PRC Regulations on Import Contracts

Administration of technology transfer import contracts is discussed; practice reflects standard practice

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Since the end of the 1970s, the government of the People's Republic of China increasingly realized the importance of technology transfer from abroad. The policy of readjustment of 1980-81 led to the insight that the acquisition of foreign technology and know-how for the production of such things as machinery and equipment may in the end be cheaper than buying the hardware and thus save foreign exchange. The business of transferring technology and know-how to the PRC now definitely shows a decisive upward trend.[1]

Although technology transfer and license agreements with the PRC sometimes follow international practice, in recent years some peculiarities typical for such agreements with Chinese partners developed. They show that the Chinese often try to interpret the oft-quoted principle of "equality and mutual benefit"[2] to their advantage. the long-awaited "Regulations of the People's Republic of China on the Administration of Technology Import Contracts" as the first law directly addressing technology transfer[3] is therefore of great interest to the practitioner.

The Regulations, promulgated by the State council on May 24, 1985, and according to their Article 13 effective as of that date, aim to expand economic and technical cooperation with other countries and to upgrade the scientific and technological standard of the PRC in order to promote the national economy's growth (Article 1). In view of these aims, it is not surprising that the responsibility not only for their interpretation, but also for formulating detailed rules[4] for their implementation, rests with the Ministry of Foreign Economic Relations and Trade ("MOFERT") (Article 12).

The Regulations address only questions typically related to technology transfer contracts with foreign technology suppliers. For other questions their Article 5 refers to the Foreign Economic Contracts Law ("FECL") and "other relevant laws" of the PRC. As the FECL contains no provisions, which in civil law countries would be part of the "general law of obligations" (such as provisions regarding the formation of contracts, agency, error, time limits, time and place of performance, warranties), the future Civil Code, still in the drafting stage, will have considerable importance in this respect.

The following overview follows the sequence of the provisions of the Regulations.

SUBJECT MATTER OF REGULATIONS

The Regulations do not cover the transfer of technology in general, but only technology *import* into the PRC, i.e. the acquisition of technology by corporations, enterprises, other organizations and individuals within the territory of the PRC ("Recipients") from corporations, enterprises, other organizations or individuals outside the PRC ("Suppliers") through trade or economic and technological cooperation. By way of example, Article 2 lists:

- Acquisition or licensing of patents or other industrial property rights.
- Supply of technical know-how in the form of drawings, technical documents and specifications, such as process specifications, formulae, product design, quality control and management skills.
- Supply of technical services.

Negotiations of licensing and know-how agreements with Chinese partners are often hampered by lack of understanding for intellectual property rights and know-how and that licensors view each form of intellectual property transferred as a basis for an increment of consideration. The list in Article 2 is remarkable. It signifies that (at least) the legislature now seems to have the right perspective. In this context, the fact that the PRC now has a trademark law,[5] a patent law,[6] and has acceded to the Paris Convention for the Protection of Industrial Property on March 19, 1985, may be of significance.

REQUIREMENTS FOR TECHNOLOGY TRANSFERRED

In conformity with standard contract practice in the PRC and the provisions of other legislation,[7] the technology to be acquired must not only be "advanced" and "appropriate," but must (also) enable one or more of the following:

- The development and production of new products.[8]
- The improvement of the quality and function of products or reduction of (production) costs or savings in energy or raw materials.
- Maximum utilization of local resources.
- The expansion of export[9] of products and an increase of earnings of foreign exchange.
- The improvement of environmental protection.
- The improvement of safety in production.
- The improvement of management.
- The advancement of the scientific and technological standard.

Compliance with any of these requirements suffices (Article 3).

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In view of Article 44[10] of the "Implementing Regulations" to the Joint Venture Law and of the aims of the Regulations considered here as set forth in their Article 1,[11] it is likely that the requirements of the technology being "advance" and "appropriate" will be met, if "marked social and economic results" are achieved domestically or "competitive capacity in the international market" is enhanced—so the language of said Article 44—and that the Implementing Rules envisaged by Article 12 will use language to that effect.

FORM AND APPROVAL OF CONTRACT

The contract for the transfer of technology must be in writing and be submitted by the recipient within 30 days from the date of signature to the MOFERT or other agencies duly authorized by it ("Approving Authority"—Article 4) together with an appropriate application for approval, a copy of the contract with a Chinese translation and documents evidencing the legal status of the parties to the contract (Article 10).

The Approving Authority shall approve the contract or deny approval within 60 days from the date of receipt of the application. If no decision is made within that period, the contract shall be deemed as having been approved and becomes effective automatically (Article 4). The procedure set forth in Articles 4 and 10 must also be observed for any revision or renewal of the term of the contract (Article 11).

REQUIREMENTS AS TO CONTENT OF CONTRACT

In recent years the PRC has negotiated so many technology and licensing agreements that the Chinese are well familiar with the usual contents of such agreements. The Regulations do not deviate in this respect from international practice:

The contract must comply with the relevant provisions of the Foreign Economic Contract Law[12]—its Article 12 gives provisions generally to be included in foreign economic contracts—and other relevant laws of the PRC. The contract must also set forth:

- The content, scope and the requisite description of the technology to be acquired[13] and a list of patents and trademarks, if such are involved.
- The technical ends to be achieved and the steps to be taken and the time limit for the achievement of such ends.
- The remuneration, the "composition" of remuneration[14] and methods of payment (Article 5).

GUARANTEES

The supplier must guarantee that it is the "legitimate owner" of the technology transferred and that it is correct, complete, effective and capable of achieving the technical ends as specified in the contract (Article 6).

The requirement of a guarantee of "legitimate ownership" seems to cover the question of the supplier's liability for infringement of third parties' rights. The other guarantee required reflects standard contract practice.

CONFIDENTIALITY REQUIREMENT

A point of major concern in every technology transaction is the problem of protecting proprietary information. Article 7 provides in this respect that the recipient shall undertake to keep confidential the technology transferred according to the terms and time limits agreed upon by the parties.

In this connection it must be kept in mind that in the PRC, as in the state economy countries of the Eastern bloc, the contractual partner of the supplier of technology is not the end-user of the technology, but a foreign trade organization (FOT),[15] which acts in close cooperation with the end-user. Its negotiators often resist attempts to limit disclosure to the end-user. Recently, however, FOT's and end-users seem to be more willing to limit disclosure or use of the "licensed" know-how, e.g. to a named plant or factory. The language of Article 7 seems to permit such limitations.

DURATION OF CONTRACT

Chinese licencees have been reluctant to enter into agreements that obligate them to make payments over long periods of time. A period of five years has been common, although longer periods are possible.

Now Article 8 provides that the term of the contract shall be as long as the recipient needs to absorb the technology transferred, but not longer than 10 years[16] without a special permit by the approving authority. The requirement of a special permit for contracts with a term of more than 10 years seems to preclude for such contracts the possibility of a contract being deemed as having been approved by the approving authority not having made a decision within 60 days (Article 4).[17]

UNFAIR CONDITIONS

In a general statement, Article 9 requires the supplier not to compel the recipient to accept unfair restrictive conditions.[18] It then lists nine restrictive provisions, which may not be included in the contract without a special permit from the approving authority.[19] This requirement seems to preclude the possibility of regarding a contract as having been approved by the approving authority not having made a decision within 60 days (Article 4), if a contract contains any of the following provisions listed in Article 9, i.e. provisions:

- Requiring the recipient to accept additional conditions irrelevant to the technology acquired, such as requiring the recipient to pay for technology, technical services, raw materials, equipment or products not needed by the recipient.
- Restricting the recipient's freedom to obtain raw materials, parts or equipment from other sources.[20]
- Restricting the recipient from developing and improving the technology acquired.
- Restricting the recipient from acquiring similar or competing technology from other sources.
- Nonreciprocal[21] exchange of improvements of the acquired technology.[22]
- Restricting the volume, variety and the sales price of products manufactured with the acquired technology.[23]
- Unduly restricting the distribution channels and export market of the recipient.
- Restricting the use of the acquired technology by the recipient after the expiration of the contract.[24,25]
- Requiring the recipient to pay for or take on obliga-

tions with respect to patents that will not be used or that have been declared invalid.

This list, which reflects Chinese economic policy, is *grosso modo* familiar to Western lawyers/licensors, because Western antitrust laws often contain partly similar provisions. It will make it even easier for the Chinese to negotiate for more favorable terms respectively less restrictive provisions, because they can now refer to this list as "the law."

CONCLUSION

The substance of the Regulations is not really new, as they reflect standard Chinese contract practice and economic policy. Overall, they fulfill Lubman's hope for "fair, uniform and ascertainable rules."[26]

NOTES

1. For a general discussion of transferring technology and licensing to the PRC see, e.g. *St. Lubman*, Technology Transfer to China: Policies, Law and Practice, in: *M.J. Moser* (ed.), Foreign Trade, Investment and the Law in the People's Republic of China (Oxford-New York-Hong Kong 1984) p. 84-105; *Ch. Kamm*, Practice of Licensing with China, in: *R. Goldscheider & Arnold (ed.)*, The Law and Business of Licensing, Vol. 3, 3 F-13-44 (reprint from *Les Nouvelles*, Volume 15, Number 4).

2. See, e.g. Articles 1 and 6 of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, adopted on 1 July 1979, at the Second Session of the Fifth National People's Congress and promulgated on 8 July 1979. It is supplemented by the Implementing Regulations for the Law of the People's Republic of China on Joint Venture Using Chinese and Foreign Investment, promulgated by the State Council on 20 September 1983, and other pertinent legislation.

See also Article 3 of the Foreign Economic Contracts Law of the People's Republic of China, adopted at the Tenth Session of the Standing Committee of the National People's Congress on 21 March 1985, effective as of 1 July 1985. English translations in China Economic News No. 12 of 1 April 1985, and Business China of 28 March 1985.

3. Articles 5 and 7 of the Joint Venture Law (see supra note 2) and chapters iv and vi of the Implementing Regulations for it (see supra note 2) address technology transfer only in connection with contributions to the capital of, respectively the importation of technology by a joint venture.

4. It seems to become a habit in Chinese legislation to enact very short laws and to refer for more details to future implementing rules: The Joint Venture Law (see supra note 2) contains only 15 articles, the Implementing Regulations (see supra note 2) contain 118 articles; in addition, other pertinent laws were enacted. Article 42 of the Foreign Economic Contracts Law (see supra note 2) refers to future Implementing Rules. See also Article 42 of the Trademark Law, its Implementing Regulations (see infra note 5) and Article 68 of the Patent Law and its Implementing Regulations (see infra note 6).

5. Trademark Law of the People's Republic of China, adopted at the 24th Session of the Standing Committee of the Fifth National People's Congress on 23 August 1982, and Detailed Regulations for the Implementation of the Trademark Law of the People's Republic of China, promulgated by the State Council on 10 March 1983.

6. Patent law of the People's Republic of China, adopted at the Fourth Session of the Standing Committee of the Sixth National People's Congress on 12 March 1984, and Implementing Regulations of the Patent Law of the People's Republic of China, approved by the State Council and promulgated by the Patent Office of the People's Republic of China on 19 January 1985.

7. Cf. Article 5 of the Joint Venture Law (see supra note 2), providing that the "technology .... contributed by a foreign participant (in a joint venture) as investment shall be truly *advanced and appropriate* to China's needs" (emphasis added). Its Article 7 provides for tax advantages, if "up-to-date technology by world standards is contributed."

8. Similar requirements are contained in respect of "industrial property rights or proprietory technology contributed by foreign participants in a joint venture on capital contributions" in Article 28 of the Implementing Regulations for the Joint Venture Law (see supra note 2).

9. In many cases the Chinese want the supplier to undertake the obligation to export—or at least assist in the export—of the products manufactured under the technology/know-how transferred (licensed).

10. "Technology imported by joint ventures shall be appropriate and advanced, enabling the resulting products to display marked social and economic results domestically or to have capacity on the international market."

11. Expansion of China's international economic and technological cooperation, upgrading of its scientific and technological standard, promotion of its economic growth.

12. See supra note 2 and text at the end of paragraph 1.

13. The supplier can expect the recipient to define as broadly as possible the scope of the contract and the technical documentation which the supplier is expected to deliver.

14. Regarding the supplier's remuneration, the Chinese more and more try to reach agreements providing not for payment of lump sums or royalties, but for compensation by delivering products manufactured in China (with the technology transferred), buy-back obligations of the supplier or other forms of countertrade, in order to alleviate the burden on their foreign exchange reserves.

15. E.g. the China National Technical Import Corporation (CNTIC) and the China National Machinery Import and Export Corporation (MACH-IMPEX).

16. Similarly Article 46 paragraph 3 of the Implementing Regulations for the Joint Venture Law (see supra note 2).

17. See supra at paragraph 4.

18. Similarly Article 46 paragraph 7 of the Joint Venture Law (see supra note 2).

19. Cf. supra at paragraph 4.

20. Similarly Article 46 paragraph 6 of the Joint Venture Law (see supra note 2).

21. As Article 9 is to protect the recipient in the author's opinion this obviously applies only to a provision unilaterally favoring the supplier respectively unilaterally obligating the recipient. This interpretation is supported by Chinese contract practice.

22. Similarly, Article 46 paragraph 5 of the Joint Venture Law (see supra paragraph 2).

23. Similarly, Article 46 paragraph 2 of the Joint Venture Law (see supra paragraph 2).

24. Similarly, Article 46 paragraph 4 of the Joint Venture Law (see supra paragraph 2).

25. This provision reflects the Chinese attitude toward technology transfer: They feel it is (or at least, should) not be limited in time under a licensee, but practically be a sales transaction conferring the right to use the technology indefinitely. This attitude is reflected in the language of Chinese standard contracts which provide for such a right even if the word "license" is used and usually prefer language such as "technology (know-how) transfer." Chapter VI of the Implementing Regulations to the Joint Venture Law (see supra note 2) uses language such as "importation," "transfer" or "acquisition" of technology.

26. See *Lubman* (supra note 1) p. 102.