1981) (available in the offices of *The International Tax & Business Lawyer*).

22. Risk planning techniques include: use of investment guaranties, timing and entry strategies, altering a subsidiary's activity, controlling the location of intangible assets, local purchasing strategies, sourcing and movement of funds, and direct lobbying. D. HAENDEL, *supra* note 6, at 78, citing Robuck, *Political Risk: Identification and Assessment*, 6 COLUM. J. WORLD BUS. 7-8 (1971).

23. Interview with James J. Combs, Associate General Counsel, Burroughs Corporation (Sept. 29, 1985).

recourse beyond the courts in the case of private violations of his property rights where piracy or a refusal to pay adequate compensation occur. Not only is this an expensive and burdensome means of protecting property interests,²⁴ it is also of limited effectiveness²⁵ because a private investor in a foreign state is subject to the law of the host state.²⁶ The law of the host country can be changed at any time in a manner unfavorable to the foreign investor, making it difficult for him to protect against risks through planning.²⁷

Political risk insurance [hereinafter PRI], available from both the government²⁸ and from private insurers,²⁹ can protect an investor or licensor against losses arising from war, expropriation, or inconvertibility of

24. Legal redress is burdened by the international normative requirement that a foreign investor exhaust all local remedies before he may turn to the international forum. See I. BROWN-LIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 482-83 (1973). Furthermore, in the case of loss through state action, an American company will generally not be able to transfer to or initiate an action in the U.S. court system because of such barriers as the Act of State doctrine, and sovereign immunity. See *Banco National de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964) (applying the Act-of-State doctrine to prevent U.S. courts from ruling on the validity of Cuban expropriation decrees despite the fact that the seizures clearly violated the rules of international law); RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 65, 68, 69 (1965) (the principle behind sovereign immunity is that a state cannot be sued, without its consent, in the courts of a foreign state for matters that relate to the states' sovereign or public acts (*jure imperii*)). These requirements mean that an investor is forced to pursue remedies through the host country's courts in spite of the fact that this option may prove fruitless. Thus, any right an investor or his country of origin might have to seek access to an international forum often will be delayed for a substantial period of time. R. Young, *Remedies of Private Claimants Against Foreign States*, 1961 Inst. on Priv. Inv. Abroad & Foreign Trade 54 ("[I]f the private party is [limited] to his local remedy, years may elapse before he completes his fruitless wanderings amid the organs of the foreign state"). Therefore, by the time an investor has gained access to an international forum, assuming that the tribunal has jurisdiction over his claim and would be able to enforce its judgment, the injured party might already have been irreparably harmed due to the long delay in receiving redress for his loss. *Id.* In this context, jurisdiction of a tribunal depends upon consent of the parties and usually is given pursuant to a particular treaty. H. STEINER & D. VAGTS, TRANSNATIONAL LEGAL PROBLEMS: MATERIALS AND TEXT 195 (1976). Enforcement of a tribunal award can pose problems in that enforcement action lies entirely with the prevailing party. In addition to diplomatic negotiations and economic retaliatory measures, a creditor-state may be able to attach property of the debtor-state within its territory. *Id.* at 204. Article 2 of the United Nations charter is generally viewed as prohibiting creditor nations from taking military action to collect a debt or to enforce awards. *Id.*

25. See, e.g., Allen & Viscusi, *Insuring the Expropriation Risks of Multinational Firms*, 11 STAN. J. INT'L STUD. 155-56 (1976) ("A firm that suffers an expropriation loss cannot rely upon the international legal system to guarantee prompt, adequate compensation"). See also Hoskins, *How to Counter Expropriation*, 48 HARV. BUS. REV. 102, 111 (1970).

26. C. BROWER, INTERNATIONAL BUSINESS TRANSACTIONS: INTERNATIONAL LEGAL PROTECTION OF UNITED STATES INVESTMENT ABROAD-A LAWYER'S GUIDE Part III 29 (1981) ("a private investor in a foreign country normally is legally protected vis-à-vis the host state only by the law of that state, as applied by its own administrative authorities and law courts, and, as a final resort, by international law.").

27. *Id.*

28. The primary U.S. underwriter of PRI covering foreign investment is the Overseas Private Investment Corporation (OPIC), a government-sponsored corporation. *Insuring Against Risk Abroad*, BUS. WK., Sept. 14, 1981 at 59; see generally T. MERON, INVESTMENT INSURANCE IN INTERNATIONAL LAW v (1976).

29. See *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 107, 126-33 (1985) (statement of A. Drury Davis,

currency.³⁰ PRI does not cover commercial risk³¹ or intellectual property rights, per se.³² However, given the flexibility of the instrument as well as the innovative coverages that PRI underwriters, particularly government agencies, have developed, PRI might be structured to protect technology transferors against infringement of intellectual property rights in foreign trade.

In addition to insurance, investors can use standby letters of credit to protect against political and commercial risk—particularly the risk of non-performance by the transferee.³³ To date, however, technology transferors have seldom relied upon standby letters of credit to protect against infringement or appropriation of intellectual property rights.³⁴ The increased willingness of banks to issue standby letters of credit,³⁵ together with the broad range of obligations the instruments have been issued upon,³⁶ suggest that a transferor could employ standby letters of credit to protect against breach of contractual terms relating to intellectual property rights or violation of the terms of a licensing agreement.

This Article will discuss the feasibility of extending PRI and standby letters of credit to cover infringement of intellectual property rights in international trade. Part I examines PRI and the coverage currently offered by

Vice President, Marsh & McLennan, Inc.) [hereinafter Davis Testimony]. Sixteen other countries have agencies similar to OPIC which provide foreign investors with insurance or guarantees against political risk. A. BRENNGLASS, *THE OVERSEAS PRIVATE INVESTMENT CORPORATION: A STUDY IN POLITICAL RISK* 120 (1983).

30. OVERSEAS PRIVATE INVESTMENT CORPORATION, *INVESTMENT INSURANCE HANDBOOK* 4-5 (1986) [hereinafter cited as *OPIC HANDBOOK*].

31. See Foreign Assistance Act of 1969, 22 U.S.C. § 2194 (1982) (as amended); see generally Note, *The 1981 Amendments and Reagan's "Newer Directions" in Third World Development Policy*, 14 *LAW & POL'Y. INT'L BUS.* 181, 195 (1982) ("OPIC has consistently maintained that as a government agency, its function is only to insure against political risks and that the private sector must insure against private risks.").

32. Interview with Jane H. Chalmers, Assistant General Counsel for Claims, OPIC (Feb. 28, 1986) [hereinafter Chalmers Feb. Interview]; see also Williams, *Transfer of Technology to Developing Countries*, 30 *FED. B. NEWS & J.* 263, 269 (1983).

33. See generally J. DOLAN, *THE LAW OF LETTERS OF CREDIT* ¶ 1.04 (1984 & Supp. 1986).

34. Interview with Professor John Dolan, Wayne State University Law School (Feb. 18, 1986).

35. Brenner, *Booming Financial Guarantees Market Generates Profits and Some Questions*, *AM. BANKER*, June 24, 1985, at 14, 17 (In 1984, U.S. commercial banks had \$146 billion outstanding in standby letters of credit, up from \$46.8 million in 1980. This growth rate of 211% was dramatically higher than the 47% throughout the same period for commercial loans).

36. See Dunn & Silberstein, *Standby Letters of Credit* 100 *N.J. LAW.* 15, 17 n.1 (1982) ("Standby letters of credit serve a variety of purposes. They are frequently issued to: (a) back up the promise of a local government unit to pay interest and principal on its bonds and notes; (b) back up the contractual promise of tax shelter investors to pay the balance of their obligations; (c) creditors to insure payment by account debtors of past due invoices; (d) bonding companies to induce the issuance of surety bonds; (e) support the commercial paper of private corporations; (f) lenders to insure payment by developers of construction loans; (g) holders of notes to serve as collateral."); see also J. DOLAN, *supra* note 33, at ¶ 1.06 (potential uses include: providing for liquidated damages; securing the balance on real estate or equipment leases; and acting as collateral for contracted payments under an installment sales contract).

the Overseas Private Investment Corporation [hereinafter OPIC or the Corporation] and by private insurers. This part explores the possibility of extending coverage to intellectual property rights and concludes that this would be economically feasible. Part II focuses on the feasibility and benefits of utilizing the standby letter of credit to protect intellectual property rights under a licensing agreement, or in the context of a contract restricting access to or the use of proprietary interests inherent in the technology. The current use of the instrument by technology transferors is discussed, leading to suggestions for the expanded use of standby letters of credit to protect proprietary interests in technology as well as licensing royalties.

I

POLITICAL RISK INSURANCE: COVERAGE AND POTENTIAL FOR EXTENSION

The concept of PRI evolved from early forms of marine insurance developed by Lloyd's of London.³⁷ PRI was introduced to the U.S. market in 1948 in the form of government-sponsored investment guaranties offered to induce investment in Post-War Europe.³⁸ During the 1950s and 1960s the U.S. Government offered investment guaranties to encourage trade with underdeveloped countries through the Agency for International Development [hereinafter AID].³⁹ In 1971, the Nixon Administration transferred all AID guaranty and insurance programs to OPIC⁴⁰ with the admonitions that the Corporation be self-sustaining⁴¹ and utilize sound risk management

37. *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 170, 172 (1985) (statement of Carol Odinet Godfrey, Director of Underwriting for Political Risk, Swett and Crawford of Texas, Inc.) [hereinafter Godfrey Testimony].

38. See BRENNGLASS, *supra* note 29, at 1; Davis Testimony, *supra* note 29, at 119.

39. In 1959, Congress expanded the Economic Cooperation Act of 1948 to include invertibility insurance for companies engaging in the export of economic resources to underdeveloped areas. BRENNGLASS, *supra* note 29, at 6. Under the Kennedy Administration, Congress passed the Foreign Assistance Act of 1961 which provided for the sale of new types of PRI, including insurance against revolution and insurrection as well as war. *Id.* at 89. The 1961 Act also authorized the establishment of an Agency for International Development (AID) to administer the insurance program. *Id.* at 7; Davis Testimony, *supra* note 29, at 119.

40. President Nixon proposed the enactment of legislation to found the Overseas Private Investment Corporation in his 1969 foreign aid message to Congress. *Id.* In response to Nixon's proposal, Congress passed legislation enabling OPIC's formation. See Foreign Assistance Act of 1969, Pub. L. No. 91-175 83 Stat. 805, 826 (1969). OPIC began operations on January 19, 1971, when President Nixon issued an executive order transferring the private investment programs administered by AID to OPIC. Executive Order No. 11,579, 36 Fed. Reg. 969 (1971). The primary reason given for this action was the high claims cost incurred by the AID programs. At the time AID programs were transferred to OPIC, existing and threatened claims totaled more than \$400 million and insurance reserves available to pay these claims amounted to only \$85 million. Gilbert, *Expropriations and the Overseas Private Investment Corporation*, 9 LAW & POL'Y INT'L BUS. 515, 515-16 (1977).

41. 22 U.S.C. § 2191(2)(a) (1982).

principles.⁴² Since then, OPIC has become the flagship PRI insurer worldwide⁴³ and has operated at a profit since 1981.⁴⁴

OPIC's success has spurred the growth of private and quasi-private sources of PRI.⁴⁵ For example, the World Bank has established a Multilateral Investment Guaranty Agency [hereinafter MIGA] which offers PRI to "support national agency investments in countries in which a national agency is already heavily exposed."⁴⁶ In light of the growth of the private market for PRI together with MIGA's potential to provide forms of PRI,⁴⁷ and the Government's growing budgetary concerns, the Reagan Administration has suggested that OPIC's programs be privatized.⁴⁸ Whatever the outcome of the Reagan Plan might be, it is clear that PRI will continue to be available in the coming years to meet exporters' growing demand for the product.⁴⁹

42. 22 U.S.C. § 2191(d) (1982); see also H.R. Rep. No. 97-195, 97th Cong., 1st Sess. 8, reprinted in 1981 U.S. Code Cong. & Admin. News, 1587.

43. Godfrey Testimony, *supra* note 37, at 188 ("The public sectors such as OPIC, EDC [Canada], ECGD [UK], etc., are in a much stronger position than we are in the private sector and of course OPIC is probably the Flag Ship of government insurance schemes.") Over the past four years [1981-84], OPIC has facilitated a total investment of \$13.1 billion, three times as much as during the preceding four years. *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 233, 236 (1985) (statement of Craig A. Nalen, President and Chief Executive Officer of OPIC) [hereinafter Nalen Testimony]. See generally Note, *The 1981 OPIC Amendments and Reagan's "Newer Directions" in Third World Development Policy*, 14 LAW & POL'Y INT'L BUS. 181 (1982).

44. See Nalen Testimony *supra* note 43, at 236. It is also noteworthy that OPIC insurance payments totaled \$249.9 million from 1972 to 1984, while OPIC funds available for claims payment reached \$933 million in 1984. *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 13, 18-19 (1985) (statement of Robert Mandel, Associate Professor of Int'l Affairs, Lewis & Clark College) [hereinafter Mandel Testimony].

45. See A. BRENNGLASS, *supra* note 29, at 129; see generally Tyler, *supra* note 12, at 39 ("The private market in political risk insurance, centered in London and New York, has mushroomed in the past ten years.").

46. Davis Testimony, *supra* note 29, at 137. In the fall of 1985, final approval was cemented for a Multilateral Investment Guarantee Agency to operate under the auspices of the World Bank. According to an official of the World Bank, MIGA is designed to "provide a framework that will improve the investment climate in the developing countries." AP Report reprinted in *The Lincoln Star*, Sept. 14, 1985; see also Nalen Testimony, *supra* note 43, at 342.

47. Chalmers Feb. Interview, *supra* note 32; see also *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 62, 73 (1985) (statement of O. Bolli, Director of International Financing, GTE Corp.) [hereinafter Bolli Testimony] ("We believe that MIGA coinsurance or reinsurance of OPIC insurance could be very useful by involving an international agency in support of U.S. direct investments, particularly in areas where U.S. political influence may be a cause of concern.").

48. N.Y. Times, Feb. 6, 1986, at A14, col. 5; OPIC officials have suggested that privatization of the Corporation might be patterned after a Fannie Mae/Sallie Mae-type model. Chalmers Feb. Interview, *supra* note 32.

49. It was estimated that in 1980, multinational corporations paid \$600 to \$700 million in political risk premiums. BRENNGLASS, *supra* note 29, at 157 n.93. The demand for PRI has paralleled the growth of increasingly complex international transactions and of the flow of investment dollars to politically volatile LDCs. Meron, *supra* note 28, at v. Economists predict that demand for PRI will continue to grow as multinational corporations become more aware of their

This part of the Article will discuss the current availability of PRI. Section A focuses on the OPIC program, emphasizing the mechanics of OPIC's expropriation coverage. Section B discusses privately underwritten PRI and its advantages relative to the insurance offered by OPIC. Section C will canvass the very limited insurance coverage available to technology transferors. Section D then examines the potential for expanding the breadth of PRI to cover intellectual property rights.

A. Political Risk Insurance and Related Services Available from OPIC

OPIC's insurance programs were established under the Foreign Assistance Act of 1969 and continue to be governed by that Act.⁵⁰ The most significant provision found in the Act stipulates that OPIC may insure investments only in those countries that expressly agree to host investments with United States-backed insurance programs.⁵¹ The Act requires that OPIC make suitable arrangements in the host countries to protect United States interests.⁵²

In order to meet its statutory obligations, OPIC has negotiated bilateral treaties⁵³ with friendly host countries.⁵⁴ Important provisions generally found in the OPIC treaties include a stipulation that OPIC will not insure projects in the absence of host country approval,⁵⁵ a clause providing for the subrogation by the United States of any claim or cause of action related to an insured project,⁵⁶ a guarantee of nondiscriminatory action by the host

own risk management needs. *Insuring Against Risk Abroad*, BUS. WK., Sept. 14, 1981 at 59. The reasons behind this increased reliance upon PRI have been summarized as follows: "[f]or the investor, the purchase of [PRI] . . . not only removes a significant measure of risk associated with an investment in an LDC, but it also removes a quantum of uncertainty, fear, anxiety and suspicion. The investor who has OPIC insurance can act more self-confidently in his dealings with various host country political groups, he can afford to have a longer time perspective, and he is less likely to act precipitously or panic when the host country experiences political or economic difficulties." Franklin & West, *The Overseas Private Investment Corporation Amendments Act of 1978: A Reaffirmation of the Developmental Role of Investment Insurance*, 14 TEX. INT'L L.J. 1, 19 (1979).

50. See, e.g., 22 U.S.C. §§ 2191(a)-(m), 2197(k)-(l), 2199(f), (g) & (i), 2200 (1982).

51. 22 U.S.C. 2197(a) (1982).

52. *Id.* at § 2197(b) (1982).

53. OPIC personnel negotiate these Investment Guaranty Treaties under the auspices of the State Department and with the assistance of embassy personnel located in the host country. Interview with Laird Robertson, Attorney, Office of the Legal Advisor, United States Department of State (Feb. 28, 1986). OPIC has negotiated treaties with one hundred and one countries from all regions of the world. OPIC, PROMOTIONAL BOOKLET 13-14 (1986) (available in the offices of *The International Tax & Business Lawyer*).

54. See 22 U.S.C. § 2197(a) (1982). ("Insurance . . . issued . . . shall cover investment made in connection with projects in any less developed friendly country or area with the government of which the President of the United States has agreed to institute a program for insurance . . .").

55. See, e.g., Investment Guaranty Treaty, Feb. 10, 1975, United States—Federal Military Government of the Federal Republic of Nigeria, art. 2, 26 U.S.T. 102, T.I.A.S. No. 8012; Investment Guaranty Treaty, April 5, 1983, United States—The Bahamas, art. 2, at 2 (unpublished, available in the offices of *The International Tax & Business Lawyer*).

56. See, e.g., Investment Guaranty Treaty, April 26, 1975, United States—Saudi Arabia, art. 2, 26 U.S.T. 459, T.I.A.S. No. 8045; Investment Guaranty Treaty, Dec. 19, 1985, United

government against the interests of insured projects,⁵⁷ and arrangements for arbitration in the case of a dispute between OPIC and the host country.⁵⁸ The most significant of these provisions for the investor is that which requires host country approval of insured projects. OPIC regulations require that an insurance applicant independently obtain the requisite foreign government approval.⁵⁹

OPIC insures qualified investments⁶⁰ in less developed friendly countries against loss due to three specific categories of political risks.⁶¹ OPIC coverage is available to eligible investors⁶² for the risks arising from: 1) inability to convert local currency into dollars; 2) loss due to political violence, i.e., war, revolution, insurrection, or civil strife; and 3) loss of investment due to

States—Bolivia, art. 3, at 2 (unpublished, available in the offices of *The International Tax & Business Lawyer*).

57. See, e.g., Investment Guaranty Treaty, Sept. 12, 1960, United States—Liberia, art. 3(d), 11 U.S.T. 2119, T.I.A.S. No. 4571, 389 U.N.T.S. 245, 248.

58. See, e.g., Investment Incentive Agreement, Nov. 5, 1983, United States—Djibouti, art. 6, at 4 (unpublished, available in the offices of *The International Tax & Business Lawyer*). The arbitration provisions in the Investment Guaranty Treaty with the Bahamas are typical of those in OPIC treaties. Article 6 of the Treaty provides that any disputes between the two Governments which “involves a question of international law arising out of any project or activity for which coverage has been issued” shall be submitted to an arbitral tribunal consisting of three arbitrators. The arbitrators are to be chosen according to the terms of the Article; if appointments are not made in accordance with Article 6(b), the Treaty provides that the International Court of Justice shall make the appointments. The arbitral tribunal must base its decision upon “applicable principles and rules of public international law.” United States—The Bahamas Treaty, *supra* note 55, art. 6(a) & (b), at 3-4.

59. OPIC HANDBOOK, *supra* note 30, at 16. The Handbook notes that OPIC will give the applicant instructions on obtaining the requisite governmental approval when the investor files the Registration letter with OPIC. *Id.*

60. OPIC regulations require that an investment be “new” in order to be eligible for insurance coverage. OPIC HANDBOOK, *supra* note 30, at 9. This requirement is designed to “assure that OPIC-supported projects make a positive development contribution.” Nalen Testimony, *supra* note 43, at 240. The additional projects do not need insurance to cover their risks because the very fact that the project is worthy of additional capital proves its safety, while companies initially investing in foreign enterprise require insurance in order to induce them to invest in a developing, politically-risky country. T. MERON, *supra* note 28, at 62-63. In addition to “newness”, coverage is provided only for “that portion of the Investor’s actual contribution to the Foreign Enterprise that is insured . . . at the United States dollar value on each Date of the Investment.” OPIC CONTRACT OF INSURANCE § 1.18 at 7 (1986) [hereinafter cited as OPIC CONTRACT]. It is also noteworthy that OPIC will insure such nontraditional forms of investments as technological loans (or guaranties of a third party loan to a foreign enterprise), arrangements based on sharing of royalties, earnings or profits, and contracts pertaining to the provision of commodities and services, and the granting of technical or managerial assistance. See 22 U.S.C. § 2198(a) (1982); see also T. MERON, *supra* note 28, at 59.

61. OPIC HANDBOOK, *supra* note 30, at 4. OPIC insures only fundamental risks (i.e., risks that are impersonal in both origin and consequence and that arise from political and economic forces) and not particular risks (i.e., those risks that are capable of identification with individual events such as the theft of an automobile or the burning of a house). Gordon, *supra* note 20, at 493-94.

62. OPIC regulations provide that in order to be eligible for insurance coverage, an investor must be either a United States citizen or a U.S. company more than fifty percent beneficially owned by U.S. citizens or by an eligible U.S. corporation. OPIC HANDBOOK, *supra* note 30, at 8. The regulations expressly provide that insurance may not be issued to a United States investor who is “merely a conduit for an otherwise ineligible investor.” T. MERON, *supra* note 28, at 56.

expropriation, nationalization,⁶³ or confiscation by action of a foreign government.⁶⁴

OPIC inconvertibility coverage provides an important hedge against arbitrary governmental manipulation of currency exchange laws.⁶⁵ The coverage protects against changes in foreign exchange control laws and practices during the course of an investment⁶⁶ and covers the repatriation of profits, interest and royalty fees, technical assistance fees, and any other form of capital.⁶⁷ Under the terms of the policy, if an insured party is prevented from converting the eligible payments into dollars,⁶⁸ OPIC will exchange dollars for the investor's local currency.⁶⁹ OPIC, in turn, exchanges with the U.S. Embassy in the host country the local currency received for equivalent dollar amounts.⁷⁰ OPIC loses money on the contract only if currency devaluation occurs during the claims settlement.⁷¹

Political violence coverage extends to losses arising from war,⁷² revolution, or insurrection,⁷³ and to actions "taken to hinder combat or defend against hostile action during war, revolution or insurrection."⁷⁴ Civil strife coverage⁷⁵ is available in conjunction with the standard political violence coverage.⁷⁶ The measure of compensation under a standard policy is the original cost of the covered property not to exceed the lesser of the cost of

63. Nationalization refers to a decree to bring within state ownership a general class of property or an entire sector of the economy. Expropriation officially means that a takeover decree is directed against a specific foreign company. A. BRENNGLASS, *supra* note 29, at 241. For the purposes of this article, expropriation, nationalization and confiscation will be dealt with under the rubric of "expropriation", except as otherwise provided. *See supra* note 13.

64. OPIC HANDBOOK, *supra* note 30, at 4.

65. A. BRENNGLASS, *supra* note 29, at 240. The importance of inconvertibility insurance can be seen in OPIC's claims history in which OPIC settled \$30 million worth of inconvertibility claims from 1979 to 1981. Stern, *Insurance for Third World Currency Inconvertibility Protection*, 60 HARV. BUS. REV., May-June 1982, at 62.

66. Stern, *supra* note 65, at 62.

67. *Id.*

68. "Blockage may be either 'active' (e.g., action by exchange control authorities denying access to foreign exchange on the basis of new, more restrictive regulations) or 'passive' (e.g., failure of authorities to act within a specified period—often 60 days—on an application for foreign exchange)." OPIC HANDBOOK, *supra* note 30, at 4. *See also supra* note 65 and accompanying text.

69. Chalmers Feb. Interview, *supra* note 32; OPIC HANDBOOK, *supra* note 30, at 4; Stern, *supra* note 65, at 62.

70. Chalmers Feb. Interview, *supra* note 32.

71. *Id.*

72. OPIC does not require that there be a formal declaration of war. OPIC HANDBOOK, *supra* note 30, at 5. OPIC's insurance also provides land-based war coverage which most private underwriters, under the 1937 Waterbourne Agreement, are prohibited from writing. Davis Testimony, *supra* note 29, at 112, 117, 128.

73. OPIC HANDBOOK, *supra* note 30, at 5.

74. *Id.*

75. Civil Strife coverage encompasses damage due to politically motivated violent acts by a group or individual, including acts of terrorism and sabotage but excluding those carried out by labor or students. OPIC HANDBOOK, *supra* note 30, at 5.

76. *Id.*

repair or replacement or, if damaged equipment remains commercially operable, the reduction in the fair market value of the asset.⁷⁷

OPIC's broad expropriation coverage is particularly useful to investors in politically volatile countries. The OPIC insurance contract defines the insurable event of "expropriatory action" to include both a direct taking of property by a foreign state as well as a series of government-initiated interferences described as creeping expropriation.⁷⁸ This inclusive coverage protects against the looming threat of total loss to the investor posed by either creeping or traditional expropriatory action.⁷⁹

Moreover, although international law generally entitles an investor to fair compensation for expropriated property,⁸⁰ collection of this compensation can create significant problems for the investor.⁸¹ Because it is difficult

77. *Id.*

78. See OPIC CONTRACT, *supra* note 60, § 1.13, at 4-5; for the definition of creeping expropriation see *supra* note 14 and accompanying text. Note that this definition does narrow the broader definition of expropriation found in OPIC's Enabling Act. "Expropriation" is defined under the Foreign Assistance Act to include: "any abrogation, repudiation, or impairment by a foreign government of its own contract with an investor with respect to a project where such abrogation, repudiation, or impairment is not caused by the investors' own fault or misconduct, and materially adversely affects the continued operations of the project." 22 U.S.C. § 2198(b) (1982).

The contractual definition limits expropriatory acts to those that last for at least one year and that prevent the investor from receiving payments from or exercising control over the investment. OPIC CONTRACT, *supra* note 60, § 1.13(1)-(8) at 5-6. "Expropriatory Action" is further defined by the standardized OPIC Contract to mean: any action which is taken, authorized, ratified or condoned by the Government of the Project Country, commencing during the Insurance Period, with or without compensation therefor, and which for a period of one year directly results in preventing: a) the Investor from receiving payment when due in the currency specified in the amount which the Foreign Enterprise owes the Investor or in respect of the Securities; or b) the Investor from effectively exercising its fundamental rights with respect to the Foreign Enterprise either as shareholder or as creditor, as the case may be, acquired as a result of the Investment; provided, however, that rights acquired solely as a result of any undertaking by or agreement with the Government of the Project Country shall not be considered fundamental rights merely because they are acquired from such undertaking or agreement; or c) the investor from disposing of the securities or any rights accruing therefrom; or d) the Foreign Enterprise from exercising effective control over its property or from constructing the Project or operating the same; or e) the Investor from repatriating, and from exercising effective control in the Project Country over, amounts received in respect of the Securities as Investment Earnings of Return of Capital, which action commences within the eighteen months immediately succeeding such receipt." § 1.13(a)-(e), at 4-5. The definition adds the following qualifiers: "Notwithstanding the foregoing, no such action shall be deemed an Expropriatory action, if it occurs or continues in effect, during the aforesaid period, as a result of: 1) any law, decree, regulation or administrative action of the Government of the Project Country which is not by its express terms for the purpose of nationalization, confiscation or expropriation . . . is reasonably related to constitutionally sanctioned governmental objectives, is not arbitrary, is based upon a reasonable classification of entities to which it applies and does not violate generally accepted principles of international law." *Id.*, § 1.13(1), at 5.

79. Allen & Viscusi, *supra* note 25, at 154-62.

80. Expropriation for such public purposes as a defensive measure in wartime is lawful even if compensation is not forthcoming. However, expropriation in all other circumstances is unlawful unless there is provision for the payment of "prompt, adequate and effective compensation." I. BROWNLIE, *supra* note 24, at 523; see also RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW § 185 (1965).

81. Allen & Viscusi, *supra* note 25, at 153.

for investors to estimate and provide for potential losses *ex ante*,⁸² "the prospect of large expropriation losses may result in overestimating takeover possibilities."⁸³ These factors often lead investors to avoid LDCs, thus bypassing good investment opportunities. OPIC coverage provides a useful hedge against expropriation, lessening investor concern regarding political risks. PRI, as a result, tends to create more productive foreign investment.

Nevertheless, OPIC operating policy and regulations substantially restrict the expropriation coverage from extending to the limits set by OPIC's enabling statute.⁸⁴ The OPIC contract, for example, covers only total expropriation while the statute appears to authorize coverage of partial expropriation as well.⁸⁵ Thus, many of the terms of the expropriation policy could be expanded to provide more comprehensive coverage.⁸⁶ Such expansion would be subject to the statutory requirement that OPIC conduct its operations with due regard to established principles of risk management.⁸⁷

Particularly noteworthy among the OPIC contractual provisions is the requirement that the alleged expropriatory action last for at least one year.⁸⁸ This requirement is designed to ensure that the insured has ample opportunity to verify the government's intentions and to begin settlement negotiations.⁸⁹ The contract underlines the provision by expressly requiring that the insured take appropriate steps within the year to resolve the expropriatory action and to preserve the company's assets.⁹⁰ OPIC guidelines do reserve to the corporation the right to find expropriatory action prior to the one year

82. *Id.* at 157.

83. *Id.*

84. C. HUNT, *A LAWYER'S GUIDE TO INTERNATIONAL BUSINESS TRANSACTIONS PART II* 298 (W. Surrey & D. Wallace, 2d ed. 1979).

85. Koven, *The "Jurisprudence" of OPIC*, 22 HARV. INT'L L.J. 269, 281 n.54 (1981).

86. It should be noted that OPIC's enabling legislation was broadly written to allow for interpretation. C. CROSSWELL, *LEGAL AND FINANCIAL ASPECTS OF INTERNATIONAL BUSINESS* 64 (1980).

87. See 22 U.S.C. § 2191(2)(d) (1982). Risk management techniques used by OPIC include: 1) careful client screening; 2) employment of detailed eligibility requirements; 3) approval from the host country; 4) use of higher premiums depending on the estimated risk; 5) screening on the basis of industry, project features and form of investment; 6) use of coinsurance or reinsurance; 7) shortening the coverage period; and 8) reliance on special monitoring services. A. BRENNGLASS, *supra* note 29, at 225-26.

88. OPIC CONTRACT, *supra* note 60, § 1.13, at 4. Note that the contract does reduce the period from one year to three months or less in the case of institutional loans. C. BROWER, *supra* note 26, at 16.

89. Gilbert, *supra* note 40, at 517; see also C. HUNT, *supra* note 84, at 306-07 (the waiting period provides the investor with an opportunity to avoid or mitigate losses as well as to evaluate the expropriatory action and to characterize it within OPIC terminology as either direct or "creeping" expropriation); cf. Lipman, *Overseas Private Investment Corporation: Current Authority and Programs*, 5 N.C.J. INT'L L. COM. REG. 337, 349 (1980) (the requirement ensures that the alleged expropriatory action is "fundamental" to the interests of the insured).

90. OPIC CONTRACT, *supra* note 60, § 1.13 (2) at 5; see generally Lipman, *supra* note 89, at 349.

mark if OPIC determines that "such action has caused or permitted a dissipation or destruction of assets of the Foreign Enterprise substantially impairing the value of the Foreign Enterprise as a going concern."⁹¹

OPIC requires an investor to carry out settlement negotiations with a host country during the period following the expropriatory action.⁹² The corporation will assist the investor in settling with the project country⁹³ by bringing both its expertise⁹⁴ and political clout⁹⁵ to the negotiating table. In addition, OPIC can provide specific services to an investor seeking to settle with his host country. OPIC will, for example, supplement cash settlement amounts⁹⁶ or guarantee notes or indebtedness arising out of a settlement.⁹⁷

In the event that negotiations fail, OPIC allows recovery under the expropriation policy of the full value of a loss up to the face value of the insurance.⁹⁸ Insurance value is calculated on the basis of the book value of the insured equity investment, adjusted for retained earnings and losses, or the principal and accrued interest for insured debt, as of the date of expropriation.⁹⁹ OPIC will insure only ninety percent of an investment,¹⁰⁰ but the corporation will provide additional coverage in standby commitments¹⁰¹ up to one hundred eighty percent of the initial investment for reinvested retained earnings or interest as accrued.¹⁰² The standby coverage is designed to complement OPIC's twenty-year coverage¹⁰³ as part of OPIC's effort to encourage investors to reinvest earnings.¹⁰⁴

91. OPIC CONTRACT, *supra* note 60, § 1.10, at 4.

92. *Id.*, § 2.06, at 13. Note also that the Contract requires OPIC approval of all agreements between the investor and the Project Country. *Id.*

93. The Legislative History behind OPIC's Enabling Statute indicates that Congress intended the Corporation to play an important role in the resolution of investor-host country disputes. H.R. Rep. No. 95-670, 95th Cong., 2nd Sess. 1, reprinted in 1978 U.S. Code Cong. & Ad. News 618, 625. A. BRENNGLASS, *supra* note 29, at 226.

94. Gilbert, *supra* note 40, at 519.

95. A. BRENNGLASS, *supra* note 29, at 226-27; Chalmers Feb. Interview, *supra* note 32.

96. A. BRENNGLASS, *supra* note 29, at 226-27.

97. 22 U.S.C. § 2199(d) (1982); Gilbert, *supra* note 40, at 524.

98. Henry, *supra* note 13, at 430.

99. OPIC HANDBOOK, *supra* note 30, at 5; see also C. BROWER, *supra* note 26, at 16; Note, *Arbitration—OPIC Investment Insurance Contracts: The Loss of Effective Control Test for Expropriation*, 14 TEX. INT'L L.J. 475, 489 (1979).

100. OPIC HANDBOOK, *supra* note 30, at 11. Note that the sole exception to this rule is insurance for institutional project loans to unrelated third parties which may be insured for 100 percent of interest and principal. *Id.* Also for large investments in countries where OPIC has an already large portfolio concentration, and for sensitive projects, coverage may be limited to less than 90 percent. *Id.*

101. The "standby amount" refers to the difference between the current insured amount (the insurance actually in force during any contract year) and the maximum insured amount. See OPIC HANDBOOK, *supra* note 30, at 6.

102. OPIC HANDBOOK, *supra* note 30, at 11; see also Franklin & West, *supra* note 49, at 19.

103. OPIC officials note that the corporation does write contracts for a shorter period of time depending on the estimated risk. Contracts for natural resource projects, for example, generally run for only twelve years. Nalen Testimony, *supra* note 43, at 291; Chalmers Feb. Interview, *supra* note 32.

104. Franklin & West, *supra* note 49, at 19.

Damages under an OPIC expropriation policy are measured as of the "date of expropriation."¹⁰⁵ OPIC defines this date as the "first day of the period in which an action through duration of time, became expropriatory."¹⁰⁶ This definition has been the source of a number of interpretive disputes,¹⁰⁷ and the problems have been especially acute in the case of creeping expropriation.¹⁰⁸ Moreover, because compensation under the policy is determined as of the date of expropriation, a policy holder is less likely to recover the full value of its investment if it struggles to maintain control of an enterprise.¹⁰⁹ The policy underlying the measuring date thus seems questionable in light of OPIC's espoused goals of encouraging compromise¹¹⁰ between U.S. investors and foreign states.¹¹¹ Finally, measuring damages as of the date of expropriation creates valuation problems.¹¹² Claims figures are often set too high or too low depending upon arbitrary determinations of the expropriation date.¹¹³ OPIC, however, has not yet established a uniform system for measuring the determinative date.¹¹⁴

OPIC pays compensation on expropriated investments only against assignment to the corporation of the entire insured investment as well as of any related claims or rights.¹¹⁵ The contract provides that OPIC may, "within its

105. OPIC CONTRACT, *supra* note 60, § 1.10, at 4.

106. *Id.*

107. Koven, *supra* note 85, at 277.

108. "For 'creeping' expropriation, where a slow accretion of interferences with the investor's management or control of the foreign enterprise results in the inability of the project to continue, determining the date on which 'an action' created that result is an absurd exercise, but one of extreme importance because of the principles of compensation at work in the contract." *Id.*

109. *Id.* Note that this will be especially true when the governmental interferences have resulted in lower profits or in losses which, under the accounting procedures dictated by the contract, must be subtracted from retained earnings. *Id.*

110. Gilbert, *supra* note 40, at 517. "In early 1971, OPIC management adopted an approach of actively attempting to settle claims, rather than merely verifying and paying claims and asking Congress to replenish its funds from time to time. The goal of this approach was to encourage insured investors and foreign governments to resolve investment disputes themselves. . . ."

111. Koven, *supra* note 85, at 277.

112. *Id.* at 316.

113. *Id.* See also Cabot International Capital Corporation, Contract No. 8383, Memorandum of Determination (OPIC Dec. 27, 1980)(The foreign enterprise was profitable until the Iranian revolution forced the closing of the plant; because the date of expropriation was set a number of months after the closing of the plant, the value of the company's net investment had been severely reduced).

114. Compare International Dairy Engineering Company of Asia, Inc., Contract Nos. 1150, 1151, 1154 and 5628, Memorandum of Determination at 6 (OPIC Dec. 7, 1976)(available in the offices of *The International Tax & Business Lawyer*)(OPIC followed principle that actual interference with operations is more important in determining the date of expropriation than are official announcements with Caltex (Asia) Ltd., Contract Nos. 1, 5197 & 5286, Action Memorandum (OPIC June 30, 1976)(copy available in the offices of *The International Tax & Business Lawyer*)(OPIC set the date of expropriation at the date of the military decree). See generally Koven, *supra* note 85, at 313.

115. OPIC CONTRACT, *supra* note 60, § 19.03, at 29-30; see also OPIC HANDBOOK, *supra* note 30, at 5.

sole discretion," reject all or part of any assignment.¹¹⁶ Under the contract, OPIC is bound to pay to the insured any amount received by OPIC as subrogee in excess of insurance paid and costs of collection.¹¹⁷

Upon assignment to it of the investor's ownership rights in expropriated property, OPIC will compensate the investor and then pursue the claim as subrogee.¹¹⁸ The insurance policy thus provides a significant bonus to the investor in that it is not necessary to wait to negotiate a recovery of the loss.¹¹⁹ Furthermore, OPIC has a good record of recovery from the host states on subrogated claims.¹²⁰ This record is due in large part to the substantial leverage OPIC wields as an organ of the U.S. government.¹²¹

B. Privately Written Political Risk Insurance

Private insurers underwrote approximately two hundred million dollars worth of political risk premiums in 1985.¹²² Approximately half of that amount was written by Lloyd's of London¹²³ which first introduced PRI coverage into the private market in 1972.¹²⁴ As of June, 1985, eleven private underwriters offered PRI.¹²⁵

Underwriters in the private market tend to insure investments when support from OPIC is unavailable.¹²⁶ Because private insurers lack the political power held by OPIC, they are generally unable to recover the value of paid-out claims. As a result, they tend to insure relatively safe investments made by established companies.¹²⁷ In addition, private insurers tend to limit coverage to investments made in countries in which the insurers have established

116. OPIC CONTRACT, *supra* note 60, § 19.03, at 30.

117. *Id.* § 19.05, at 30-31.

118. Gilbert, *supra* note 40, at 543-44.

119. *Id.*

120. Chalmers Feb. Interview, *supra* note 32; Gilbert, *supra* note 40, at 547.

121. Chalmers Feb. Interview, *supra* note 32 (Noting that OPIC has the authority to disband U.S. aid to a host country that fails to settle a claim with OPIC).

122. Davis Testimony, *supra* note 29, at 112; Mr. Davis projects the breakdown by insurance type as follows:

1. Confiscation, Expropriation, and Nationalization	\$ 60,000,000
2. Contract Frustration/Repudiation, Embargo, License	\$118,000,000
3. Currency Inconvertibility	\$ 17,000,000
4. Civil War, Civil Strife & Insurrection	\$ 1,000,000
5. Other Miscellaneous	\$ 4,000,000
TOTAL	\$200,000,000

123. Tyler, *supra* note 12, at 39.

124. A. BRENNGLASS, *supra* note 29, at 126.

125. Davis Testimony, *supra* note 29, at 141; *see also* Tyler, *supra* note 12, at 39.

126. A. BRENNGLASS, *supra* note 29, at 126; *see also* Nalen Testimony, *supra* note 43, at 294.

127. *See* Davis Testimony, *supra* note 29, at 126 (both OPIC and private underwriters primarily insure Fortune 1000 companies); *see also* Tyler, *supra* note 12, at 42 ("Because they are in business primarily to make money, private underwriters will tend to fight shy of the inexperienced exporter.").

operations.¹²⁸ By doing so, a private underwriter can increase its chances of recovering compensation on a subrogated expropriation claim by threatening to cease its own activity in the host country.¹²⁹ Similarly, in the case of inconvertibility insurance, local operations provide a vehicle through which the insurer can utilize the local currency subrogated to it in exchange for its claims payment in U.S. dollars.¹³⁰

A private underwriter has access to far fewer risk assessment resources than OPIC does.¹³¹ For this reason, the insurer not only must choose his clients more carefully,¹³² but the insurer will also charge more for coverage given its own higher risks.¹³³ In practice, rates for non-catastrophic PRI coverage in the private market can be five to twenty times higher than conventional commercial insurance on the same project,¹³⁴ and substantially higher than OPIC's standard rates for PRI.¹³⁵ In spite of the higher premiums, the total cost of privately-purchased insurance may be lower due to the private market's willingness to insure a portfolio of risks rather than a specific project.¹³⁶

128. Chalmers Feb. Interview, *supra* note 32.

129. *Id.*

130. *Id.*

131. Tyler, *supra* note 12, at 42. OPIC has access to confidential information from the State Department and the Central Intelligence Agency to aid it in formulating risk assessments. See Mandel Testimony, *supra* note 44 at 19; Chalmers Feb. Interview, *supra* note 32; Note, *Overseas Private Investment Corporation*, 10 LAW & POL'Y INT'L BUS. 287, 296 (1978). OPIC has access to the services of U.S. Embassy and AID Mission staffs. C. HUNT, *supra* note 84, at 281.

132. Tyler, *supra* note 12, at 42 ("A private underwriter . . . will put the quality of the customer high on the list of criteria.").

133. See Godfrey Testimony, *supra* note 135, at 179. See also *Insuring Against Risk Abroad*, BUS. WK. Sept. 14, 1981, at 59.

134. *Insuring Against Risk Abroad*, BUS. WK., Sept. 14, 1981, at 59.

135. OPIC's base rates for manufacturing and service projects are as follows:

Annual Base Rates per \$100 of Coverage

Coverage	Current	Standby
Inconvertibility	30¢	25¢
Expropriation	60¢	25¢
Political Violence	60¢	25¢
With Civil Strife	75¢	30¢

OPIC HANDBOOK, *supra* note 30, at 6. Although private insurers do not publish base rates, it is interesting to compare with the OPIC rates the following authority's estimate of private rates:

Private coverage looks a lot more expensive, although the range of quotations may be large: perhaps over 2 percentage points for the same risk. Premiums typically range from 1% to 5%, according to one Lloyds syndicate director, but an exporter would currently pay, say, 7 1/2% on a contract in Nigeria—if he could find someone to underwrite it. Outside Lloyds, one big insurance company estimated the typical premium range for riskier markets at nearer 8-10%.

Tyler, *supra* note 12, at 40. See also Godfrey Testimony *supra* note 37, at 179 ("While OPIC's rates may be higher than those of other government insurance schemes such as EDC or ECGD, their rates are still lower than those charged by the private sector.").

136. Tyler, *supra* note 12, at 40-42; see generally Bolli Testimony, *supra* note 47, at 65 ("private insurers seem to have little interest in insuring single investment projects in developing

Privately written policies present some disadvantages when compared with governmental insurers. These include a much shorter coverage period than OPIC policies.¹³⁷ The maximum length of credit at Lloyd's is approximately three years and at American Insurance Group approximately seven (for "A" category markets)¹³⁸ as compared to the twenty-year standard coverage offered by OPIC.¹³⁹ Furthermore, the private market's capacity to issue PRI is not large;¹⁴⁰ the evidence suggests that PRI capacity among private insurers has shrunk by approximately forty percent over the past several years.¹⁴¹ Authorities have attributed the decrease in capacity to the combined impact of a worldwide decrease in reinsurance capacity¹⁴² and large PRI losses experienced by Lloyd's of London,¹⁴³ including a fifty million dollar loss in the Sudan as a result of non-payment due to currency inconvertibility.¹⁴⁴

In spite of the shortcomings of private PRI insurers, they do provide several advantages over OPIC. First, they tend to respond more quickly than OPIC to an applicant's request for PRI.¹⁴⁵ Secondly, private insurers hold the contents of insurance applications in confidence.¹⁴⁶ Unlike OPIC which requires that an insured disclose the existence of insurance to the host government, private insurers generally keep the existence of PRI a secret.¹⁴⁷ This

countries, whereas OPIC has a specific mandate to do so. Private insurers attempt to insure the entire portfolio of a company's foreign investments . . .").

137. Godfrey Testimony, *supra* note 37, at 182-83.

138. Tyler, *supra* note 12, at 42; Lloyds' policies are limited to three years due to their accounting practices. Davis Testimony, *supra* note 29, at 117.

139. OPIC HANDBOOK, *supra* note 30, at 11. Commentators have evaluated the advantages to the investor of longer policy coverage as follows:

[T]he use of [OPIC] insurance reduces the perceived need for an investor to seek a rapid recapture of this investment cost. This can yield a variety of benefits both to the investor and to the host country . . . Insured investors, who usually feel more secure, also tend to be more willing to consider LDC investments with a lower aggregate cash flow or return on investment.

Franklin & West, *supra* note 49, at 18.

140. Tyler, *supra* note 12, at 42.

141. Godfrey Testimony, *supra* note 37, at 175.

142. *Id.* at 175.

143. *Id.* at 176.

144. *Id.*

145. Tyler, *supra* note 12, at 39-40; Godfrey Testimony, *supra* note 37, at 185-86 (private insurers generally can give an indication of interest rate and price within 48 hours, while OPIC might take two months); *Oversight of the U.S. Overseas Private Investment Corporation: Hearings on H.R. 1988 Before the Subcomm. on Commerce, Consumer, and Monetary Affairs of the House Comm. on Government Operation*, 99th Cong., 1st Sess. 79, 82 (1985) (statement of W. Michael McDonald, Risk Manager, Foreign Administration, United Technologies Corporation) ("The time for OPIC to process the application is, in our opinion, excessive, taking as long as six months for acceptance.").

146. Davis Testimony, *supra* note 29, at 25; cf. C. HUNT, *supra* note 84, at 304 ("[I]t is OPIC policy to regard as public information a description in general terms of the project in which the investment is being made and the nature and amount of the insurance contract. This policy does not require disclosure, however, of private agreements or other documents pertaining to the investments that were submitted to OPIC by the investor.").

147. Davis Testimony, *supra* note 29, at 25.

secrecy may give an investor greater leverage when negotiating with an expropriating government for compensation. Thirdly, privately-written PRI is available for a wide variety of investments without regard to OPIC concerns about the investment's environmental impact,¹⁴⁸ impact on the U.S. employment market,¹⁴⁹ impact on U.S. balance-of-payments,¹⁵⁰ or involvement of participants who have been convicted under the Foreign Corrupt Practices Act.¹⁵¹ Private insurers are also in a position to offer "selective cover," which means that in evaluating risk they weigh more heavily the client's track record than they do the political or economic state of the country in question.¹⁵²

The private market, however, remains limited in its ability to provide PRI that is both profitable to the insurer and affordable for the investor.¹⁵³ A number of private insurers have suggested OPIC should help support the private underwriters by providing reinsurance,¹⁵⁴ primarily on a facultative basis,¹⁵⁵ and by sharing OPIC underwriting opportunities and risks with the private sector through joint underwriting efforts.¹⁵⁶ OPIC's response to these suggestions has been mixed. OPIC officials generally reject the possibility of reinsuring privately-written PRI on the theory that if OPIC were to provide such reinsurance, it would have to provide a subsidy to the private insurer in order to equalize the cost of coverage between OPIC-written and privately-written PRI.¹⁵⁷ The officials emphasize that Congress not only failed to provide OPIC with authority to subsidize the private sector, but it also directed

148. 22 U.S.C. § 2199(g) (1982).

149. *Id.* § 2191(h).

150. *Id.* § 2197(k).

151. *Id.* § 2197(l).

152. Tyler, *supra* note 12, at 39.

153. *Id.* at 42.

154. A reinsurance contract is an indemnity contract against an insurance loss as opposed to one for direct liability. *Skandia America Reinsurance Corp. v. Schenck*, 441 F. Supp. 715 (S.D.N.Y. 1977), *cited in* 19 G. COUCH, R.A. ANDERSON & M.S. RHODES, *COUCH ON INSURANCE* § 80.1, 624 (2d ed. 1983) [*hereinafter cited as COUCH ON INSURANCE*]. The reinsurance contract operates solely between the reinsurer and the reinsured and confers no rights on the insured. *General Reinsurance Corp. v. Missouri General Ins. Co.*, 596 F.2d 330 (8th Cir. 1979), *cited in* COUCH ON INSURANCE, § 80.1 at 624. The term "reinsurance treaty" is generally used to denote a contract for insurance of an initial or "ceding" company; this is distinct from a reinsurance policy which is synonymous with a contract of insurance, i.e., one of liability. COUCH ON INSURANCE, § 80.2 at 625.

155. Facultative reinsurance is "one where the initial insurer seeks to place reinsurance in order to spread the risk involved with large policy exposures." COUCH ON INSURANCE, § 80.3, at 626. A facultative insurer, thus, insures a ceding company on the basis of one specific risk. This should be contrasted with "treaty reinsurance", "whereby the reinsurer provides reinsurance on all policies underwritten by the reinsured in a specified percentage either on all or specified classes of the reinsured's business." *Id.*

156. The phrase "joint underwriting" is used here to refer to what is often called "other insurance," e.g., concurrent insurance coverage of the same interest. *See* 5 J.A. APPLEMAN & J. APPLEMAN, *INSURANCE LAW AND PRACTICE* §§ 3053-3057, at 217-56 (1986).

157. Nalen Testimony, *supra* note 43, at 300.

OPIC to be self-sustaining which seems inconsistent with providing subsidies.¹⁵⁸ In contrast, OPIC officials express their support for joint underwriting efforts with the private sector, and the Agency generally encourages such activity.¹⁵⁹

Whatever comes of the suggestions that OPIC and the private sector cooperate in efforts to underwrite PRI, it seems clear that PRI is an extraordinarily risky form of insurance whose underlying risks are difficult to assess.¹⁶⁰ Given OPIC's access to confidential country risk information¹⁶¹ together with its governmental backing for collection purposes,¹⁶² it is difficult to conceive of how the private market could adequately compete with it or fill its place should it be disbanded.¹⁶³ In light of these observations, it seems accurate to state that OPIC and other national agencies are, and will remain, the primary source of PRI.

C. Existing PRI Coverage for Technology Transfers

PRI offered by OPIC covers investments¹⁶⁴ and not exports or receivables.¹⁶⁵ As such, in order for a technology transferor to qualify for insurance, he must structure his transaction to fall within OPIC's specified insurable interest. In addition to standard debt and equity investment structures, OPIC will provide coverage for fees accrued and earned under a technical assistance agreement.¹⁶⁶ Such agreements provide for the transfer of

158. *Id.*

159. *Id.* at 302-03.

160. Allen & Viscusi, *supra* note 25, at 156 (“[T]he distinguishing feature of takeover risks is that their assessment requires subjective judgments rather than exclusive reliance on objective frequencies, such as the death rates used in setting life insurance premium levels A standard pitfall in such efforts is that the probability assessors underestimate the likelihood of rare events—a difficulty affecting risk assessment for all but the most volatile countries.”).

161. See *supra* note 131 and accompanying text.

162. See *supra* note 121 and accompanying text. Note also that OPIC's governmental backing provides it with other advantages such as the facilitation of arbitration through the Investment Guaranty Treaties and representative offices worldwide. Chalmers Feb. Interview, *supra* note 32.

163. See *Insuring Against Risk Abroad*, *BUS. WK.*, Sept. 14, 1981, 59.

164. Chalmers Feb. Interview, *supra* note 32. Private insurers are more flexible as to what they can and will insure; however, there is no evidence that the commercial insurers do not also impose this limitation on coverage.

165. Both political and commercial risk insurance covering credit risks for exports and receivables is available through the Export-Import Bank's Export Credit Insurance Program conducted through the Foreign Credit Insurance Association (FCIA), a private sector association of fifty-one insurance companies. FCIA insures the foreign receivables of U.S. exporters against commercial and political risks. Under a “multibuyer program,” FCIA will insure all, or a reasonable spread, of an exporter's global sales. See Graham, *Sources of Export Financing*, 14 *GA. J. INT'L. & COMP. L.* 455, 456-457 (1984); Holden, *Export Credit Insurance and the FCIA*, 14 *U.C.C. L.J.* 140, 140-145 (1981); GABA, *EXPORT FINANCE AND THE ROLE OF THE EXPORT-IMPORT BANK OF THE UNITED STATES IN INTERNATIONAL BANKING: U.S. LAWS AND REGULATIONS 6-31—6-33* (American Bankers' Association ed. 1984); Linzmeyer, *Eximbank Exporter Assistance Programs*, 60 *MARQ. L.R.* 825, 825-853 (1977).

166. Interview with Jane H. Chalmers, Assistant General Counsel for Claims, OPIC (September 11, 1985) [hereinafter Chalmers Sept. Interview]; see also Williams, *supra* note 32, at 269.

technical training, and maintenance or engineering services for a fixed number of years at a set fee. They are commonly used by technology transferors in the context of a turn-key operation.¹⁶⁷ OPIC also provides coverage for licensing agreements.¹⁶⁸

OPIC's coverage of technical assistance or licensing agreements differs from its coverage for standard debt or equity investment. Although OPIC treats the stream of payments arising out of most technology transfer agreements as insurable, it limits claims to those fees that have been earned and accrued as of the date of a triggering event (such as expropriation, insurrection, or outbreak of war).¹⁶⁹ OPIC will not compensate an insured investor for the loss of his right to a stream of profits, even in a fixed amount.¹⁷⁰ Thus, the bulk of an insured's loss may go uncompensated. Moreover, it is difficult for an investor to circumvent OPIC's accrual limitation by maneuvers such as the use of an acceleration clause in the technical assistance agreement. An acceleration clause would probably recast the investment as straight debt under OPIC operating guidelines.¹⁷¹

Neither OPIC¹⁷² nor the private sector¹⁷³ currently insures proprietary rights in intellectual property.¹⁷⁴ OPIC-sponsored PRI covers only the capital investment required to develop the technological project as well as the

[Technical Assistance Agreements] usually include scientific, engineering and/or management services and consulting agreements. This license is really a know-how license for very specific purposes, and is usually initiated by the foreign concern. In many cases there will be no patents, trademarks or other statutory protected information, but the owner of the capability will want to be paid for the release of information. The solution is to offer technical services and call the remuneration "fees".

C. CROSSWELL, *supra* note 86, at 262.

167. Chalmers Feb. Interview, *supra* note 32.

168. *Id.*

169. *Id.*; see also Williams, *supra* note 32, at 269.

170. Chalmers Feb. Interview, *supra* note 32.

171. Note that investors sometimes structure transactions in the form of technical assistance agreements in order to obtain favorable tax treatment and to circumvent host country restrictions on repatriation of profits. The investor might lose these benefits should he add an acceleration clause to the agreement. The Internal Revenue Service, at the very least, is likely to recharacterize the instrument as debt and disallow the more favorable reporting requirements for technical assistance agreements. See, e.g., *Fin Hay Realty Co. v. United States*, 398 F.2d 694, 696 (3d Cir. 1968) (In determining whether funds entrusted to a corporation should be characterized as debt or equity "courts and commentators have isolated a number of criteria by which to judge the true nature of an investment . . . [for example,] a provision for redemption at the option of the holder") *Diamond Bros. Co. v. Commissioner of the Internal Revenue Service*, 322 F.2d 725, 732 (3d Cir. 1963) (Whether or not an investment is characterized as debt turns on whether "the degree of risk may be said to be reasonably equivalent to that which equity capital would bear had an investor, under similar circumstances, made the advances . . ."); see generally Plumb, *The Federal Income Tax Significance of Corporate Debt: A Critical Analysis and a Proposal*, 26 TAX L. REV. 369 (1971).

172. Williams, *supra* note 32, at 269.

173. See, e.g., CHUBB INTERNATIONAL, FOREIGN INVESTMENT POLICY 15 (Form 11-2-0173 1985 ed.) (available in the offices of *The International Tax & Business Lawyer*).

174. "The word 'proprietary' means 'holding property or the (exclusive) right to property'. Proprietary property includes both tangible and intangible assets, and patented and unpatented

investor's equity in overall investment.¹⁷⁵ Utilizing existing PRI products, a technology transferor can obtain PRI (including inconvertibility insurance)¹⁷⁶ on his capital outlay and accrued licensing royalties but not on any patent, copyright or trademark rights that might be included in his investment.¹⁷⁷

In addition to providing established forms of coverage, OPIC has a policy of examining the needs of specific investments and covering political risks on a case-by-case basis.¹⁷⁸ OPIC is currently examining the possibility of insuring an exclusive distribution agreement for minerals on the basis of profits on accrued sales.¹⁷⁹ Although this type of coverage would not be directly applicable to technology transfers, official sanction of insurance for an intangible property right and of coverage for list profits suggests that approval may be forthcoming for an insurance product that covers intellectual property rights.¹⁸⁰

D. Developing Coverage for Intellectual Property Rights

Technology transferors face potentially enormous risks of loss through infringement of intellectual property rights¹⁸¹ by foreign trading partners or pirates and through adverse government regulation. An owner of a proprietary right in intellectual property stands to lose not only the development costs inherent in his intellectual property right, but also a share of the market

technology, as long as it is institution-specific." Dunning, *Alternative Channels and Modes of International Resource Transmission*, in *CONTROLLING INTERNATIONAL TECHNOLOGY TRANSFER* 3, 4 (T. Sagafi-nejad, R. Moxon & H. Perlmutter eds. 1981).

175. Williams, *supra* note 32, at 269; Chalmers Feb. Interview, *supra* note 32.

176. See Williams, *supra* note 32, at 269 ("Under current guidelines OPIC can issue insurance against risks of inconvertibility of local currency and expropriation of an investment in the form of a licensing agreement for the use of patents, processes or techniques in exchange for royalty or other payments").

177. One case where PRI might provide an important incentive for U.S. corporations to engage in technology licensing with foreign countries is where a transferring corporation sinks a significant portion of its own capital into development costs of licensed projects. This scenario might arise where a country decided to computerize large sectors of its economy. For example, a developing country, such as Nigeria, might contract with a large U.S. computer manufacturer, such as IBM, to design a system which would store, calculate and automate the country's social security and tax systems. In a contract of this type, IBM would initially pay development and training costs and then would expect to gain reimbursement of capital outlays as well as earnings through periodical royalty payments. If the contract is insured by OPIC and the Nigerians refused to pay royalties and expropriated the system, IBM could recover both its capital investment in the project and accrued royalty payments. Telephone Interview with Donald R. McDonald, Vice-President and Manager of Multinational Insurance Services, Marsh & McLennan, Inc., in Detroit, Michigan (Sept. 18, 1985).

178. Williams, *supra* note 32, at 269.

179. Chalmers Feb. Interview, *supra* note 32.

180. *Id.* The important features of this proposed coverage in terms of intellectual property rights is the compensation for profits (vs. accrued fees) and the breakdown of an investment, other than a straight fee-generating agreement, into a generator of a stream of income.

181. The primary intellectual property rights are patents, trademarks and copyrights. Trade secrets are not generally recognized as a property right.

for the patented or copyrighted product.¹⁸² Moreover, because it is difficult to measure political risk,¹⁸³ generally a technology transferor cannot self-insure against the risk of infringement or loss of his intellectual property rights.

A governmental agency like OPIC appears to stand in a strong position to help absorb some of the risks faced by technology transferors. OPIC might insure the intellectual property rights held by transferors against specified forms of expropriation¹⁸⁴ and do so profitably through diversification on the basis of country risk and salvage potential.¹⁸⁵ Moreover, such a program would be in keeping with the role Congress envisioned OPIC would play. A House Report on the 1978 Amendments to OPIC's enabling statute discussed the need to establish investment climates favorable to the transfer of financial resources and technology to LDCs. With respect to OPIC's role in this project, the Report stated:

[A]n unusual opportunity for OPIC may be at hand. Private companies are still reluctant to risk their capital and technology, given past nationalizations and the frequently unstable political environment. OPIC can possibly play a role in bridging this gap between the current uncertainty in the investment environment and can spread the transition by bringing greater certainty to foreign investment decision-making.¹⁸⁶

In order for OPIC to carry out such a program, intellectual property rights must (1) constitute an insurable interest; (2) the Corporation must be able to define coverage and to value the intellectual property rights; and (3) OPIC must ensure that, as subrogee, it is legally entitled to compensation from an expropriating government.¹⁸⁷ Although these issues present difficulties, the problems are not insurmountable, and an insurer could profitably underwrite such a policy.

1. *Insurable Interests*

In designing insurance coverage, the first matter to be considered is whether the interest is legally insurable.¹⁸⁸ To the extent that a transferor of

182. Nelson, *Planning for Resolution of Disputes in International Technology Transactions*, 7 B.C. INT'L & COMP. L. REV. 269, 272-73 (1984).

183. See *supra* note 142 and accompanying text.

184. In the early 1980s, OPIC investigated the possibility of insuring against expropriation of intellectual property rights. The Corporation eventually abandoned the idea because of the difficulties it perceived in valuating proprietary rights in intellectual property and in measuring and limiting the underwriter's enormous potential exposure. Chalmers Feb. Interview, *supra* note 32.

185. Risk management by OPIC through diversification, wherein a balance is maintained between relatively safe and relatively risky coverage, is specifically mandated by Congress in the legislative history underlying OPIC's Enabling Statute. H.R. Rep. No. 97-195, 97th Cong., 1st Sess. 8, reprinted in 1981 U.S. Code Cong. & Ad. News 1581, 1587.

186. H.R. Rep. No. 95-670, 95th Cong., 2d Sess. 20, reprinted in 1977 U.S. Code Cong. & Ad. News 618, 636.

187. This last requirement is necessary in order to meet the Enabling Statute's requirements that OPIC remain self-sustaining and that it adhere to good risk management principles. See 22 U.S.C. § 2191(a), (d) (1982).

188. A noted insurance treatise defines insurable interest as one which "exists when the insured derives pecuniary benefit or advantage by the preservation or continued existence of the

technology loses pecuniary benefits when LDCs infringe his proprietary rights, intellectual property seems to fit within the definition of an insurable interest.¹⁸⁹ Patents, for example, not only constitute established property rights,¹⁹⁰ but insurers also treat patent rights as insurable for purposes of domestic infringement insurance.¹⁹¹ For other, less rigidly defined areas of intellectual property, the insurer must clearly delineate the boundaries of coverage. This practice would be particularly important for insurance designed to protect against expropriation of an intellectual property right where the scope of the right itself is amorphous, such as in the case of a trade secret, and where damages are inherently broad and ill-defined.

Although OPIC only insures against political risks,¹⁹² OPIC officials have indicated that state action might include a general policy of encouraging piracy by private actors.¹⁹³ In light of these broad guidelines, it would be important for OPIC to define which specific government acts would constitute expropriatory action for the purposes of insuring intellectual property. Among the acts that OPIC might include as expropriatory are direct infringement of a patent, trademark, or copyright by a government-owned or sponsored organization;¹⁹⁴ violation of provisions in joint venture or licensing agreements governing the use of proprietary rights in intellectual property by a governmental entity or under governmental regulation or policy; compulsory licensing legislation that violates international accords covering intellectual property rights;¹⁹⁵ and a change in the national laws to retroactively nullify proprietary interests in technology. The advantage of limiting

property or will sustain pecuniary loss from its destruction." 4 J. A. APPLEMAN AND J. AP-
 PLEMAN, *supra* note 156, at 35, § 2123.

189. It should be noted, however, that trade secrets or know-how may not fit within this definition of insurable interest. See Note, *U.S. Software Protection: Problems of Trade Secret Estoppel Under International and Brazilian Technology Transfer Regimes*, 23 COLUM. J. TRANS-
 NAT'L L. 679, 700 (1985) (arguing that "[s]ince the software developer voluntarily discloses the trade secrets by distributing the software under the UNCTAS and Brazilian regimes, no risk of loss is involved. Given the disclosure of trade secrets whenever software is distributed interna-
 tionally, this loss of secrecy is not an insurable event.").

190. Henry, *supra* note 13, at 431 (Given the recognized notion of the patent as a property interest, the exclusion of the patent itself from protection against expropriation, regardless of the form of the underlying license agreement, seems unreasonable).

191. Under a patent infringement policy, an insurance company litigates all infringement suits on behalf of the insured. COUCH ON INSURANCE, *supra* note 154, § 1.87, v. 1 at 253.

192. See *supra* note 31 and accompanying text.

193. Chalmers Feb. Interview, *supra* note 32.

194. This might include a situation in which the government implicitly authorized such in-
 fringement by a private actor.

195. The oldest and most important of several international accords is the Paris Union Con-
 vention on Industrial Property Rights. The Convention was signed in 1833 and revised six
 times, most recently in 1965. There are more than eighty member states to the Paris Con-
 vention—the majority of them are LDCs. Williams, *supra* note 32, at 266. Since 1967, the Con-
 vention has been administered by the World Intellectual Property Organisation (WIPO). Note,
Paris Convention, Patent Protection and Technology Transfer, 3 BOST. U. INT'L L.J. 209, 210 n.15
 (1985). WIPO, in order to better represent the viewpoint of the LDC member countries, has
 orchestrated four sessions to revise the Convention: Geneva, Switzerland from Feb. 4-March 4,
 1980; Nairobi, Kenya from Sept. 28-Oct. 24, 1981; Geneva, Switzerland from Oct. 4-30 and Nov.

coverage in these ways is that the acts themselves are likely to fall within traditional notions of expropriation and confiscation¹⁹⁶ which is critical to OPIC's salvage potential.¹⁹⁷

2. Valuation

Valuation of intellectual property rights presents a number of problems. A United States patent, for example, allows the patent holder to prevent others from making, using or selling the patented invention.¹⁹⁸ However, the patent holder may be unable to exercise such rights because of the broad scope of earlier patents in the field or for reasons unrelated to the patent (for example, lack of the requisite governmental approval). Should the patent be valued at its cost to the patent holder or at its potential earning power? United States patent law does little to resolve the problem. Damages are assessed as an "amount adequate to compensate for the infringement but in no event less than a reasonable royalty."¹⁹⁹ Such an amount can be adjusted up to treble levels at the court's discretion.²⁰⁰ In addition, a patent holder may obtain an injunction preventing others from making the patented product.²⁰¹ What value should be put upon the ability to exclude competitors? A trade secret may be legally reverse engineered, stolen, or licensed to another.²⁰² What value does such a right have? Logically, the loss of a proprietary right should include not only the waste of the owner's capital investment, inherent in the intellectual property interests by virtue of research and development expenditures, but also the reduction of an owner's market share and the loss of royalties and profits stemming from breach of a licensing agreement. Clearly, it would be uneconomical to underwrite insurance on the basis of so far-reaching a definition.

In order to formulate an insurance rate for an intellectual property right, an insurer must establish a base measure of quantifiable value in the right in

23-27, 1982, and Geneva from Feb. 27-March 24, 1984. *Id.* at 218. These revisions would substantially alter the Convention guidelines governing when an issuing country may require a patentee to grant a compulsory license to his rights for failure to "work" the patent (e.g. introduce the invention into the economy) within the later of four years from the application date or three years from the date of issuance. Under the proposed revisions, nonvoluntary licenses could be granted for up to four and a half years if "competent authorities" find an abuse in working the patent where failure to work it persists for at least two years following the grant of the first nonvoluntary license. *Id.* at 221.

196. For definitions of expropriation and confiscation, see *supra* note 13.

197. See *infra* notes 216-233 and accompanying text.

198. See *supra* note 181.

199. 35 U.S.C. § 284 (1982).

200. *Id.*

201. 35 U.S.C. § 283 (1982).

202. "Reverse engineering" refers to the process of examining a product or device to ascertain the ideas and methods involved in its manufacture. Under trade secret law, the activity is legitimate, and the law holds that any information obtained through reverse engineering is within the public domain and beyond trade secret protection. S. ELIAS, *NOLO'S INTELLECTUAL PROPERTY LAW DICTIONARY* 21 (1985). A trade secret is not an insurable interest. If it were, valuation problems would be moot. See *supra* note 189.

order to assess insurable value. The licensing price appears to offer such a base amount. This price presents a negotiated value, which presumably incorporates development costs, is not monopolistic, and accounts for the opportunity cost to the licensor in lost sales.²⁰³ Moreover, in the case where an investor does not use a licensing agreement, an insurance underwriter could extrapolate a reasonable licensing price from the insured's financial data regarding development costs, market share, estimated life span, and so forth, to serve as a base amount.

After calculation of the base amount, there are essentially three ways in which an insurer could build a valuation model. The first and simplest method would be to accept the licensing figure without adjustment and insure the proprietary interest on the basis of that value. Insurance would thus be based upon the contracted-for stream of royalty payments. Although this model would be easy to apply, it is vulnerable to manipulation by the insured²⁰⁴ and to inaccuracies stemming from the marketing pressures on the licensor.²⁰⁵ It would not, therefore, provide the best basis on which to value the interest to be insured.

A second model, also centered on the use of a licensing fee as a base to measure value, comes from the damages standard relied on by the U.S. courts in patent infringement actions. This standard is statutorily derived and provides for "damages adequate to compensate for the infringement, but in no event less than a reasonable royalty for the use made of the invention by the infringer, together with interest and costs as fixed by the court."²⁰⁶ The theory behind the statutory standard recognizes that damages should make the patent owner whole for losses caused by the infringer's illicit activity and restore him financially to the position he would have occupied but for the infringement.²⁰⁷ The term "reasonable royalty" has been interpreted by the courts to mean "that amount which would have been set in a hypothetical negotiation between a willing patent owner and a willing potential user as of the date when the infringement began in fact and on the assumption that the

203. Cf. Root, *The Pricing of International Technology Transfers via Non-Affiliate Licensing Arrangements* in *CONTROLLING INTERNATIONAL TECHNOLOGY TRANSFER* 120, 130 (T. Sagafinejad, T. Moxon & H. Perlmutter eds. 1981) (U.S. licensors tend not to integrate research and development costs into the licensing fee and "a technology transfer price will most probably be a price that substantially exceeds transfer costs but is less than a monopoly price."); F. CONTRACTOR, *supra* note 3, at 124 (regression model indicates that U.S. firms are not using a monopoly pricing model markup to price technology transferred to LDCs); 1 L. ECKSTROM, *LICENSING IN FOREIGN AND DOMESTIC OPERATIONS* § 1.10 (3d ed. 1985) (licensing fills the vacuum present when a U.S. business enterprise decides not to arrange for direct export sales. It provides the advantages of flexibility, avoidance of trade barrier problems, employment of the licensee's first-hand knowledge of local conditions, and avoidance of the need to survey foreign markets).

204. In light of insureds' desire to purchase more extensive insurance coverage, this model would give investors an incentive to artificially inflate an actual licensing price and particularly an extrapolated price calculated for insurance purposes.

205. See Root, *supra* note 203, at 129-30.

206. 35 U.S.C. § 284 (1982).

207. 5 D. CHISUM, *PATENTS* § 20.03 at 71 (1986); see also *Seymour v. McCormick*, 57 U.S. (16 How.) 480 (1853).

patent was valid and entitled to respect.”²⁰⁸ In determining this amount, the court considers such factors as the rate set for prior and existing licenses negotiated under the patent involved in the suit,²⁰⁹ and the benefits to be anticipated from the use of the invention.²¹⁰ A reasonable royalty award may include lost profits from the sale of underlying components,²¹¹ and lost profits are most likely to figure into a damage award when the patentee and infringer are the only suppliers in the market.²¹² In addition to the primary recovery of compensatory damages, a patent owner may be entitled to an award of collateral assessments for prejudgment interest, increased damages (up to three times actual damages) and reasonable attorney fees.²¹³

There are several problems in applying the judicial damages standard to valuations for insurance purposes. First, the measurements inherent in the standard are retrospective rather than the prospective, actuarial estimates that insurers require. Second, since the standard is largely discretionary, it is open to subjective and variable analysis. Finally, the calculation of damages under the standard is based in large part on estimates regarding how great an impact an already-fixed loss has had upon a patent owner. Because most of the factors relied upon in this formula are unknowns for purposes of insurance valuation, application of this standard in the insurance context creates great difficulties.

The third, and probably most workable, model would be to use the licensing fee as a base figure and factor in relevant variables. For example, an insurer could value the impact of a loss of market share on the proprietary right by factoring into the base figure an average estimated loss. This figure could be calculated by averaging the present value cost of a worst case loss scenario with that of a best case loss scenario, each multiplied by the probability of occurrence based on the riskiness of the climate in the host country. Similarly, an insurer might factor into the calculation an estimated lifespan for the technology based upon predictions of when the underlying invention will become obsolete. The extent to which development costs have been imbedded in the value of the property²¹⁴ together with the likelihood

208. D. CHISUM, *supra* note 207, at 20.03(3).

209. *Id.*

210. *Id.* This factor is given weight because the benefits to be anticipated from the use of the invention normally constitute a limit on the amount a willing user would agree to pay as a royalty. *Id.*

211. Lost profits may take the form of sales diversion, price erosion, or increased expense. *Id.* at § 20.03(1). In order to prove lost profits, the owner bears the burden of meeting the but-for causation test and of establishing a reasonable approximation of the amount of lost profits. *Id.*

212. *Kori Corp. v. Wilco Marsh Buggies & Draglines, Inc.*, 761 F.2d 649 (Fed. Cir. 1985). *See id.* at 653.

213. D. CHISUM, *supra* note 207 at § 20.03(1).

214. A recent survey of thirty-nine U.S. firms engaged in foreign licensing agreements indicated that several industries, pharmaceutical and electronics concerns in particular, tend to amortize their research and development costs over licensing profits. F. CONTRACTOR, *supra* note 3, at 78. As one commentator stated, “[f]irms with high R & D expenses that are located in

that competitors will enter the market could be quantified and factored into the base. Finally, profit inherent in the licensing price is a variable that the insurer might want to factor out of the base depending on the insurance policy. All told, the factoring model closely resembles techniques traditionally relied upon by property and casualty insurers to value property and measure risk.²¹⁵ In light of this, it seems entirely plausible that this model could be applied to insurance coverage of intellectual property rights.

3. OPIC's Compensation

In addition to the problems of insurability and valuation, salvage potential is critical in determining the feasibility and marketability of PRI coverage. OPIC's right to recover salvage value from a host government depends on whether the state actions infringing on or interfering with an owner's intellectual property right legally constitute expropriation.²¹⁶ Although customary international law does not protect intellectual property rights,²¹⁷ it does provide several principles that proscribe state action against contracts or treaties entered into with foreigners. This type of state action might provide an insurer, especially OPIC, with a cause of action.²¹⁸ First, a subrogee-insurer might rely upon the principle of *pacta sunt servanda*, which provides that a country must honor the commitments it has made (particularly through treaties) to other countries.²¹⁹ Although the principle has not been interpreted by international tribunals,²²⁰ it might provide some protection to OPIC in cases where the expropriatory governmental action interfered with an owner's

the industrialized countries and are asked to license their patents and know-how to the developing countries do so in the expectation that these costs will be recouped by royalties, and that these royalties will be commensurate with the royalties that they receive from their licensees in the industrial countries." Timberg, *The Role of the International Patent System in the International Transfer and Control of Technology*, in *CONTROLLING INTERNATIONAL TECHNOLOGY TRANSFER* 64, 66 (T. Sagafi-nejad, R. Moxon & H. Perlmutter eds. 1981). A problem in this regard is the difficulty firms have measuring their own R & D costs. F. CONTRACTOR, *supra* note 3, at 81.

215. See, e.g., W. RODDA, *MARINE INSURANCE: OCEAN AND INLAND* 54 (1949) ("Factors taken into account in determining the value of a ship are the replacement cost of the vessel, its age and condition, the market value if the ship were sold, [and] the amount of net freight that it could earn during its remaining lifetime . . . General average, salvage, or use and labor charges are assessed . . .").

216. See *supra* note 80 and accompanying text.

217. Interview with Laird Robertson, Attorney, Office of the Legal Advisor, United States Department of State (Feb. 28, 1986).

218. See *supra* note 58.

219. The principle is articulated in Article 26 of the Vienna Convention on the Law of Treaties as follows: "Every treaty in force is binding upon the parties to it and must be performed by them in good faith." Vienna Convention on the Law of Treaties, U.N. Doc. A/CONF 39/27 (1969) reprinted in 8 I.L.M. 679 (1969). Two publicists on international law state the principle more broadly to embody "a widespread recognition that commitments publicly, formally and (more or less) voluntarily made by a nation should be honored." H. STEINER & D. VAGTS, *supra* note 24, at 282.

220. H. STEINER & D. VAGTS, *supra* note 24, at 283.

contractual right to receive licensing fees²²¹ or to restrict access to the know-how underlying a technological product. A cause of action under this doctrine would prove especially strong when used in conjunction with a claim that governmental action violated specific terms of a treaty between the U.S. and the host country. In this regard, OPIC might rely upon specific language in bilateral investment treaties,²²² more general language in the OPIC-negotiated Investment Guaranty Treaties,²²³ or, tangentially, very broad language in the Friendship, Commerce and Navigation Treaties.²²⁴

Under certain circumstances, OPIC might be able to rely upon the doctrine of "denial of justice"²²⁵ to provide it with a claim against a host country that had substantially interfered with the proprietary rights of an insured's intellectual property. This doctrine has been used in a broad sense to proscribe "all types of wrongful conduct on the part of the State toward

221. Overseas Private Investment Corporation, *Study of Loss, Valuation and Salvage Problems 2* (unofficial, unpublished study by OPIC personnel from OPIC internal files, available in the office of *The International Tax and Business Lawyer*).

222. Those treaties contain provisions that expressly protect intellectual property rights. Art. I 1(b) includes under "investment":

(iv) intellectual and industrial property rights, including rights with respect to copyrights, patents, trademarks, trade names, industrial designs, trade secrets and know-how, and goodwill; and

(v) any right conferred by law or contract, and any licenses and permits pursuant to law;

United States Model Treaty Concerning the Reciprocal Encouragement and Protection of Investment of February 24, 1984, *reprinted in 4 INT'L TAX & BUS. LAW* 136 (1986). Approval is expected from Congress for treaties signed with Egypt, Morocco, Panama, Turkey, Senegal, Zaire, and Haiti. Robertson Interview, *supra* note 217.

223. *See, e.g.*, Investment Guaranty Treaty, April 26, 1975, United States-Saudi Arabia, art. I, 26 U.S.T. 459, T.I.A.S. No. 8045 ("In order to increase participation by United States private enterprise in projects bringing new technology to Saudi Arabia . . ."). Investment Guaranty Treaty, Feb. 10, 1975, United States-Federal Military Government of the Federal Republic of Nigeria, art. I, 26 U.S.T. 102, T.I.A.S. No. 8012 ("Conscious of the need for attracting investors of the United States of America into Nigeria as a means of promoting industrial growth and transferring desired technical skill . . ."). Investment Guaranty Treaty, Oct. 30, 1980, United States-People's Republic of China, attached note in Treaty Appendix, T.I.A.S. No. 9924 (including in "investment" "transfer of technical service and management agreements").

224. Robertson Interview, *supra* note 217 (noting that the broad definition of property in the FCNs is too general to provide a cause of action for breach of an "intellectual property" right).

225. "Denial of justice" is defined by Professors Sohn and Baxter in their Draft Convention on the International Responsibility of States to Aliens as follows:

This term has in the past been used in at least three different senses. In its broadest sense, this term seems to embrace the whole field of State responsibility, and has been applied to all types of wrongful conduct on the part of the State toward aliens. In its narrowest sense, this term has been limited to refusal of a State to grant an alien access to its courts or a failure of a court to pronounce a judgment. In an intermediate sense, the expression "denial of justice" is employed in connection with the improper administration of civil or criminal justice as regards an alien, including denial of access to courts, inadequate procedures, and unjust decisions. The last appears to be the most apposite usage, since the term may thus be usefully employed to describe a particular type of international wrong for which no other adequate phrase exists in the language of the law.

Draft No. 12, *quoted in* H. STEINER & D. VAGTS, *supra* note 24, at 374.

aliens.”²²⁶ Nevertheless, tribunals and writers have not uniformly applied the doctrine in such a broad sense,²²⁷ and the doctrine may be most appropriately employed in the sense of denial of access to courts, inadequate judicial procedures and unjust decisions.²²⁸ This narrower definition might still prove helpful to OPIC. The local laws provide some protections for intellectual property in all but eleven of the countries in which OPIC insures.²²⁹ Thus, OPIC might be able to argue that the host country discriminated against foreigners in the enforcement of local law.

Reliance on the doctrine of “denial of justice”, however, involves several difficulties. First, substantiation of a claim will depend upon decisions involving fine points of a foreign country’s law and legal system difficult to ascertain and apply.²³⁰ Second, application of the doctrine seems to contradict the general principle that aliens accept the local laws and jurisdiction.²³¹ Finally, the actual injury often appears to be merely a breach of local law and not a discriminatory act against a foreigner that rises to the level of a violation of international law.²³²

In addition to reliance on express principles of international law or on treaty terms to dictate a cause of action, OPIC may be able to recover by claiming that the action of the host government violates customary international law. As evidence of customary law, OPIC might rely on general state practices,²³³ laws and, in the case of non-signatory countries, international patent conventions. Although this alternative probably does not constitute OPIC’s strongest claim under which to recover, it does provide another potential source of a cause of action against an expropriating government.

Although insurance coverage of intellectual property rights could entail heightened risks to OPIC or another underwriter, these risks can be greatly reduced through careful country-by-country risk assessment and portfolio diversification. The extension of PRI coverage to intellectual property rights is consistent with the mandates set out by Congress for OPIC’s operation. Such an extension would seem to provide a sound and economically viable means for exporters of technology to shift some of the risk they face to a third party.

226. *Id.*

227. *Id.*

228. *Id.*

229. For relevant data, see 2 J. BAXTER & J. SINNOTT, *WORLD PATENT LAW & PRACTICE* xvii-xxiv (1987) (list of countries having patent laws) and 2A J. BAXTER & J. SINNOTT, *WORLD PATENT LAW & PRACTICE* 232.21 app. 2A (1987) (Tables concerning patentability of computer programs and biologicals).

230. I. BROWNLIE, *supra* note 24, at 515-16.

231. *Id.* at 516.

232. *Id.*

233. Clagett, *Protection of Foreign Investment Under the Revised Restatement*, 25 VA. J. INT’L. L. 73, 81-82 (1984) (“[The] substantial and growing body of decisional law is supplemented and confirmed by state practice, a well-recognized source of customary international law.”).

II STANDBY LETTERS OF CREDIT: POTENTIAL COVERAGE FOR INTELLECTUAL PROPERTY RIGHTS

Political risk insurance, even in its broadest possible form, would not provide complete protection to a technology transferor seeking to hedge the risk of loss of intellectual property rights in foreign trade. PRI insures only against political, not commercial, risk.²³⁴ Moreover, PRI generally covers, at best, only ninety percent of an investment or licensing agreement.²³⁵

A "standby letter of credit"²³⁶ or a "guaranty letter of credit"²³⁷ provides an attractive alternative to supplement insurance coverage or to protect against infringement of intellectual property rights abroad. A standby letter of credit can be used to protect against both political and commercial risks²³⁸ in almost any situation in which a transferor fears that a transferee may breach an agreement or infringe retained intellectual property rights.²³⁹ The instrument provides an inexpensive and convenient method of guaranteeing compensation to an injured party in the case of default, and has been relied upon by both private and public parties in a number of non-routine international transactions.²⁴⁰

234. See *supra* notes 28-31 and accompanying text.

235. See OPIC HANDBOOK, *supra* note 30, at 11. Note that a transferor may be able to insure 100% of his investment against political risk by supplementing coverage offered by OPIC with privately written PRI. Chalmers Feb. Interview, *supra* note 32. Nevertheless, because of the declining availability of privately written PRI, this option is not generally available to technology transferors.

236. The term standby letter of credit has been defined by the Board of Governors of the Federal Reserve Board to mean:

[E]very letter of credit (or similar arrangement however named or designated) which represents an obligation to the beneficiary on the part of the issuer (i) to repay money borrowed by or advanced to or for the account of the account party or (ii) to make payment on account of any indebtedness undertaken by the account party, or (iii) to make payment on account of any default by the account party in the performance of an obligation.

12 C.F.R. § 208.8(d)(1) (1986). Similar definitions have been adopted by the Comptroller of the Currency 12 C.F.R. § 7.7016 (1986), and by the Federal Deposit Insurance Corporation (FDIC), 12 C.F.R. § 337.2(a) (1986).

The standby letter of credit has been issued primarily either to secure performance or to secure credit. Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees*, 24 ARIZ. L. REV. 319, 325 (1982). P. Lloyd-Davies of the research staff of the Board of Governors of the Federal Reserve referred to these transactions as "non-financial" and "financial". *Id.* The issuing bank generally assumes a higher level of risk in the case of a financial standby than with the non-financial, although that is not universally true. *Id.* at 326-27.

237. See 6 W. HAWKLAND & T. HOLLAND, U.C.C. SERIES § 5-102:06 (art. 5) at 16 (1986).

238. Dolan Interview, *supra* note 34.

239. Arnold & Bransilver, *The Standby Letter of Credit—The Controversy Continues*, 10 U.C.C.L.J. 272, 279 (1978) ("[A] standby letter of credit can be of use in almost any situation where the ability of one party to a contract to perform its business obligations is questioned.").

240. Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 STAN. L. REV. 716, 717 n.7 (1973) ("The newly acquired status of the letter of credit is reflected by its use in one of the more unusual international transactions—the ransom from Cuba of the Bay of Pigs prisoners."); Kimball & Sanders, *Preventing Wrongful Payment of Guaranty Letters of Credit—Lessons from Iran*,

This Part of the Article will discuss potential application of the standby letter of credit to foreign technology transfers involving intellectual property rights. Section A examines the structure of the standby letter of credit and existing problems with the instrument. Section B discusses ways in which the standby letter of credit might be used as a hedge against the risk of loss through infringement or piracy of proprietary rights in technology. The section concludes that the instrument, as it presently exists, could be efficiently and economically applied in the setting of international technology transfer.

A. *The Standby Letter of Credit: Mechanics and Limitations*

1. *The Commercial Letter of Credit*

The standby letter of credit was developed by U.S. banks²⁴¹ as a variation on the commercial letter of credit.²⁴² The basic commercial letter of credit²⁴³ involves a transaction under which a financial institution or other entity (the "issuer"), in accordance with instructions from his customer (the "account party," "applicant," or "customer") issues to a third party (the "beneficiary") a written undertaking²⁴⁴ to make payment to the beneficiary or to negotiate drafts drawn by the beneficiary upon the presentation of stipulated documents,²⁴⁵ provided that all parties comply with the terms and conditions of the letter of credit.²⁴⁶

The transaction depends upon three separate and independent contracts: (1) the contract between the issuer and the beneficiary (which sets forth the obligations of the issuer regarding payment under the letter of credit); (2) the contract between the issuer and the customer (which provides for reimbursement of the issuer)²⁴⁷; and (3) the contract between the customer and the

39 BUS. LAW. 417 (1984) ("These versatile bank credits have become a convenient, inexpensive substitute for performance bonds or the bank guaranties required in some countries.").

241. Schmitthoff, *The New Uniform Customs for Letters of Credit*, 1983 J. BUS. L. 193, 195.

242. Rapson, *Problems in Perspectives: The Lure and Snare of "Standby Letters" of Credit*, N.J.L.J. Feb. 24, 1983, at 8.

243. Squillante, *Letter of Credit: A Discourse: Part VII*, 86 COMM. L.J. 220 n.2 (1981) (Letters of credit have been in common commercial use since 110 A.D.).

244. U.C.C. § 5-104(1) requires that the letter of credit be in writing and that it be signed by the issuer. For the definitions of "writing" and "signed" see U.C.C. §§ 1-201(46), 1.201(39).

245. Documents commonly specified in a letter of credit include bills of lading and certificates of origin which establish shipment of goods by a seller-customer. Dunn & Silberstein, *supra* note 36, at 15.

246. See Arnold & Bransilver, *supra* note 239, at 272-73; P. O'HANLON, DOCUMENTARY COLLECTION AND LETTERS OF CREDIT IN TRADE FINANCING 49 (Euromoney Pub. ed. 1981); see also U.C.C. § 5-103(1)(a) (A letter of credit is "an engagement by a bank or other person made at the request of a customer . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit.") The three principal parties are defined by the U.C.C. as follows: "An 'issuer' is a bank or other person issuing a credit." U.C.C. § 5-103(1)(c); "A 'beneficiary' of a credit is a person who is entitled under its terms to draw or demand payment." U.C.C. § 5-103(1)(d); "A 'customer' is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer." U.C.C. § 5-103(1)(g).

247. See generally Ryan, *Letters of Credit Supporting Debt for Borrowed Money: The Standby as Backup*, 100 BANKING L.J. 404, 405 (1983). Note that even in the absence of an

beneficiary (which creates the obligation pursuant to which the letter of credit is established to effect payment).²⁴⁸ The separate contracts ensure that the obligation of the issuer to pay is independent of the underlying transaction between the customer and the beneficiary.²⁴⁹ It is this independence that gives the letter of credit its primary value by substituting the known and secure credit of the issuer for the often uncertain credit of the other party to the underlying transaction.²⁵⁰

In a letter of credit transaction, the issuer's obligation to pay the beneficiary is triggered by presentation to the issuer of the documents stipulated in the letter of credit.²⁵¹ Courts have generally held that these documents must strictly conform to the terms of the letter of credit.²⁵² The Uniform Commercial Code [hereinafter UCC], which governs most domestic letter of credit

express agreement, a customer has a duty to reimburse an issuer who has "Duly honored a draft or demand for payment." U.C.C. § 5-114(3).

248. *Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 230, 235 (5th Cir. 1983); see also *Waidmann v. Mercantile Trust Co. National Assoc.*, 711 S.W.2d 907, 912 (Mo. App. 1986) (In a letter of credit transaction, the final contract between the issuing bank and the beneficiary is separate and distinct from the contract between the beneficiary and the account party and is not tied to or dependent upon any underlying transactions); Verkuil, *supra* note 240, at 719; Arnold & Bransilver, *supra* note 239, at 273.

249. Justice, *Letters of Credit: Expectations and Frustrations—Part I*, 94 BANKING L.J. 424, 428-29 (1977); see generally J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE, 711-12 (2d ed. 1980).

250. *Insurance Co. of North America v. Heritage Bank, N.A.*, 595 F.2d 171, 173 (3d Cir. 1979); *Intraworld Industries, Inc. v. Girard Trust Bank*, 461 Pa. 343, 357, 336 A.2d 316, 323 (1975) (The great utility of letters of credit flows from the principle that the issuer's obligation in the beneficiary is primary and direct); see also Macintosh, *Letter of Credit: Dishonor When a Required Document Fails to Conform to the Section 7-507(b) Warranty*, 6 J. L. & COMM. 1, 4 (1986).

251. Rapson, *supra* note 242, at 8.

252. *Bebco Distribs., Inc. v. Farmers & Merchants Bank*, 485 So. 2d 330, 331 (Ala. 1986); *Security State Bank of Basin v. Basin Petroleum Services, Inc.*, 713 P.2d 1170, 1172 (Wyo. 1986); *Pro-Fab, Inc. v. Vipa, Inc.*, 772 F.2d 847, 852 (11th Cir. 1985); *Banque Paribas v. Hamilton Industries Int'l, Inc.*, 767 F.2d 380 (7th Cir. 1985); *Dubose Steel, Inc. v. Branch Banking & Trust Co.*, 72 N.C. App. 598, 600, 324 S.E.2d 859, 862 (1985); *Mitsui Mfrs. Bank v. Texas Commerce Bank-Fort Worth*, 159 Cal. App. 3d 1051, 1055, 206 Cal. Rptr. 218 (1964); *Banco Nacional de Desarrollo v. Mellon Bank, N.A.*, 726 F.2d 87, 91 (3d Cir. 1984); *Consolidated Aluminum Corp. v. Bank of Virginia*, 704 F.2d 136, 138 (4th Cir. 1983); *Kelly-Springfield Tire Co. v. Dakota Northwestern Bank, N.A.*, 321 N.W.2d 516, 518 (N.D. 1982); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886 (3d Cir. 1977); *Board of Trade of San Francisco v. Swiss Credit Bank*, 728 F.2d 1241, 1243 (9th Cir. 1984); *Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 230, 236 (5th Cir. 1983); *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 686 F.2d 112, 114 (2d Cir. 1982); *Courtald's N. Am. Inc. v. North Carolina National Bank*, 528 F.2d 802, 805-06 (4th Cir. 1975); *AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc.*, 448 F. Supp. 222, 223 (D. Ariz. 1978); *Bank of Italy v. Merchant's National Bank*, 236 N.Y. 106, 108-09, 140 N.E. 211, 211-12 (1923), cert. denied 264 U.S. 581 (1924); but see *Bank of Cochín Ltd. v. Mfrs. Hanover Trust Co.*, 612 F. Supp. 1533, 1541 (S.D.N.Y. 1985), aff'd 808 F.2d 209 (2d Cir. 1986) (failure of beneficiary of letter of credit to provide sixth set of identical documents as required in the letter of credit did not violate strict compliance standard for determining whether confirming bank wrongfully honored the letter of credit where failure to provide additional document did not mislead paying bank to its detriment); *American Airlines, Inc. v. Federal Deposit Ins. Corp.*, 610 F. Supp. 199, 202 (D. Kan. 1985); *Flagship Cruises Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699, 705 (1st Cir. 1978); *Crocker Commercial Services v. Countryside Bank*, 538 F. Supp. 1360, 1362-63 (N.D. Ill. 1981); *Transamerica Delaval Inc. v.*

transactions,²⁵³ retains the strict compliance rule and provides that if an issuer pays in the absence of strict compliance, he breaches his contract with his customer, and thereby forfeits his claim to reimbursement.²⁵⁴ This strict construction is deemed necessary to maintain the independent relationship between the letter of credit contract and the underlying contract, thus preventing the incorporation of obligations arising under the contract between the customer and the beneficiary into the letter of credit contract between the issuer and the beneficiary.²⁵⁵

Although strict compliance remains the rule, the internationally observed Uniform Customs and Practice for Documentary Credits Act [hereinafter UCP] and several courts have sought to loosen the strict compliance requirement.²⁵⁶ Courts have applied the doctrines of waiver and estoppel to letter of credit transactions to allow recovery without strict compliance where the issuing bank agreed beforehand not to require strict compliance or told the beneficiary that payment would be forthcoming on the basis of the documents submitted.²⁵⁷ Similarly, in 1983, the UCP relaxed the doctrine of strict compliance by allowing the parties to instruct the bank beforehand to pay the beneficiary upon presentation of any number of documents indicating that goods to be paid for under a letter of credit had been shipped.²⁵⁸

Citibank, N.A., 545 F. Supp. 200, 203, 204 (S.D.N.Y. 1982) (advocating adoption of a bifurcated standard imposing strict compliance when the beneficiary sues the issuer but substantial compliance when the customer sues the issuer).

253. Arnold & Bransilver, *supra* note 239, at 274.

254. U.C.C. § 5-114.

255. Harfield, *Identity Crises in Letter of Credit Law*, 24 ARIZ. L.R. 239, 240 (1982).

256. See generally International Chamber of Commerce, *Uniform Customs & Practice for Documentary Credits* (Publ. No. 400) (rev. ed. 1983). The UCP was formulated in 1933 and recently revised in 1983 by the International Chamber of Commerce. Schmitthoff, *supra* note 241, analyzes the 1983 revisions. The document is relied upon by banks in 165 countries. Although Article 5 of the U.C.C. usually governs the letter of credit in domestic transactions, U.C.C. § 1-102(3) permits the parties to a letter of credit to give the UCP priority over the U.C.C. where the latter does not provide otherwise. Cf. Farrar, *Letters of Credit*, 39 BUS. LAW. 1319, 1328 (1984) (for significant problems with respect to invoking the election). Note, for example, that New York passed its own version of the U.C.C. allowing parties to opt for coverage under the UCP exclusive of the U.C.C. N.Y. U.C.C. § 5-102(4) (McKinney's 1964). The 1983 UCP expressly covers standby letters of credit. UCP art. 1. For critique of this aspect of the revision, see Schmitthoff, *supra* note 241, at 195.

257. Schweibish v. Pontchartrain State Bank, 389 So. 2d 731 (La. Ct. App. 1980), *cert. denied* 396 So. 2d 885 (La. 1981) (holding that, where a bank which issued several letters of credit did not require strict compliance with the terms of the prior letters of credit it had paid to the beneficiary, the bank could not assume a totally inconsistent position by insisting upon strict compliance for a subsequent letter of credit); Voest-Alpine International Corp. v. Chase Manhattan Bank, N.A., 707 F.2d 680 (2d Cir. 1983) (applying New York law); see generally 44 A.L.R.4th 172, 182 (1986) ("Although a determination of waiver depends on the particular facts involved, counsel should note that evidence showing that a bank which had the status of a confirming bank in that it agreed to review the documents submitted by the beneficiary in connection with its drafts for payment under the letter of credit initially approved the submitted documents, and evidence showing that the bank had accepted the drafts with a statement that payment would definitely be forthcoming, if believed by the trier of fact, may establish the requisite intentional relinquishment of the bank's right to insist on strict compliance thereby precluding summary judgment in favor of the bank").

258. Schmitthoff, *supra* note 241, at 193.

Letters of credit may be either revocable or irrevocable.²⁵⁹ In the absence of an express statement declaring revocability, the UCC provides a presumption that the letter of credit pertaining to an underlying sales contract is irrevocable while the UCP provides the opposite presumption.²⁶⁰ An irrevocable letter of credit represents a binding offer by the customer which, once executed, may not be withdrawn or altered without the beneficiary's consent.²⁶¹ Thus, if an issuer holds an irrevocable letter of credit running to a particular beneficiary, the issuer is required to pay the beneficiary upon presentation of specified and valid documents regardless of whether the customer revokes or alters the contract between itself and the beneficiary. A customer's proof of supervening impossibility, insurrection, accidents and all other defenses to the underlying contract is immaterial to payment under the letter of credit and in no way excuses an issuer's failure to pay.²⁶² The only exception to this rule has been codified in UCC section 5-114(2) and provides that the customer may obtain an injunction against payment if he can demonstrate "fraud in the transaction."²⁶³

A customer and beneficiary may involve financial institutions other than the issuer in the transaction. If a beneficiary is concerned about his issuer's credit standing or if there are political risks associated with the issuer's country of origin, the beneficiary may arrange contractually to have his local bank confirm the letter of credit, and thereby guarantee that the issuer's obligations to the beneficiary are met.²⁶⁴ Similarly, a beneficiary may contract with a financial institution to act as an "advising bank" and to undertake transmission of the letter.²⁶⁵ Finally, a beneficiary may transfer or assign his right to draw under a letter of credit so long as the letter of credit expressly provides that it is assignable or transferable.²⁶⁶

259. P. O'HANLON, *supra* note 246, at 51; U.C.C. § 5-103(1)(a); 1974 UCP art. 1; 1983 UCP art. 7.

260. U.C.C. § 2-325; UCP, *supra* note 256, art. 1(c).

261. Harfield, *supra* note 255, at 248.

262. KMW Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10, 16 (2d Cir. 1979).

263. Justice, *Letters of Credit: Expectations and Frustrations—Part 2*, 94 BANKING. L.J. 493, 495-98 (1977). See *Sperry Int'l Trade Inc. v. Government of Israel v. American Arbitration Ass'n*, 670 F.2d 8, 11 (2d Cir. 1982) (A customer seeking to enjoin payment under a letter of credit must make a sufficient showing not only of all the elements of fraud but also of irreparable injury and likelihood of success on the merits). But see *Sperry Int'l Trade, Inc. v. Government of Israel*, 689 F.2d 301 (2d Cir. 1982) (affirming confirmation of arbitration award requiring escrow of letter of credit proceeds based on equitable grounds. The court acknowledged that the law would not enable a court to grant this action, which is effectively the preliminary injunction denied in the case above).

264. J. KAMMERT, INTERNATIONAL BANKING MANAGEMENT 41 (1981). U.C.C. § 5-103(1)(f) defines "confirming bank" as: "a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank."

265. U.C.C. § 5-103(1)(e) defines "advising bank" as: "a bank which gives notification of the issuance of a credit by another bank." U.C.C. § 5-103(1)(e). For obligations of a notifying or advising bank, see U.C.C. § 5-107(1).

266. Squillante, *supra* note 243, at 224; see U.C.C. § 5-116.

2. *The Standby Letter of Credit*

The structure of the standby letter of credit is identical to that of the commercial letter of credit.²⁶⁷ The functions of the two types of letters, however, vary considerably.²⁶⁸ A commercial letter of credit is designed to effect payment in a transaction involving the sale of goods.²⁶⁹ A standby letter of credit is used to assure the beneficiary of payment if the customer fails to perform his obligations under the underlying agreement.²⁷⁰ Under a standby letter of credit, if the customer defaults, the beneficiary may draw upon the credit by presenting to the issuer a certificate of default, a demand for payment or the draft required by the particular credit.²⁷¹

An institution (generally, a commercial bank) contemplating issuing a standby letter of credit on behalf of its customer usually performs a careful credit analysis of the customer on the assumption that it will be called to pay the letter of credit and will be forced to turn to this customer for reimbursement.²⁷² Several commentators liken the standby letter of credit to an unsecured loan and point out the far greater risk of loss to the issuer presented by the standby than by the traditional commercial letter of credit.²⁷³ Recognizing the risk inherent in the standby letter, banking regulators require banks to treat standbys as loans for the purpose of lending limits and have proposed imposing capital reserve requirements on issuing banks.²⁷⁴ But because these restrictions fail to provide complete protection to an issuer of

267. In addition to the general transactional requirements described in the preceding text, letters of credit issued by national banks are expected to conform to the guidelines laid down by the Board of Governors of the Federal Reserve Board, *see supra* note 236. Note also that an issuer of a standby letter of credit, like that of a commercial letter of credit, becomes liable upon strict compliance by the beneficiary with the letter's terms for presentation of documents. Rapson, *supra* note 242, at 277.

268. Arnold & Bransilver, *supra* note 239, at 277.

269. *Id.* A classic scenario in which a commercial letter of credit might be used is one in which a seller (beneficiary) has been requested to manufacture widgets for sale to a purchaser (applicant). Since the seller has never dealt with the purchaser previously he wishes to obtain assurance that the purchaser will pay for the goods. Bank X (issuer) has banking relationships with both the seller and the purchaser and is satisfied that the purchaser has the means to pay for the widgets at the agreed upon sales price at the expected time of shipment. The seller has confidence in the credit of Bank X. The purchaser applies to Bank X for a letter of credit to be issued in favor of the seller requiring delivery of shipping documents and other documents certifying the quality and quantity of the goods to be sold. The application also provides that the purchaser will promptly reimburse Bank X for any amount disbursed under the letter of credit. The letter of credit is issued, the sales contract is executed, and the seller commences manufacturing widgets. *Id.* at 277-78.

270. W. HAWKLAND & T. HOLLAND, *supra* note 237, at § 5-102:06, at 17. Rapson, *supra* note 242, at 8.

271. Kimball & Sanders, *supra* note 240, at 418.

272. Harfield, *The Standby Letter of Credit Debate*, 94 BANKING, L.J. 293, 300 (1977).

273. Verkuil, *supra* note 240, at 726-28; *see also* Harfield, *Uncertain Politics Spell Danger for Letter of Credit Issuers*, Am. Bnker, July 28, 1982, Int'l Bnker Sec. at 30, 64 ("Common sense and common experience dictate that a banker must proceed on the assumption that the beneficiary will use the [standby] letter of credit.").

274. *See* 12 C.F.R. § 337.2(b) (1987) (FDIC—covering insured banks); 12 C.F.R. § 208.8(c) (1986) (Federal Reserve—covering state member banks). Note, however, that there is authority

standby letters of credit, an issuer often protects itself by requiring that the customer provide collateral to secure this obligation to reimburse,²⁷⁵ by co-issuing the letter of credit with another institution,²⁷⁶ or by writing protective terms into the contract, such as an acceleration clause or a clause requiring additional collateral in the event of deterioration of the customer's financial condition. In addition, given greater risk, an issuer will raise the issuance fee for the standby letter of credit.²⁷⁷

The issuer of a standby letter of credit, unlike the issuer of a commercial letter of credit, does not expect the standby letter of credit to be drawn upon.²⁷⁸ Moreover, a demand for payment under a standby letter of credit indicates to the issuer either that there has been a serious breakdown in relations between the beneficiary and the customer, or that the customer is insolvent and thus could not perform the contract. In the former case, the issuer may be forced to sue its customer to obtain reimbursement if it honors the letter of credit. In the latter case, the issuer may never collect reimbursement.²⁷⁹ As a result, the issuer of standby letters of credit usually contacts the customer after presentation of the requisite documents and before paying the beneficiary.²⁸⁰ The process of contacting the customer often results in a delay in payment, during which time the customer generally seeks the issuer's

holding that a bank standby letter of credit is enforceable against the bank issuer even though the letter of credit exceeds the bank's lending limit to its customer. Ryan, *supra* note 247, at 412 n.34.

A regulatory group comprised of the Federal Reserve Board, the Office of the Comptroller of the Currency, the FDIC, and the Bank of England, Britain's central bank, has recently proposed imposing reserve requirements on standby letters of credit. Yang, *U.S. and Britain Propose a Rule on Bank Capital*, Wall St. J., Jan 9, 1987, at 3, col. 4; Nash, *Similar Standards for Banks are Set by U.S. and Britain*, N.Y. Times, Jan. 9, 1987, at D2, col. 5. The proposal, called a risk-based capital standard, calls for issuing banks to set aside capital as a reserve for loss to cover, among other things, standby letters of credit. N.Y. Times at D2, col. 5. Standby letters of credit are not shown on a bank's balance sheet because they do not represent a direct claim on the bank's assets. *Id.* The proposal would place a higher reserve requirement on standby letters of credit securing credit than on those securing performance. Interview with Ernest Patrikis, Federal Reserve Board, Office of the Legal Advisor (Jan. 28, 1987). Paul A. Volcker, Chairman of the Federal Reserve Board, acknowledged that the guidelines might force banks to reduce their activity in the standby letter of credit market. N.Y. Times at D2, col. 5.

275. Harfield, *supra* note 272, at 299-300. The average collateral required by large banks issuing standby letters of credit is 18% of standby value and for small bank issuers is 38%. Kozolchik, *supra* note 236, at 328. In regard to collateral for standby letters of credit, it is interesting to note that the United States Supreme Court recently held that contingent promissory notes used to back standby letters of credit are not insured deposits subject to FDIC insurance. Federal Deposit Insurance Corp. v. Philadelphia Gear Corp., — U.S. —, 106 S.Ct. 1931 (1986).

276. Harfield, *supra* note 272, at 65.

277. The profit on a standby letter of credit stems from the fee charged by the issuer. Dunn & Silberstein, *supra* note 36, at 16.

278. J. Dolan, *supra* note 33, at ¶ 1.04; Arnold & Bransilver, *supra* note 239, at 279.

279. Note, *Letters of Credit: Injunction as a Remedy for Fraud in U.C.C. Section 5-114*, 63 MINN. L. REV. 487, 495-96 (1979).

280. *Id.* at 496 citing Telephone Interview with Jeffrey Judy, Manager, Letter of Credit Area, Northwestern National Bank, Minneapolis (Nov. 27, 1978) and Telephone Interview with Ronald Smith, Second Vice President, Chase Manhattan Bank, New York City (Nov. 27, 1978).

cooperation in avoiding payment pending resolution of the contractual issue. The issuer often complies with the wishes of the customer in the hope of circumventing litigation.²⁸¹

A delay in payment by the issuer, however, as well as any subsequent refusal by the issuer to pay under the credit (even if based upon valid defenses and claims the customer may have against the beneficiary) directly contravenes the basic nature and purpose of the letter of credit.²⁸² A standby letter of credit, unlike a guarantee, is governed by traditional letter of credit law which precludes assertion of defenses by an issuer.²⁸³ An issuer of a letter of credit is primarily liable with respect to its obligations under the letter of credit and must carry out its obligations upon presentation of the requisite documents.²⁸⁴

An issuer's refusal to pay under a standby letter of credit entitles the beneficiary to sue the issuer for breach of contract.²⁸⁵ In order to succeed in such an action, the beneficiary need only prove due performance of the letter of credit contract on his part and nonpayment by the issuer.²⁸⁶ Damages for a successful beneficiary-claimant usually constitute recovery of the amount of the payment demand²⁸⁷ but may also include recovery of a prejudgment interest²⁸⁸ and attorneys' fees under a negotiated contract clause or applicable state statute.²⁸⁹

The customer under a standby letter of credit will often seek an injunction to restrain the issuer from honoring the credit. Under traditional letter of credit law, a court may enjoin payment only when there is "fraud in the

281. Justice, *supra* note 249, at 436. Note that under the U.C.C., a bank issuer may legally defer honor of a documentary sight draft of demand for payment until the close of the third banking day following receipt of the documents and under the UCP an issuer may wait "a reasonable time" following receipt of the documents before paying the beneficiary. In the case of a sight draft, the parties may specify a deferment period and, thus, change the U.C.C. and UCP rules. Ryan, *supra* note 247, at 406.

282. Rapson, *supra* note 242, at 8.

283. Harfield, *Enjoining Letter of Credit Transactions*, 95 BANKING. L.J. 596, 598-601 (1978).

284. Philadelphia Gear Corp. v. Federal Deposit Insurance Corp., 751 F.2d 1131, 1134 (10th Cir. 1984) *rev'd on other grounds*, — U.S. —, 106 S.Ct. 1931 (1986). (A standby letter of credit represents a primary, not a secondary, obligation of the issuing bank). Arnold & Bransilver, *supra* note 239, at 279-80.

285. Harfield, *supra* note 283, at 600.

286. *Id.*

287. U.C.C. 5-155(1); *see generally* W. HAWKLAND & T. HOLLAND, *supra* note 237, § 5-115:01 at 211.

288. *See* Republic National Bank v. Northwest National Bank, 578 S.W.2d 109, 117, 25 U.C.C. Rep. Serv. (Callaghan) 832, 842 (Tex. 1978); Tosco Corp. v. Federal Deposit Insurance Corp., 723 F.2d 1242, 1249, 37 U.C.C. Rep. Serv. (Callaghan) 1660, 1666 (6th Cir. 1983) (applying Tennessee law).

289. *See* Temple-Eastex, Inc. v. Addison Bank, 672 S.W.2d 793, 798, 38 U.C.C. Rep. Serv. (Callaghan) 971, 979 (Tex. 1984), *reh'g denied* (in action for wrongful dishonor of a letter of credit, held that a party claiming under a letter of credit was entitled to attorney's fees for its wrongful dishonor by the issuer on the ground that a state statute allowed recovery of attorney's fees in suits founded on written contracts).

transaction”²⁹⁰ together with a showing of the elements necessary to obtain equitable relief.²⁹¹ UCC § 5-114 does not define “fraud in the transaction,” and much debate has been focused on the issue of what acts entitle a claimant to obtain injunctive relief.²⁹² Many courts adopt a narrow view of the provision and grant injunctive relief only in the face of outrageous fraud.²⁹³ As an alternative, one commentator has suggested that the warranty provisions of UCC § 5-111 provide the account party with sufficient grounds to enjoin payment of the standby letter of credit fraud by the beneficiary, and that a court should rarely, if ever, rely on the fraud provision of § 5-114.²⁹⁴ Section 5-111(1) provides that the beneficiary’s presentation of a “documentary draft of demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with.”²⁹⁵ Use of this cause of action has not been explored in practice and thus, it presents only a potential source of relief to a customer.

When the customer is unable to restrain honor of the letter of credit by the issuer, he may nevertheless refuse to reimburse the issuer on the ground that payment breached the conditions of payment under the letter of credit contract. Even if the issuer has a meritorious claim, its only recourse in this case may be costly litigation. Thus, a prospective issuer of a standby letter of credit should evaluate not only its customer’s creditworthiness, but also the likelihood that the customer will contest honor of the letter of credit.

Although standby letters of credit may be issued by institutions other than banks,²⁹⁶ most standby letters of credit, measured by amount of principal, are issued by large, multinational banks.²⁹⁷ An important reason for the dominant presence of large banks in the issuance of standby letters of credit is the wide network of correspondent banking relations they enjoy.²⁹⁸ This network facilitates communication and transactional speed and offers an issuer a wide pool of information regarding customers, beneficiaries and correspondent banks.²⁹⁹

290. U.C.C. § 5-114(2)(b) (1978).

291. See, e.g., *Sperry Int’l Trade, Inc. v. Government of Israel v. American Arbitration Ass’n*, 670 F.2d 8 (2d Cir. 1982); *Enterprise Int’l Inc. v. Corporacion Estatal Petrolera Ecuatoriana*, 762 F.2d 464 (5th Cir. 1985).

292. See *Macintosh*, *supra* note 250, at 5-7.

293. *Id.* at 6-7.

294. See *Dolan, Letters of Credit, Article 5 Warranties, Fraud, and the Beneficiary’s Certificate*, 43 *BUS. LAW.* 347, 354-59 (1986).

295. U.C.C. § 5-111(1) (1978).

296. *Murray, Letters of Credit in Nonsale of Goods Transactions*, 30 *BUS. LAW.* 1103, 1106 (1975).

297. *Kozolchik*, *supra* note 236, at 324.

298. *Id.*

299. *Id.* at 324-25. The research staff of the Federal Reserve Board developed a list of additional explanations for the dominant presence of multinational banks in the standby letter of credit issuing business: 1) beneficiaries are more apt to rely on a standby letter of credit issued by a large bank than a smaller one; 2) large banks have developed an expertise in the area; 3) the substantial capital base of large banks permits them to issue a larger number of letters of credit in higher principal amounts. *Id.*

Bank regulators expressly authorize banking institutions to issue standby letters of credit and state that standby letters of credit do not constitute "guarantees", which banks are prohibited from issuing.³⁰⁰ Article 5 of the UCC also recognizes that banks may issue standby letters of credit.³⁰¹ Because state and national law prohibit bank issuance of guarantees,³⁰² a customer under a standby letter of credit may attempt to resist an action for reimbursement by characterizing the letter of credit as a guarantee.³⁰³ Although courts have been reluctant to allow a customer to claim that the standby letter of credit issued at his behest constitutes an illegal guarantee,³⁰⁴ the two instruments are largely indistinguishable.³⁰⁵

B. Standby Letters of Credit As a Vehicle to Protect Intellectual Property Rights

1. Flexibility of the Instrument

The flexible nature of the standby letter of credit, together with the large number of contractual situations to which it can be applied, make it a good risk protection vehicle for a number of foreign investments.³⁰⁶ Both commentators³⁰⁷ and the UCC Official Comments³⁰⁸ have advocated expanded use of the instrument to facilitate a broad range of commercial transactions. The standby letter of credit performs an especially important risk hedging function in international transactions by allowing the beneficiary to hold disputed funds during litigation, thereby shifting the burden of litigation to the account party.³⁰⁹ This function provides a significant advantage to the beneficiary in light of the jurisdictional and choice of law problems inherent in

300. See 12 C.F.R. § 7.7016 (1986) (Comptroller of the Currency—covering national banks); 12 C.F.R. § 208.8(d) (1986) (Federal Reserve—covering member banks); 12 C.F.R. § 337.2 (1986) (FDIC—covering insured banks).

301. U.C.C. § 5-102 comment 1 (1978) states:

Banks and private bankers also issue money credits which do not require documents of title to be presented as one of the conditions of honor. So far as these institutions are concerned the accompanying papers can range from a certification that certain building contracts have been performed in whole or in part or a notice that goods have been sent or a notice of default of some kind into the more traditional document of title.

302. See Squillante, *supra* note 243, at 221; Ryan, *supra* note 247, at 410.

303. See 44 A.L.R. 4th 172, *supra* note 257, at 183.

304. *Id.* See, e.g., Federal Deposit Insurance Corp. v. Freudenfeld, 492 F. Supp. 763 (E.D. Wis. 1980) (applying Wisconsin law).

305. Wheble, "Problem Children"—Standby Letters of Credit and Simple First Demand Guarantees, 24 ARIZ. L. REV. 301, 303 (1982).

306. Telephone interview with Alfred K. Daiboch, Vice President of the Global Trade Group, Bankers Trust Co., New York City (Feb. 7, 1986).

307. See, e.g., Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 BANKING L.J. 816, 850 (1977).

308. See U.C.C. § 5-102 comment 2 (1964).

309. Kimball & Sanders, *supra* note 240, at 419. The standby letter of credit contract providing for payment prior to litigation on the contract is more favorable to the beneficiary than either an insurance policy or a surety contract. Under the latter two, payment (or performance)

international litigation.³¹⁰ In addition, the standby letter of credit vehicle insulates the beneficiary from foreign governmental intervention in the contractual payment process³¹¹ and ensures that he will receive payment despite foreign governmental interference, provided the letter of credit places liability upon an issuer subject to U.S. jurisdiction.³¹²

The standby letter of credit provides a convenient mechanism to secure payment under a licensing agreement covering intellectual property rights in the context of transfer of technology abroad.³¹³ The standby letter of credit can be structured to provide the beneficiary, e.g., the transferor of technology, with rights of acceleration or collection of accrued licensing fees.³¹⁴ This arrangement ensures that a transferor will receive the benefit of its bargain, in spite of a breach of the licensing agreement or of a governmental expropriation of the underlying technology, and without the additional cost and burden of litigation. The standby letter of credit thus operates somewhat like a liquidated damages clause.

A standby letter of credit may also be structured to trigger payment upon breach by a transferee of restrictive terms designed to protect against infringement or theft of an intellectual property right. A transferor might secure under a standby letter of credit and incorporate into the licensing agreement or contract such provisions as a covenant guarantying return of patented molds,³¹⁵ production volume restraint clauses,³¹⁶ export restrictions,³¹⁷ field of use restrictions,³¹⁸ or unilateral grant-back provisions.³¹⁹ A

is delayed pending determination that the obligor has defaulted. J. DOLAN, *supra* note 33, at ¶ 1.05.

310. See *supra* notes 24-27 and accompanying text. Although jurisdictional and conflict of law problems can sometimes be resolved through provisions in the underlying contract, the letter of credit simplifies the process and obviates the need for complication and protracted discussions of the subject *ex ante*. See Saunders, *Letters of Credit in International Transactions*, 102 *BANKING L.J.* 361, 365 (1985).

311. See *J. Zeevi & Sons v. Grindlays Bank (Uganda), Ltd.*, 37 N.Y.2d 220, 333 N.E.2d 168, 371 N.Y.S.2d 892, *cert denied* 423 U.S. 866 (1975) (holding that the Act of State Doctrine did not apply to the Ugandan government's order to an issuing bank to cancel a credit running to an Israeli beneficiary and that such cancellation constituted an anticipatory breach).

312. This might be accomplished through an arrangement with a local confirming bank.

313. See, e.g., *Computer Corporation of America v. Zarecor*, 16 Mass. App. Ct. 456, 452 N.E.2d 267 (1983) (an initial licensing fee of \$408,000 was secured by a standby letter of credit during the first year that the licensing agreement was in effect).

314. Dolan Interview, *supra*, note 34.

315. See *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128 (App. Div. 1981) (a New Jersey bank, at the request of its customer, issued an irrevocable letter, confirmed by a foreign licensor. As a condition to payment, the letter of credit required the foreign licensee to present a statement confirming the failure of the New Jersey licensee of patented furniture molds to return the molds as of a specified date).

316. Production volume restraint clauses restrict either the volume of production of a licensed process or the volume of the licensed product. Finnegan, *A Code of Conduct Regulating International Technology Transfer: Panacea or Pitfall?*, 1979 A.B.A. INST. ON CURRENT INT'L LEGAL ASPECTS OF LICENSING & INTELL. PROP. 59. Volume restrictions are included to preserve the competitive position of the licensor in the licensee's market. *Id.* at 58.

317. Export restrictions include:

transferor could also protect against negligent loss of trade secrets by the transferee or deliberate theft of trade secrets.

Nothing in the UCC or letter of credit law prohibits the inclusion of nondocumentary restrictions into a letter of credit.³²⁰ Thus, assuming a technology transferor had the requisite bargaining leverage over his transferee, he could demand that the transferee establish a standby letter of credit in his favor providing for payment of specified liquidated damages, both of a restitutionary and of a consequential nature (e.g. loss of market share), in the case of either political action or commercial action against the technology he has transferred abroad. Similarly, although excessively high principal standby letters of credit might be voided as contractual penalties, a transferor may be able to use a standby letter of credit to protect against loss of market share (even worldwide) resulting from unauthorized dissemination of trade secrets by a licensee. At the very least, a transferor could use a standby letter of credit to obtain reimbursement for the development costs underlying the trade secret.

2. *The Risk that a Letter of Credit will be Deemed a Guarantee*

The primary risk in structuring a standby letter of credit arrangement as a liquidated damages clause is that a court might find that the contract constituted a guarantee rather than a letter of credit, and thus the credit would be void as *ultra vires* if issued by a bank or subject to litigation of defenses or

clauses and/or practices prohibiting or limiting in any way the export of products manufactured on the basis of the technology in question including restrictions on exports to certain markets, permission to export only certain markets; and requirement of prior approval of the licensor for exports . . . clauses and/or practices requiring higher technology payments on goods produced for exports (sic) vis-à-vis goods for the domestic market.

Id. at 61 (citing The Working Group on Code on Transfer of Technology of the Pugwash Conference on Science and World Affairs (Pugwash Code), ch. III, para. 4(i) & 4(v) (Geneva, Switzerland, April 1-5 1974)). One situation in which export restrictions are particularly useful to a licensor is where he has an exclusive licensee in each of one or more territories and wishes to protect one licensee's market from competition by another licensee. Finnegan, *supra* note 316, at 61. A clause that requires higher royalty payments for items produced for export than for domestic items is a form of export restriction. *Id.* at 62.

318. Field of use restrictions are "clauses and/or practices restricting the recipient's volume, scope and range of production or field of activity." Finnegan, *supra* note 315, at 63 (citing Pugwash Code, ch. III, para. 4 (vii)). Field of use restrictions have been upheld under U.S. antitrust law. See *General Talking Pictures Corp. v. Western Electric Co.*, 305 U.S. 124 (1938), *aff'g* 304 U.S. 175 (1938), *reh'g denied*, 305 U.S. 675 (1939).

319. Unilateral grant-back provisions establish:

a unilateral flow of technical information and improvements from the technology recipient without reciprocal obligations from the technology supplier. All new technologies, patents and improvements developed by the technology recipient as a result of the agreement shall be the property of the technology recipient.

Finnegan, *supra* note 316, at 63 (citing Pugwash Code, ch. III, para. (4)(xi)). Other licensing restrictions are described in Finnegan, *id.* at 51-85.

320. 44 A.L.R.4th 172, *supra* note 257, at 181; see also *Raiffeisen-Zentralkasse Tirol Reg. Gen. M.B.H. v. First Nat'l Bank in Aspen*, 671 P.2d 1008 (Colo. App. 1983).

claims by the issuer in the case of a nonbank issuer. In either case, the realization of this risk would limit the efficacy of the standby letter of credit.

The trend of recent judicial and administrative decisions has been to find an ambiguous instrument, executed by a bank at the request of its customer for the purpose of securing an obligation, to be a standby letter of credit, rather than a guarantee.³²¹ For example, in *Bank of North Carolina, N.A. v. Rock Island Bank*,³²² the Seventh Circuit ruled that an instrument was a letter of credit even though it failed to state that it was a letter of credit. The opinion noted that since every letter of credit serves some sort of guarantee function, and a court should not deny enforcement of a letter of credit as *ultra vires* simply because it resembles a guarantee.³²³ Similarly, in 1985 the Comptroller of the Currency approved Citibank's proposal to insure municipal bonds on the basis that municipal bond insurance constituted a standby letter of credit.³²⁴ The Comptroller reasoned that since the credit risk in a standby letter of credit supporting a municipal bond issue is the same as the "insurance risk" undertaken in a municipal bond insurance contract, the two instruments are interchangeable.³²⁵ This reasoning suggests that a standby letter of credit could be successfully drafted (taking account of the Comptroller's guidelines for issuance of letters of credit³²⁶) to cover infringement or

321. See *Bank of North Carolina, N.A. v. Rock Island Bank*, 570 F.2d 202 (7th Cir. 1978), *rev'd on other grounds*, 630 F.2d 1243 (7th Cir. 1980) (applying Illinois law); *American Nat'l Bank & Trust Co. v. Hamilton Indus. Int'l, Inc.* 583 F. Supp. 164 (N.D. Ill. 1984) (applying Illinois law); *Prudential Ins. Co. v. Marquette Nat'l Bank*, 419 F. Supp. 734 (D. Minn. 1976) (applying Minnesota law); *First Am. Nat'l Bank v. Alcorn, Inc.*, 361 So. 481 (Miss. 1978); *New Jersey Bank v. Palladino*, 77 N.J. 33, 389 A.2d 454 (1978); *Toyota Indus. Trucks U.S.A. Inc. v. Citizens Nat'l Bank*, 611 F.2d 465 (3d Cir. 1979) (applying Pennsylvania law); *but see Wichita Eagle & Beacon Publishing Co. Inc. v. Pacific Nat'l Bank of San Francisco*, 493 F.2d 1285 (9th Cir. 1974) (same result under Kansas or California law) The court in *Wichita Eagle* held that an instrument issued by a bank in lieu of a performance bond did not constitute a letter of credit because the conditions for payment were so complex and the obligation of the bank so dependent upon the ascertainment of facts rather than upon examination of documents that the instrument constituted a guaranty. Despite its nature as an *ultra vires* guaranty, the bank was obligated to pay the beneficiary under the instrument. *Western Petroleum Co. v. First Bank Aberdeen v. East Side 1 Stop, Inc.* 367 N.W.2d 773 (S.D. 1985) (a letter written by a bank officer in which the bank guaranteed any invoice or invoices up to \$17,000 for purchase of petroleum products by its customer was a letter of guaranty and void as the bank could not lend its credit by guaranteeing the debt of its customer).

322. *Bank of North Carolina, N.A. v. Rock Island Bank*, 570 F.2d 202 (7th Cir. 1978).

323. *Id.* at 206.

324. Interpretive Letter No. 338 from Michael Patriarca, Deputy Comptroller for Multinational Banking to Patrick Mulhern, General Counsel, Citibank, N.Y. (May 2, 1985), 4 Fed. Banking L. Rep. (CCH) ¶ 85, 508 at 77,790 (1987).

325. *Id.*

326. As a matter of sound banking practice, letters of credit should be issued in conformity with the following: (a) each letter of credit should conspicuously state that it is a letter of credit or be conspicuously entitled as such; (b) the bank's undertaking should contain a specified expiration date or be for a definite term; (c) the bank's undertaking should be limited in amount; (d) the bank's obligation to pay should arise only upon the presentation of a draft or other documents as specified in the letter of credit, and the bank must not be called upon to determine questions of fact or law at issue between the account party and the beneficiary; (e) the bank's

theft of intellectual property rights even if the letter of credit were closely tied to the underlying contract and functioned as a liquidated damages provision.

a. *Avoiding Issuing a Guarantee*

An instrument is most likely to qualify as a standby letter of credit if the instrument conforms to the Comptroller's guidelines and maintains its independence from the underlying contact. The instrument should expressly state that any reference to the contract between the customer and the beneficiary is not intended to subject the letter of credit to conditions contained in that or any other agreement.³²⁷ Above all, the standby letter of credit must be structured so as to trigger payment by the issuer upon presentation to it of evidence of default or breach of specified contractual terms.³²⁸ This evidence should be documentary, and preferably certified by an independent party or based upon facts capable of determination in the United States.

For example, if a standby letter of credit were issued in conjunction with a licensing agreement that included a grant-back provision and an express covenant prohibiting reverse engineering by the transferee-account party, the independent nature of the letter of credit might be emphasized by providing for independent third party confirmation of a branch by the account party.³²⁹ As a result, the issuer would not have to substantiate or evaluate the claims of the beneficiary, and the account party would be protected against fraudulent or subjective certification by the beneficiary. Alternatively, the instrument might require that a specified officer of the beneficiary provide detailed factual representations in conjunction with certification that the account party breached the grant-back provision or restrictive covenant.³³⁰ The beneficiary, thus, would not be forced to secure the assistance of a third party. Either substantiation provision would help conform the appearance of the instrument to that of a typical standby letter of credit. At the same time, both provisions would give the account party greater assurance that the beneficiary could not induce payment under the instrument on the basis of false certification.

customer should have an unqualified obligation to reimburse the bank for payments made under the letter of credit.

12 C.F.R. § 7.7016 (1986).

327. W. HAWKLAND & T. HOLLAND, *supra* note 237, § 5-102:06 at 19.

328. *See, e.g.*, Squillante, *supra* note 243, at 221 ("If the bank has a primary obligation but it is triggered by the presentation of certain documents as a condition to payment, then we would have a true letter of credit.").

329. *See* Kimball & Sanders, *supra* note 240, at 436.

330. *Id.* at 437. This would require that the beneficiary take care not to make the documentary demands so specific that strict compliance would be virtually impossible. Note, *Letters of Credit: The Role of Issuer Discretion in Determining Documentary Compliance*, 53 FORDHAM L. REV. 1519, 1522 n.26 (1985) (citing G. GILMORE & C. BLACK, THE LAW OF ADMIRALTY 121 (2d ed. 1975)).

b. The Line of Credit Alternative

Another way in which a bank and its customer might structure a transaction covering proprietary interests in technology would be to issue an irrevocable line of credit in favor of the beneficiary.³³¹ A transaction structured as a line of credit avoids many of the regulatory and conceptual problems associated with standby letters of credit. Nevertheless, under such a transaction, the parties would run the risk that a court would still treat the transaction as a standby letter of credit or a guarantee. In *Toyota Industrial Trucks USA, Inc. v. Citizens Nat'l Bank*,³³² for example, the Third Circuit held that a "line of credit" issued by a bank at the request of a truck distributor for the benefit of the distributor's dealer, whereby the bank would honor documented drafts submitted by the distributor, constituted a letter of credit within the ambit of Article 5 of the UCC. Similarly, in *Robert Mallery Lumber Corp. v. B. & F. Associates Inc.*,³³³ the court held that a bank's letter to a seller of lumber products informing the seller that the bank had established a \$50,000 line of credit for the customer was an unauthorized guarantee.

3. Other Shortcomings of the Standby Letter of Credit

Assuming that the beneficiary-transferor and the account party-transferor agree to transfer technology in a transaction whereby the transferor's proprietary interests in the technology are secured by a standby letter of credit, the transferor must still be aware of several shortcomings of the standby letter of credit as a vehicle for risk protection. First of all, an issuing bank will probably not agree to an open-ended standby arrangement that extends for more than one year.³³⁴ This period of time may be insufficient to detect infringement or expropriation of intellectual property rights. Secondly, beneficiaries run the risk that a court will enjoin payment of the credit on the basis that the beneficiary failed to comply strictly with the terms of credit. Although Article 5 of the U.C.C. authorizes issuance of an injunction only in the face of fraud³³⁵, some courts have interpreted that phrase quite broadly and enjoined payment under letters of credit in situations where the actions of the beneficiary, if fraudulent at all, did not constitute an egregious

331. Interview with Donald Rapson, Associate General Counsel C.I.T. Corporation, (Nov. 20, 1986).

332. 611 F.2d 465, (3d Cir. 1979) (applying Pennsylvania law).

333. 294 Pa. Super. 503, 440 A.2d 579 (1982).

334. Daiboch Interview, *supra* note 306. Note that the United States Court of Appeals for the Third Circuit held that an issuer legally could issue a standby letter of credit with a duration exceeding one year and that was open-ended in terms of the beneficiary's right to recovery. *National Surety Corp. v. Midland Bank*, 551 F.2d 21 (3d Cir. 1977) (The instrument provided that the beneficiary would claim under the credit after completion of performance (applying New Jersey law). See generally, Kozolchik, *supra* note 236, at 359.

335. U.C.C. § 5-114(2) (1978).

wrongdoing.³³⁶ Finally, if the issuer of the letter is a foreign bank not subject to suit in the United States, and the letter of credit fails to provide for the use of a local confirming bank, then the beneficiary would be relegated to litigating the issue in an unfavorable forum. The result is anomalous since this is precisely the situation the beneficiary had hoped to avoid by obtaining the credit in the first place.

4. Assessment of the Standby Letter of Credit

Although the standby letter of credit may not meet all the needs of every technology transferor, it does present an attractive vehicle by which a transferor can hedge the risk of loss through infringement or expropriation of intellectual property rights. The instrument provides significant benefits: 1) liquidity; 2) shifting of litigation burdens and costs; 3) political and economic clout of an issuing bank vis-à-vis a local customer; 4) flexibility; and 5) coverage of both political and commercial risk. In addition, as compared with PRI, the instrument is inexpensive, its cost is borne by the transferee and it promises a faster financial settlement. The instrument also gives the parties the power to negotiate the value of the intellectual property rights secured by the standby letter of credit.

The overall flexibility of the standby letter of credit, together with the increased willingness of banks to issue letters of credit,³³⁷ make it a good risk protection vehicle. This is particularly true with respect to losses that can be readily ascertained and reduced into documentary form and for technology transferors who are seeking short-term coverage. Moreover, coverage under a standby letter of credit provides a good supplement to PRI in the case of technology transfer.³³⁸ Government-sponsored PRI might be employed alongside a standby letter of credit to provide long-term coverage as well as coverage against governmental expropriation. In the final analysis, a combination of insurance and letters of credit seems to be the best coverage available to a transferor of technology.

CONCLUSION

There is a growing need to protect American intellectual property transferred abroad from piracy and unauthorized use by foreign nationals. This need is heightened by the increased flow of technology to LDCs whose governments at times both encourage the infringement of intellectual property rights and expropriate the property rights directly.

336. See, e.g., *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344 (11th Cir. 1982); *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10 (2d Cir. 1979); *NMC Enterprise Inc. v. Columbia Broadcasting System*, 14 U.C.C. Rep. Serv. (Callaghan) 1427 (N.Y. Sup. Ct. 1974).

337. Dolan Interview, *supra* note 34.

338. Frank, *Hedging Foreign Political Risks*, *INDUSTRY WEEK*, Apr. 15, 1985, at 61.

Insurance, particularly the PRI model, presents a viable mechanism by which a transferor could protect against governmental expropriation of intellectual property rights. OPIC, whose objective is “[t]o mobilize and facilitate the participation of United States private capital and skills in the economic and social development of the less developed friendly countries and areas,”³³⁹ appears to be well positioned from both a financial and a marketing perspective to meet the existing need and to provide the relevant insurance coverage. Nevertheless, OPIC may, within the foreseeable future, lose its advantageous governmental authority. As part of the Reagan Administration’s efforts to pare down the federal government, the Administration is currently considering a proposal to privatize OPIC. This proposal could result in a drastic curtailment of existing functions and a reduction in the Agency’s ability to insure the riskier international investments. Should such a transformation occur, it is possible that OPIC would be both unable and unwilling to insure against expropriation of intellectual property rights. If so, the established private insurance market, (including private underwriters of PRI) supplemented to the extent possible by OPIC and MIGA, will become a primary facilitator of risk management in foreign trade.

Another important source of risk protection for intellectual property rights might be available from commercial banks in the form of standby letters of credit. A standby letter of credit could be used to protect against loss of intellectual property rights transferred pursuant to foreign trade contracts, provided the transferor has the leverage to demand such a letter of credit from the transferee. The ability to shift the investment risk to large multinational banks, which are better situated to evaluate political and commercial risks abroad and more able to exert pressure on the transferee, would be attractive to a transferor and efficient from the standpoint of the relative ability of the parties to protect themselves against risk.

Political risk insurance and standby letters of credit, used separately or in combination, provide a vehicle through which technology transferors abroad can hedge the risk of loss of intellectual property rights. The usefulness of either of these instruments is dependent upon the willingness and ability of the public and private issuers to adapt the instruments to cover intellectual property. Application of PRI and standby letters of credit to intellectual property rights would benefit technology transferors, the transferees, and the issuing institutions and result in more efficient and profitable transfers of technology abroad. American “know-how”, the nation’s strongest export, deserves such protection.

339. 22 U.S.C. § 2191 (1982).