

# China's New Technology Import Regs

*Their true value will be revealed with experience, but they appear to be a step forward*

BY ELLEN R. ELIASOPH\*  
and JEROME ALAN COHEN\*\*

The acquisition of advanced foreign technology is the cornerstone of China's program of foreign economic cooperation. Although China also seeks substantial foreign investment and trade, its leaders are well aware that it is ultimately the mastery, application, and popularization of new technology that will enable the country to achieve fundamental improvements in infrastructure, economic efficiency, and living standards. For the majority of foreign companies, technology transfer holds the key to China's potentially vast marketplace. Thus the recently issued "Regulations of the People's Republic of China for the Administration of Technology Import Contracts" (hereafter the "Regulations") provide long-awaited insight into the government's attitudes and objectives in the all-important area of technology transfer.

Overall, the Regulations clearly indicate that China plans to intensify its scrutiny and control over technology transfer, reserving the power to shape the technology transfer process to fit the country's needs. Foreign companies will find many of the Regulation's provisions unsurprising and unobjectionable, reflecting the largely successful Sino-foreign technology transfer experience of the past seven years. Nevertheless, the Regulations also contain more restrictive provisions that may complicate—and thereby lengthen—many negotiations. Whether these restrictive provisions will actually turn away potential business partners will depend upon the manner in which they are interpreted by Chinese negotiators and officials.

The Regulations, issued and put into effect by the State Council on May 24, 1985, govern all transfers of technology to companies, enterprises, organizations, and individuals "within the PRC" from similar entities and individuals "outside of the PRC." It does not matter whether the transaction occurs in the course of trade or

\*Formerly resident Beijing attorney for Paul, Weiss Rifkind, Wharton & Garrison, New York, now firm's resident attorney in Shanghai.

\*\*Partner in Paul, Weiss, supervises China operations from firm's New York and Hong Kong offices. Paper reprinted from the November-December 1985 issue of The China Business Review with permission of The National Council for US-China Trade.

economic and technical cooperation. Transactions subject to the Regulations include the transfer and licensing of patent and other industrial property rights, the transfer of other forms of proprietary technology, and the provision of technical services. Detailed confirmation of the scope of the Regulations is provided by the "Measures for the Examination and Approval of Technology Import Contracts" (hereinafter "Approved Measures,") promulgated on September 18, 1985.

The Regulations govern technology transfer contracts concluded by Chinese-foreign joint ventures, whether they involve the foreign joint-venture partner or a third-party foreign entity or individual. However, since the technology transfer provisions contained in the new Regulations differ in some respects from those outlined in the PRC's previous joint venture legislation, questions of interpretation are likely to arise. It is not yet clear whether the legislation specifically applicable to joint ventures will prevail over the more recent, but more general, Regulations. What is clear, from the Approved Measures, is that contracts under which the foreign investor makes an equity contribution to a joint venture in the form of technology do *not* fall under the approval process for technology import contracts, but are instead to be approved like other joint-venture contracts.

The Regulations *are* intended to govern the acquisition of technology by Chinese-foreign cooperative ventures, whether by licensing contract or, apparently, by capital contribution. However, pending the promulgation of legislation defining the status of such ventures, it is difficult to characterize many of them as either "companies," "enterprises," or "organizations," as contemplated by the wording of the Regulations. As for wholly-owned foreign enterprises established in the PRC, the Approved Measures make clear that their technology import contracts are also subject to the Regulations, even before promulgation of the legislation that is expected to define these as PRC enterprises subject to the jurisdiction and protection of PRC law.

## GUIDELINES FOR FORMULATING CONTRACTS

Articles 3 through 8 of the Regulations help clarify the nature of technology import contracts and should be generally encouraging to foreign technology suppliers. Article 3 of the Regulations provides that technology must be "advanced and appropriate" in order to qualify for importation, and, in addition, must meet one or more of the conditions enumerated in the Article. These conditions seem to apply the fairly workable standard that has existed heretofore.

Articles 5 through 8 of the Regulations set forth guidelines for the contents and scope of technology im-

port contracts. Article 5(c) appears to give the contracting parties full discretion over the manner in which the recipient of technology will compensate the supplier, providing only that the contract must make provision for "remuneration, the form of remuneration, and the means of payment." By contrast, Article 46 of the 1983 "Implementing Regulations of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment" (the "Joint Venture Regulations") requires that fees for the use of technology be "fair and reasonable," states that royalties "shall generally be adopted as the form of payment," and provides guidelines for the setting of royalty rates and calculation of royalty payments. Whether these differences in the two sets of regulations will result in differences in practice between joint ventures and other forms of cooperation remains to be seen.

Article 6 contains the unsurprising requirement that the supplier of technology "guarantee that the technology being provided is complete, free of error, effective, and can achieve the objectives stipulated in the contract." Similar provisions appear in the 1984 "Interim Provisions of the Shenzhen Special Economic Zone for the Import of Technology" (the "Shenzhen Provisions"). Moreover, the Approval Measures require the approval agency to determine "whether the contract has reasonable provisions on the technical standards the transferred technology should attain, including a guarantee of the quality of the products produced using the technology."

Long prior to the existence of relevant legislation, PRC negotiators regularly raised such demands. Obviously, for any given transaction the ultimate scope of such guarantees hinges upon the manner in which the "objectives" are defined in the contract, and upon other contractual stipulations requiring the recipient to apply the technology in a proper manner.

The foreign business community will welcome Article 7's confirmation of the importance of the recipient's contractual obligations of confidentiality. (Curiously, the Article omits any reference to reciprocal obligations on the part of the supplier.) The provisions of Article 8, like the Joint Venture Regulations, allow for a contract term of 10 years in the usual case, but also explicitly offer the possibility of a longer contract. This should encourage foreigners who wish to license their technology in return for long-run royalties and who were unnerved by the Shenzhen Provisions' restriction of contract terms to periods of five years.

## PROBLEMS WITH THE "RESTRICTIVE PROVISIONS"

In contrast to the provisions described above, Article 9 of the Regulations may leave prospective technology suppliers with the impression that in certain respects China's conception of technology transfer is incompatible with their own. The Article lists nine types of restrictive conditions that cannot be included in technology import contracts without special approval. It reads like a checklist of areas in which, right or wrong, PRC legislators believe foreign suppliers of technology have taken advantage of their Chinese partners.

Depending on the transaction, the contracting parties may have sound economic reasons to agree to provision

that fall within Article 9's restrictive categories. Although the Regulations do allow for approval of such provisions on a case-by-case basis, Article 9 establishes a strong legislative presumption that such provisions are undesirable. Thus, a party that deems any such provision essential to its interests must persuade both its negotiating partner and the PRC authorities of its acceptability.

Several of the "restrictive provisions" prohibited by Article 9 are unlikely to provoke dispute since they are clearly unfair. For example, Section 9(i) prohibits "requirements that the recipient pay remuneration for or undertake obligations with respect to patents that are not usable or have become invalid." Certain other restrictions prohibited by Article 9, such as restricting the recipient's continued use of the technology following expiration of the contract term, are invariably rejected by PRC negotiators, and prohibited by other PRC legislation. It is therefore not surprising that they appear on the prohibited list in the Regulations.

Unfortunately, not all the restrictive provisions are so clear-cut. Characterization of the following as restrictive terms will in all likelihood give rise to serious concern among prospective suppliers of technology:

1. Section 9(a) of the Regulations prohibits "requirements that the recipient accept supplemental conditions unrelated to the import of technology, including the purchase of unnecessary technology, technical services, raw materials, equipment, or products." This broad wording raises the risk of arbitrary interpretation.

It is generally not possible for a supplier of technology to fulfill contractual guarantees that the technology "can achieve the objectives stipulated in the contract" unless the recipient agrees to master the necessary technology, accept certain technical services, and use appropriate raw materials and equipment in the course of applying the technology. Very often the supplier will require the recipient to purchase such additional services and material. In recognition of these practices, only sales of "unnecessary" technology, services, and materials are prohibited — but who is to judge what is necessary? The wording of this section will certainly increase the pressure on PRC negotiators to purchase the absolute minimum required. And can it be assumed that, once the contracting parties have agreed on the technology required, the approval authorities will accept their judgment? If not, the submission of a signed contract to the authorities could be followed by a second round of negotiations in which the foreign party must again present its case.

2. Section 9(b) of the Regulations, which prohibits "restrictions on the recipient's freedom to choose to purchase raw materials, spare parts, or equipment from different sources," is evidently designed, like the previous one, to discourage the common practice of linking technology transfer to sales.

Since the prospect of securing orders of spare parts and proprietary products has frequently been a strong incentive for foreign suppliers to enter into licensing arrangements in China, strict interpretation of this provision could inhibit the growth of the PRC's licensing trade. In addition, if suppliers of technology have no say in the choice of the raw materials or equipment used in applying the technology, they will inevitably restrict their performance guarantees accordingly. Trademark licensing will also be affected, as licensors unable to exercise effective

quality control will refuse to put their reputations at risk.

3. Section 9(c) prohibits "restrictions on the recipient's development and improvement of the imported technology." Although suppliers of technology may not find this section objectionable in and of itself, they may be more concerned upon reading it in conjunction with Section 9(d), which prohibits "restrictions on the recipient's acquisition from other sources of technology similar to that imported or technology of the same type that is competitive with it."

A technology supplier hoping to form a relationship with a PRC partner, establish a sound reputation for its technology, and gain a foothold in the PRC marketplace can hardly be expected to want its partner cooperating with its competitors, purchasing their technology, experimenting with the technology acquired from different sources, and even competing directly with the supplier. Read together, Sections 9(c) and (d) could constitute a rebuff to foreigners' hopes of using technology transfer as a means of competing effectively in China's domestic market.

4. Section 9(f) of the Regulations prohibits "restrictions on the volume, varieties, or sales prices of the products produced by the recipient using the imported technology," and Section 9(g) prohibits "unreasonable restrictions on the recipient's sales channels or export markets." While these prohibitions were included in earlier legislation and therefore come as no surprise, they differ from earlier formulations in an instructive manner.

Article 42(2) of the 1983 Joint Venture Regulations provides that "unless otherwise agreed upon by both parties, the technology exporter must not restrict the regions, quantities, and prices of the technology importer's export of the resulting products." This is a much narrower wording than that of Sections 9(f) and (g) of the new Regulations; it does not prohibit restrictions on the "varieties" of the products manufactured; nor does it prohibit restrictions on the volume and prices of products produced for the PRC domestic market.

Most important, in the Joint Venture Regulations the entire provisions is qualified by the phrase "unless otherwise agreed upon by both parties." The Regulations contain no such statement, thereby leaving the approval authorities with the power of ultimate decision. The denial of the right to stipulate which "varieties" of products can be manufactured is disturbing: how can a supplier of technology give performance guarantees without knowing what types of products will be produced? The lack of control over sales prices makes it difficult for a foreign supplier of technology to implement a pricing strategy for entry into the domestic market, even though its royalty may be linked to the sales price. Moreover, combined with the inability to "unreasonably" restrict export markets, this raises a real prospect of competition with PRC licensees for overseas markets, something that many foreign companies may not be prepared to risk.

Article 9 of the Regulations, then, places significant obstacles in the way of a supplier of technology who wishes to maintain control over the recipient's application of the technology and marketing of the resulting products. But at this early stage it is difficult to assess whether Article 9 is intended to mark a departure from past practice, or whether it is merely intended to compel PRC agencies to tighten their scrutiny of technology import contracts.

If in fact PRC approval agencies will rarely grant the "special approvals" required for inclusion of the so-called "restrictive terms" in contracts, then the effect of the Regulations will be to alter PRC technology transfer practice in a significant way. For example, until now it has been fairly common in PRC licensing transactions for licensees to commit to purchasing production materials and equipment from licensors. In addition, licensors have occasionally obtained the right to inspect and reject raw materials being used in the production process. It has also been possible to limit PRC licensees' export markets, either by designating certain countries and regions as off-limits or by explicitly granting export rights to a restricted group of countries. The extent to which the new Regulations will make it difficult, if not impossible, for technology suppliers to obtain such contractual protection awaits clarification through practice.

Article 4 of the Regulations outlines the process for obtaining approval of a signed technology import contract, and the Approved Measures offer details. Prospective suppliers of technology should bear in mind that the contract "approval" process actually begins before the contract negotiations, at the time of initial project approval. At this stage the PRC entity is officially authorized, on the basis of an approved project feasibility study or its equivalent, to commence contract negotiations. The Approval Measures confirm that this preliminary project authorization will continue to be the critical first step in the approval process for all PRC technology import contracts. The proper source for project authorization may be the national ministry having jurisdiction over the PRC participant, the relevant bureau directly under the State Council, the State Planning Commission, or the planning commission under the county, municipality, special economic zone, or province in which the project will be located, depending upon factors such as the scope and value of the proposed project.

Article 4 of the Regulations requires that the contract be submitted for final approval within 30 days of being signed by the contracting parties. The contract must be accompanied by the documents listed in Article 10 of the Regulations. The contract is submitted to the appropriate "examination and approval authority," i.e., MOFERT, its subordinate agencies, or another agency that MOFERT has authorized to examine and approve the contract—the Approval Measures provide details. The approving agency must decide within 60 days of receipt of the application whether or not to approve the contract. An approved contract becomes effective on the day of approval; however, if the approving agency fails to make a decision within the prescribed 60-day period, the contract is deemed approved and automatically enters into effect.

Article 4 is basically clear and simple, but this last provision allowing for "automatic effectiveness" raises an important question: what will be the legal effect of any "restrictive terms" prohibited by Article 9 that appear in a contract entering into effect because of the approving agency's failure to take action? One might be tempted to assume that, if a contract enters into effect automatically, it becomes effective in its entirety. However, Article 9 states that "without special approval by the examination and approval authority" such restrictive terms are illegal. In the case of automatic effectiveness, no "special approval" has affirmatively been granted. Should it therefore be assumed that the restrictive terms are null and

void, and not binding on the parties to the contract? Until this question is answered definitively, a contract that has become effective "automatically" will be a legal document of uncertain value.

The Approval Measures raise even greater doubts about "automatic effectiveness." They make no mention of the possibility that a contract can become effective without actual approval and they require the approval agency to issue a certificate for each approved contract. Finally, they state that a copy of this certificate must be provided when "such matters as bank guarantees, letters of credit, payments, foreign exchange settlements,

customs clearances, tax payments, or applications for tax reduction or exemption are handled." If the certificate is not produced, the relevant authorities are authorized to refuse to process the matter.

Although China's new technology transfer regulations do not seem as hospitable to foreign economic cooperation as the "Law of the People's Republic of China on Economic Contracts Involving Foreign Interests" promulgated earlier this year, they are a step forward when compared to at least one of their forerunners, the Shenzhen Provisions. Only actual practice, however, will determine their true significance.

## REGULATIONS OF THE PEOPLE'S REPUBLIC OF CHINA FOR THE ADMINISTRATION OF TECHNOLOGY IMPORT CONTRACTS\*

**Article 1.** These Regulations are formulated in order to further expand economic and technical cooperation with foreigners, raise the level of our country's science and technology, and promote the development of the national economy.

**Article 2.** The import of technology provided for in these Regulations refers to the acquisition of technology by companies, enterprises, organizations, or individuals within the People's Republic of China (hereafter referred to as "recipients") from companies, enterprises, organizations, or individuals outside of the People's Republic of China (hereafter referred to as "suppliers") through the channels of trade or economic and technical cooperation, including: (a) the transfer or license of patent rights or other industrial property rights; (b) proprietary technology in such areas as technological processes, formulae, product design, quality control, and management provided in such forms as drawings, technical documentation, and technical norms; and (c) technical services.

**Article 3.** Imported technology must be advanced and appropriate and shall meet one or more of the following requirements: (a) be able to develop and produce new products; (b) be able to raise the quality and performance of products, lower production costs, and conserve energy or materials; (c) further the full utilization of this country's natural resources; (d) be able to expand product exports and increase foreign exchange revenue; (e) further environmental protection; (f) further safety in production; (g) further the improvement of management and administration; (h) assist in raising the level of science and technology.

**Article 4.** The recipient and the supplier must sign a written technology import contract (hereafter referred to as a "contract"), and the recipient shall, within 30 days of signature, submit an application to the Ministry of Foreign Economic Relations and Trade of the People's Republic of China or another authority authorized by the Ministry of Foreign Economic Relations and Trade (hereafter referred to as the "examination and approval authority") for examination and approval. The examination and approval authority shall, within 60 days of receiving the application, decide whether or not to approve it; an approved contract shall come into force from the date of approval. If the examination and approval authority has not made a decision within the stipulated examination and approval period, a contract shall be regarded as having been approved, and shall automatically come into force.

**Article 5.** In signing technology import contracts, the Law of the People's Republic of China on Economic Contracts Involving Foreign Interests and the relevant provisions of other laws shall be observed.

The parties shall make clear provision in contracts for the following matters: (a) the contents, scope, and the necessary explanation of the technology to be imported; when patents and trademarks are involved a list shall be attached; (b) the expected technical objectives to be achieved and the time periods and measures for realizing each of such objectives; (c) the remunera-

tion, the form of remuneration, and the means of payment.

**Article 6.** The supplier shall guarantee that it is the lawful owner of the technology being provided and shall guarantee that the technology being provided is complete, free of error, effective, and can achieve the objectives stipulated in the contract.

**Article 7.** The recipient shall, in accordance with the scope and the time period agreed upon by the parties, undertake the obligation to maintain the confidentiality of the confidential portion of the technology being provided by the supplier that has not yet been made public.

**Article 8.** The term of a contract shall correspond to the time that is adequate for the recipient to master the technology being imported and, without special approval of the examination and approval authority, may not exceed 10 years.

**Article 9.** The supplier may not compel the recipient to accept unreasonable requirements of a restrictive nature; without special approval of the examination and approval authority, a contract may not contain the following provisions of a restrictive nature: (a) requirements that the recipient accept supplemental conditions unrelated to the import of the technology, including the purchase of unnecessary technology, technical services, raw materials, equipment, or products; (b) restrictions on the recipient's freedom to choose to purchase raw materials, spare parts, or equipment from different sources; (c) restrictions on the recipient's development and improvement of the imported technology; (d) restrictions on the recipient's acquisition from other sources of technology similar to that imported or technology of the same type that is competitive with it; (e) unequal conditions for the parties' exchange of technical improvements; (f) restrictions on the volume, varieties, or sales prices of the products produced by the recipient using the imported technology; (g) unreasonable restrictions on the recipient's sales channels or export markets; (h) prohibitions of the recipient's continued use of the imported technology following the expiration of the contract term; and (i) requirements that the recipient pay remuneration for or undertake obligations with respect to patents that are not usable or have become invalid.

**Article 10.** When submitting a contract for approval, the following documents must be submitted: (a) an application for approval; (b) a copy of the contract and the text of the translation of the contract; (c) documents evidencing the legal status of the contracting parties.

**Article 11.** Modifications of a contract or extensions of the contract term shall all be handled with reference to the provisions of Articles 4 and 10 of these Regulations.

**Article 12.** The Ministry of Foreign Economic Relations and Trade shall be responsible for interpreting these Regulations; the Ministry of Foreign Economic Relations and Trade shall formulate implementing rules.

**Article 13.** These Regulations shall go into effect from the date of their promulgation.

\*These regulations were issued by the State Council on May 24, 1985. Translated by Paul, Weiss, Rifkind, Wharton & Garrison.