

## NEWSLETTER

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### IN THIS ISSUE

This newsletter covers various issues and topics related to **Technology Transfers in China**.

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## **I. Technology Transfers: an Overview**

Although actively trying to develop its own technology, the People's Republic of China (the "PRC", or simply "China") also recognizes the need to import technology from overseas. The relevant laws covering the import of technology, more properly translated as 'technology transfer', are as follows (please note that the titles of these laws have been translated from their original Chinese wordings and as a result may sound slightly unusual):

- A. The *Contract Law of the PRC* ("《中华人民共和国合同法》"), effective as of October 1<sup>st</sup>, 1999, which includes one (1) whole chapter in relation to technology agreements, including technology transfer agreements;
- B. The *Management Rules on the Restriction and Banning of Technology Imports* ("《禁止进口限制进口技术管理办法》"), latest amendment effective as of March 3<sup>rd</sup>, 2009, which aims to supervise the import of technology by restricting the importing of certain technology into China; and
- C. The *Rules of the PRC on the Administration of Technology Imports and Exports* ("《中华人民共和国技术进出口管理条例》"), effective as of January 1st, 2002, which attempts to regulate the import and export of technology to and from the PRC.

## **II. Administration of Technology Transfers into China**

Technology that can be transferred into China can take the form of patent rights (and licenses relating to such rights) and patent application rights, technology-related confidential information, technology services (such as engineering services) and 'technology in other forms'.<sup>1</sup> Note that the rules for such transfer into China apply to all foreign entities and technology found outside of China, including those held by overseas subsidiaries of Chinese companies.

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<sup>1</sup> Article 2 of the *Rules of the PRC on the Administration of Technology Imports and Exports*  
HJM Asia Law & Co. LLC (v7 08.03.10) NEWSLETTER MARCH 2010  
2/9

The Chinese government only allows technology to be imported into China which it deems to be beneficial to China's economic development, and has implemented the *Rules of the PRC on the Administration of Technology Imports and Exports* in order to achieve such ends. This legislation classifies technology into three (3) categories, namely, encouraged technology for transfer, restricted for transfer and prohibited for transfer, although note that the 'encouraged' category is not mentioned in the legislation and exists only by default.

#### A. Prohibited technology

Technology in this category is prohibited from being transferred or imported into China due to reasons such as its negative impact on state security, public interests or morals, human health, or the environment. There are a total of thirty-nine (39) technologies in ten (10) industries which fall into this category in accordance with the *Categories on Restricted and Banned Technology Imports into China* (“*中国禁止进口限制进口技术目录*”). Typical examples are technology related to pesticides, certain mining technology (such as technology related to gold mining) and technology related to certain chemicals.

#### B. Restricted technology

Generally, restricted technology can be transferred into China, but note that a technology transfer agreement can only be effected after proper authorizations have been issued by the PRC authorities (see the paragraph titled 'The Process for the Transfer of Technology into China' below). The reasons for 'restriction' are similar to the reasons for prohibition as outlined in point (a) above, namely the impact on public security and the like. There are a total of eighty-seven (87) technologies in sixteen (16) industries falling into this category in accordance with the *Categories on Restricted and Banned Technology Imports into China*. Examples include technology related to the forgery-proofing of currency and to oil boilers for use in the manufacturing industry, standard sewage treatment technology, technology related to vacuum system control, and technology related to paper shredding.

#### C. Encouraged technology

Those technologies not listed in the category of prohibited technology transfer and the category of restricted technology transfer fall into the default ‘encouraged’ category are allowed to be transferred/imported freely into China but the technology transfer agreement still requires registration.<sup>2</sup>

### **III. The Process for the Transfer of Technology into China**

The process of transferring technology contained in the restricted category is different from that for technology in the encouraged category. Prohibited technology cannot be transferred.

#### **A. Process for Restricted Technology**

1. Where the technology needs special approval from the departments which supervise such technology (or the industry it is contained in), applications should be made for such approval;
2. An application shall be submitted to the local Commerce Bureau (the “CB”) in regards to the importation. The CB will approve or deny the application within thirty (30) working days upon receipt of the application documents. Upon such approval, a letter of intent will be issued;<sup>3</sup>
3. Upon receipt of the letter of intent mentioned above, the importer can enter into a technology transfer agreement with the foreign transferor;<sup>4</sup>
4. The executed technology transfer agreement and other documents shall be submitted to the local CB to apply for a technology importation license, which will be issued within ten (10) working days upon the submission of the aforesaid agreement and related documents;<sup>5</sup> and
5. Once the license is obtained, the relevant foreign exchange, banking, tax and customs procedures must be handled.<sup>6</sup>

<sup>2</sup> Article 17 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

<sup>3</sup> Article 6 and Article 9 of the *Management Rules on the Restriction and Banning of Technology Imports*

<sup>4</sup> Article 9 of the *Management Rules on the Restriction and Banning of Technology Imports*

<sup>5</sup> Article 11 of the *Management Rules on the Restriction and Banning of Technology Imports*

<sup>6</sup> Article 17 of the *Management Rules on the Restriction and Banning of Technology Imports*

Note that where the main content of the technology transfer agreement changes, a new license must be obtained and the above steps must be repeated. Where the technology transfer agreement expires or is terminated, a record of such must be filed with the national Foreign Economic and Trade Bureau (the “FETB”).<sup>7</sup> However, the approving authority for the technology has changed to the *local* CB from the *national* FETB as per the latest *Management Rules on the Restriction and Banning of Technology Imports*. The office is essentially the same, only the name and level of office has changed (this is also true for some other departments of the FETB). A record for termination of expiry of the technology transfer agreement should be filed with the local CB.

All procedures need to be done by the importer of the technology, who in China is the transferee.

#### B. Process for Encouraged Technology

The process here is more straightforward than for restricted technology:

1. Obtaining special approval, if required, from the departments which supervise such technology (or the industry it is contained in);
2. Enter into the technology transfer agreement;
3. Submit the relevant documents to the local CB for confirmation that the technology is encouraged and the subsequent issuance of a registration certificate (note that no technology import license is required for encouraged technology);<sup>8</sup> and
4. Once the certificate is obtained, the relevant foreign exchange, banking, tax and customs procedures must be handled.<sup>9</sup>

Note that the same rules apply for the amendment, termination or expiry of a technology transfer agreement as per the restricted technology above.<sup>10</sup>

<sup>7</sup> Article 21 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

<sup>8</sup> Article 17,18 and 19 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

<sup>9</sup> Article 20 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

<sup>10</sup> Article 21 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

### C. Process of Transfer of Technology into China as an Investment

A foreign investor may use its technology as part of the registered capital contribution regarding the establishment of a foreign invested company in China.<sup>11</sup> Under these circumstances, the import will be subject to another set of rules and restrictions similar to the restrictions on import of technology that is being transferred (rather than used as investment capital).

## IV. Crucial issues for Foreign Entities regarding Technology Transfers into China

The transferors of the technology, which will be the foreign investors owning the technology or otherwise having right to transfer it, will need to adopt proper measures to protect their rights and interests. Listed below are some crucial issues worth considering when entering into a technology transfer agreement with a Chinese entity:

- A. The technology transfer agreement for restricted technologies will not have legal effect until the issuance of the importing license by the CB.<sup>12</sup> As a result, it is advisable not to disclose any important information related to the technology to be transferred until the license is issued to avoid the possible risks that could be incurred where a technology importing license is denied by the CB. If any of the information needs to be transferred, a confidentiality agreement should be executed upon initial negotiations between the transferor and the transferee, with such agreement stating clearly that the obligations contained therein persist even where no transfer or other dealings eventuate between the parties.
- B. Irrespective of their classification under the *Rules of the PRC on the Administration of Technology Imports and Exports*, any technology may be deemed inappropriate to transfer due to certain circumstances. Such decision is to be made by the local CB when the license is being applied for.<sup>13</sup> A technology agreement which illegally monopolizes

<sup>11</sup> Article 22 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

<sup>12</sup> Article 13 of the *Management Rules on the Restriction and Banning of Technology Imports*

<sup>13</sup> Article 12 of the *Rules of the PRC on the Administration of Technology Imports and Exports*

technology, impairs the technological advancement or infringes on the technology of a third party is invalid.<sup>14</sup> Article 10 of the *Interpretations of the Supreme People's Court on issues concerning the Application of Law in Technology Contract Dispute Cases* (“*最高人民法院*关于审理技术合同纠纷案件适用法律若干问题的解释”) provides a clarification on “illegally monopolizes technology” and “impairs technological advancement”, including terms in agreements which:

1. Restrict either party in the carrying out of new research to improve the technology transferred;
2. Request either party to provide the improved technology to the other party free of charge;
3. Restrict either party from obtaining technology similar to, or in competition with, the technology transferred, from a third party;
4. Restrict either party from reasonably utilizing the technology transferred, such as through the placing of restrictions on the quantity, sales channels and/or export markets of the products manufactured with the technology;
5. Request that the transferee accept supplementary conditions which are neither relevant to, nor necessary for the implementation of, the technology, including the purchasing of other technology, raw materials, or other goods and services. Such conditions are referred to in some jurisdictions as “third-line forcing”;
6. Unreasonably restrict the channels from which the transferee purchases supplies or any other products; and
7. Prohibit the transferee from raising objection to the effectiveness of the intellectual property rights of the technology transferred.

### Case study

*Company A is a Chinese company, whilst Company B is a French company. Company A and Company B set up a joint venture company, Company C. Company B transfers its patent rights to Company C. The technology transfer agreement stipulated that Company C shall not distribute its final products, manufactured using the transferred technology, to France. This*

<sup>14</sup> Article 329 of the *Contract Law of the PRC*

*restriction clause is void for a technology transfer agreement under Chinese law. Company B has no right to restrict the sales territory of product manufactured by Company C, and as a result, the technology transfer agreement will not be registered by the CB.*

## **V. How to better protect the Technology**

As described above, there are many 'fair trading' restrictions on the protection of the transferor's technology and its use. However, there are still ways in which the technology can be protected:

- A. Enter into a confidentiality or non-disclosure agreement upon commencement of any negotiations between the parties, as mentioned above;
- B. Check the validity of any technology transfer agreement before it is executed in order to avoid any loss and damages arising out of the fact that the technology transfer agreement is made invalid due to the failure to obtain the technology importation license or due to the including of some clauses breaching the laws and regulations into the agreement;
- C. Obtain any available patent rights in China and over the world for the technology;
- D. Use the correct form of patent transfer. Under Chinese law, there are three (3) types of patent licensing, namely, exclusive licensing, sole licensing and ordinary licensing. The transferor's rights and benefits are different under each license. If the transferor wishes to keep the licensed patent and use the licensed patent to some extent, it is advisable that a sole license agreement or an ordinary license agreement shall be concluded to at least allow the transferor to exploit the patent rights although the patent rights have been transferred to others. An exclusive license restricts the use of the patent to the transferee and does not allow for the transferor to use the technology; and
- E. If the technology can't be patented, it should be made clear in the technology transfer agreement that the unpatented technology is part of the confidential information of the transferor, and the transferee has to bear the obligations to keep it confidential by

entering into a confidentiality or non-disclosure agreement as mentioned above. This can side-step some of the restrictions in the technology transfer agreement relating to the restriction of the transferee's rights such as follows:

1. The technology transfer agreement is not allowed to include clauses restricting the transferee to conduct new research on the technology transferred, which may harm the transferor's rights and benefits. Although the transferee is allowed to conduct new research on the basis of the technology, the use of such technology will be restricted as long as the transferred technology secrets are kept confidential,
2. Although the technology transfer agreement is not allowed to include clauses prohibiting the transferee from raising objection to the effectiveness of the intellectual property rights of the technology transferred, as the transferee has the obligation to keep the technology confidential, the transferee can only raise objection to the effectiveness of the rights where such objection does not contain information relating to the confidential information.

## **VI. Summary**

Technology transfer is taking place everywhere in China. The Chinese government adopts various measures to benefit from the technology transfer while limiting the possible negative effects. The technologies restricted for transfer into China may be transferred in China subject to a series of approval procedure, and the technologies which are encouraged to be transferred into China are subject to registration.

A foreign party wishing to transfer technology into China must be aware of the restrictions and obligations discussed above, and should take note that a confidentiality or non-disclosure agreement should always be entered into in the initial stages of negotiations for such technology transfer. A foreign transferor should also note that the onerous obligations on the provision of technology which appear to favor the transferee are not always concrete and can be subject to such confidentiality or non-disclosure agreement.