

China Amended Its Technology Transfer Regulations Amidst Trade Disputes

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On March 18, 2019, China announced amendments of its joint venture law and the Regulations on Administration of Technology Import and Export (TIER) with immediate effect. The changes in nature took away some of the restrictions around cross border technology transfers, delivering more freedom of contract for future transactions. The announcement has attracted lots of attention from around the world as the rules are directly related to some of the claims in the US China trade disputes. The changes may turn out to be beneficial to both Chinese and foreign companies in the long run. We highlight the background and key changes below.

Background

China regulated cross border technology transfers from the beginning of 1980s, with a view of protecting domestic companies who were not sophisticated in such transactions. At the heart of the regulations, China uses a classified system to categorize technologies into freely-tradable, restricted and prohibited. If a technology (patented or non-patented) subject to technology licensing or assignments, falls into the catalogues of restricted technologies, import or export bound, must require approvals. After the US China trade dispute escalated in recent years, China also passed a special law to add national security and industry impact reviews for the technologies intended to be licensed or assigned to overseas entities.

In its joint venture law, China stipulated that in a joint venture involving foreign parties, the Chinese parties should have rights to continue using the licensed technology after the initial 10-year term expires.

What has long been controversial are the restrictions imposed by TIER in the technology import contracts, which cover all sorts of patent licenses, assignment and licenses of know-how or technical secret.

First, TIER makes it compulsory that a foreign licensor has the obligation to indemnify Chinese licensees for any loss arising from the use of the licensed technology under the contract. (Art. 24) What was often criticized is that such compulsory rules prevail over the Contract Law of the PRC under which two Chinese parties are allowed to freely negotiate the indemnification terms.

Second, TIER requires that any improvements made by the Chinese licensee to the imported technology shall per se belong to the licensee. (Art. 27) Similarly, the Contract Law does not contain such rules. Parties are free to use contracts to allocate the ownership of improvements made by the licensee. However, the judicial interpretations issued by the top court authority further clarify that there must be a reasonable

consideration for any grant-back of the improvement by the licensee.

Further, TIER also requires that anti-competitive restrictions imposed by a foreign licensor shall be invalid. Such anti-competitive restrictions include (a) bundled sales of unnecessary technology, raw materials, products, equipment or services; (b) pay for expired or invalid patents; (c) restraining licensees from improving the technology; (d) restraining licensees from obtaining licenses from competing sources; (e) imposing restrictions on sourcing of the raw materials, parts, products or equipment; (f) imposing restrictions on quantity, types, sales price of products; and (g) restricting export channels. Notably, similar anti-competitive restrictions are prohibited under the PRC Contract Law and relevant judicial interpretations for any and all licensors.

The adoption of these rules in the TIER as well as the joint venture law are widely believed to be based on the consideration back to the 1980s when China just started cross border transactions at large scales. The protections were enacted to ensure the interest of unsophisticated Chinese enterprises. However, since China entered WTO, the necessity and utility of such rules had encountered continuous questioning. Criticism often focused on the inconsistency between the TIER and those in the Contract Law, as well as the unnecessary complexities or even failures caused to cross border technology transactions by TIER.

Implication of Amendments

The amendments, as enacted, seems to eliminate all the controversial rules that are accused to violate the national treatment obligations stipulated in the TRIPS Agreement.

The direct impact of the changes is the broadened freedom of contract in the technology transactions.

Parties may independently agree on indemnity provisions and the ownership of improvements made by the licensees. Cross license, royalty free license or joint ownership should be allowed. Parties may leverage on their business interest to decide on these terms. But licensors need to keep in mind that China has some general requirements on fairness of contract terms. Gross unfairness might be cited as grounds to void licensing contracts.

What might be more interesting are those anti-competitive terms that have been taken away in the new amendments. The old TIER stipulated several anti-competitive or restrictive clauses shall not be allowed. Most of these provisions are actually in Article 329 of the Contract Law and the relevant judicial interpretations. The Anti-monopoly Law can always be invoked to question some of the licensing arrangements under analysis, in addition to the general provisions dealing with IP abuse. One notable item is tie-in sales or bundling. The current Contract Law and the judicial interpretation do not include prohibitions against bundling. Thus, the net effect of the

changes to TIER means that bundling is no longer a per se violation in the technology licensing contracts.

To conclude, the amendments of the TIER and the joint venture law are significant changes to the technology transfer regime in China. Hopefully, the legislative changes will lead to significant increase of transactions and, more importantly, the confidence among licensors and licensees.