REGULATION OF TECHNOLOGY IMPORT: CHINA

This note provides an overview of Chinese laws and regulations concerning the import of technology into China. It discusses the 2019 revocation of some of the more offensive provisions of the Technology Import and Export Regulations (TIER) and discusses the lingering effects of the revoked provisions. The note provides practical and up-to-date advice to foreign companies seeking the import of technology into China.

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SCOPE OF THIS NOTE

Despite being both lawful and commonplace to choose foreign governing law and foreign forum in a technology import contract entered into between a foreign transferor and a Chinese transferee, it is impracticable for the foreign party to the contract to avoid the Chinese court when it seeks to enforce against the Chinese counterparty. As the Chinese court is virtually inevitable where enforcement is sought against the Chinese transferee, so is the application of mandatory Chinese law.

This note provides an overview of Chinese laws and regulations concerning the import of technology into China. It focuses on the details that one should be familiar with to competently draft a technology import contract for

the Chinese market. The note also discusses the 2019 revocation of some of the more offensive provisions of the ***Technology Import and Export Regulations 2001*** (TIER) and discusses the lingering effects of the revoked provisions.

The note provides practical and up-to-date advice to foreign companies seeking the import of technology into China. Accordingly, the note expresses views and provides suggestions almost exclusively from the perspective of the foreign technology transferor. The same views and suggestions may prove unhelpful, or even counterproductive, while preparing a draft contract for the Chinese importer in a technology import transaction.

WHY CHINESE LAW MATTERS FOR TECHNOLOGY IMPORT

A good understanding of the relevant Chinese legislation is crucial to the success of any technology import into China, even though these transactions can be, and often are, governed by foreign laws that the parties to the transactions choose.

Foreign law and foreign forum: a prevalent choice

Parties to technology import transactions are free to choose foreign governing law and foreign forum, and they often do.

In any technology import, there must be a domestic importer (that is, the transferee) and a foreign transferor. Because of the presence of a foreign party, any contract governing technology import meets the definition of "foreign-related contract" (涉外合同) under Chinese law.

There is no official definition for the phrase "foreign-related contract" as used in Article 126 of the ***Contract Law 1999*** (1999 Contract Law) or Article 145 of the ***General Principles of Civil Law 1986*** (1986 Civil Law Principles). However, support can be found in a number of legal authorities for a general consensus in practice that any contract to which there is at least one foreign party is "foreign related". See for example:

- The ***Interpretations I Regarding Several Issues in the Application of the PRC Law on the Application of Laws to Foreign-Related Civil Relationships 2012*** (2012 Foreign-Related Civil Relations Interpretation) allow Chinese courts to find any civil relationship to be foreign-related, provided, among other things, one or both parties to the relationship are foreign citizens, foreign legal persons or other organisations, or stateless persons (*Article 1*).
- The ***Provisional Opinions on Several Issues Concerning the Thorough Implementation and Enforcement of the General Principles of the Civil Law 1988*** define "foreign-related civil relationships" to be, among other things, civil relationships in which one or both parties are foreign persons, stateless persons, or foreign legal persons (*Article 178*).

According to Chinese conflict-of-laws rules, foreign-related contracts may be governed by any foreign law chosen by the parties (*Article 126, 1999 Contract Law, Articles 41 and 49,* ***Law on the Application of Laws to Foreign-Related Civil Relationships 2010*** (2010 Foreign-related Civil Relations Law) and *Article 145, 1986 Civil Law Principles*). (See also ***Practice note, Choice of governing law in China-related contracts: Foreign-related contracts: basic rule***.)

Additionally, Chinese law generally honours any choice of foreign forum in a technology import agreement, also because it is a foreign-related contract (*Article 271,* ***Civil Procedure Law 2017*** (2017 Civil Procedure Law) and *Article 531,* ***Interpretation Regarding the Application of the Civil Procedure Law 2015***).

It is not unusual to come across technology import contracts wherein the parties choose a foreign governing law and a foreign forum, although it is difficult to find exact figures on the prevalence of such choices. According to the ***Practical Law China Governing Law Survey 2014***, only 31% of the Chinese cross-border IP and IT contracts surveyed are governed by Chinese law and more than half of such contracts choose one type of common law or another (21% New York, 19% Other (including California), 17% Hong Kong, 10% England and Wales, and 2% Australian). Presumably, most technology import contracts that choose foreign laws also choose foreign forums for dispute resolution.

Chinese court enforcement: eventually inevitable

Notwithstanding the choice of foreign law and foreign forum, Chinese courts are virtually inevitable if the foreign party wants to enforce a technology import contract against the Chinese counterparty in China.

In a typical technology import transaction, the technology importer (the Chinese transferee of the imported technology) tends to be a smaller, domestic business with little or even no assets abroad. Despite any provisions for choice of foreign governing law and foreign forum that it may put into the contract, the foreign technology transferor would eventually have to come to China to enforce the contract against the domestic importer. In any legal action initiated by the foreign party, the most likely way for the technology import contract to end up in a Chinese court is when the foreign party seeks to execute a successful foreign judgment, or enforce a successful foreign arbitral award against the Chinese technology importer in China. This is typically in the Chinese importer's

home court. Once in a Chinese court, the Chinese importer would likely try to challenge the validity of the technology import contract that underlies the foreign judgment or foreign arbitral award finding in favour of the foreign party.

There are other, less probable, but still realistic ways by which the technology import contract could end up, and have its validity challenged, in a Chinese court. For example:

- A third party, bona fide or otherwise, might sue the Chinese technology importer in the Chinese court, claiming that the importer's practice or commercialisation of the imported technology in China infringes the third party's IP rights. In such a case, the defendant importer would probably produce the technology import contract and then seek to join the foreign technology transferor as co-defendant.
- The Chinese importer might be sued in China by its (former) employee-inventor in an inventorship and patent ownership dispute, which could also drag the foreign technology transferor into a Chinese proceeding.

In these examples, neither the choice of foreign governing law nor the choice of foreign forum in the technology import contract would be sufficient to keep the foreign party out of the Chinese court. Irrespective of the legality or prevalence of the choice of foreign law and foreign forum in technology import contracts, for almost all practical purposes, the foreign parties to these contracts cannot avoid Chinese courts.

Mandatory application of Chinese law

Notwithstanding the parties' choice of foreign substantive law, a Chinese court would not honour a choice of foreign law and would apply Chinese law instead of the chosen foreign law on either of the following two statutory grounds:

- Non-compliance with mandatory rules of Chinese law.
- Harm to "social and public interests".

(*Articles 4-5,* ***2010 Foreign-related Civil Relations Law*** and *Article 150,* ***1986 Civil Law Principles***.)

The distinction between these two grounds is unclear, and an interpretation by the Supreme People's Court (SPC) only causes further uncertainty by discussing both "mandatory rules" and "social and public interests" together.

Mandatory rules

In a non-exhaustive list, the SPC identifies the following five areas of law with close ties to "social and public interests" where any Chinese statutory or regulatory provisions should be treated as "mandatory rules":

- The protection of the rights and interests of labourers.
- Food or public health security.
- Environmental security.
- Foreign exchange control and other financial security.
- Anti-monopoly or anti-dumping.

(*Article 10,* ***2012 Foreign-Related Civil Relations Interpretation***.)

None of these areas appear to encompass technology import, therefore leaving the question of whether technology import is subject to "mandatory rules" unresolved. However, a more conservative conventional view maintains that Chinese regulations on technology import are nonetheless mandatory rules. See also ***Consequences of violating mandatory rules***.

Social and public interests

The concept of "social and public interests" is less relevant to technology import than "mandatory rules", though it is even more ill-defined. It is muddled up with "mandatory rules" by even the SPC and the phrase "social and public interests" is also often used interchangeably with "public policy". Although it is used in a wide variety of statues, "social and public interests" has no official legal definition.

Despite the conceptual ambiguities, the phrase "social and public interests" works as one of the grounds for denying recognition and execution of foreign court judgments, or denying enforcement of domestic and foreign arbitral awards (*Articles 237, 274 and 282,* ***2017 Civil Procedure Law***), or for revoking domestic arbitral awards (*Article 58,* ***Arbitration Law 2017***).

To date, there has been a drastic difference in how the phrase "social and public interests" is interpreted by Chinese courts in the enforcement of domestic verses foreign arbitral awards.

In the domestic context, there are many cases in which the Chinese court revokes, or denies enforcement of, a variety of arbitral awards on that ground. See for example:

- ***Hainan Yixing Urban Construction v Zhongchengjian Sixth Engineering Bureau Group*** [2015] (Haikou Intermediate People's Court) (revoking domestic arbitral award for violating social and public interests).
- ***Wuhan Chaofan Logistics (Ezhou) v CCCC Second Navigation Engineering Bureau*** [2015] (Wuhan Intermediate People's Court) (revoking domestic arbitral award for violating social and public interests).
- ***Shenzhen Rongxinbao Non-Financing v Xie*** [2019] (Shanwei Intermediate People's Court) (denying enforcement of domestic arbitral award for violating social and public interests).

Some legal commentators view these cases as evidence of widespread abuse of the doctrine.

With respect to the recognition and enforcement of foreign arbitral awards, however, Chinese courts have generally relied on social and public interests or public policy much less frequently. This is mainly due to a formal internal reporting mechanism whereby the lower court hearing these cases should seek advisory opinions from the SPC (***Notice on the Handling of Issues Concerning Foreign-Related Arbitration and Foreign Arbitration by People's Courts 1995***).

Although there has been no direct precedent on technology import, in numerous cases regarding other types of international transactions, the SPC has overruled invocations of "social and public interests" or public policy against enforcement of foreign arbitral awards and urged for more judicious application of such a doctrine only as a last resort. See for example:

- *Reply Concerning the Request by Western Bulk Pte Ltd for Recognition and Enforcement of the British Arbitral Award 2012* (关于韦斯顿瓦克公司申请承认与执行英国仲裁裁决案的请示的复函) ("Only when the recognition and enforcement of foreign commercial arbitral awards will lead to violations of the basic principles of our country's laws, violations of our national sovereignty, endangering national and social public security, violations of moral rules and other situations that endanger China's fundamental social public interests, can we deny recognition and execution for public policy reasons.").
- *Reply to the Request for Instructions on Non-Recognition of No. 07-11 (Tokyo) Arbitral Award of the Japan Commercial Arbitration Association 2010* (关于不予承认日本商事仲裁协会东京07-11号仲裁裁决一案的请示的复函) ("The issue of public policy should be limited to situations where recognition of arbitral award would violate our basic legal system and undermine the fundamental social interests of our country. If there are other grounds for denying recognition in the case, it would not be appropriate to apply the doctrine of public policy to deny recognition of the arbitral award.").

For technology import contracts (which are necessarily foreign-related) there is a real possibility that the Chinese defendant may cite "social and public interests" to resist the enforcement of foreign arbitral award or judgment and to force the application of Chinese law. However, arguments based on "social and public interests" will likely be unpersuasive in the Chinese court against a foreign plaintiff.

By contrast, the application of "mandatory rules" of Chinese law to technology import contracts is a larger and more realistic risk to the foreign party whose technology import contract comes under the scrutiny of a Chinese court. (See ***Mandatory rules.***)

HOW CHINESE LAW DEFINES TECHNOLOGY IMPORT

The definition of "technology import" is given in a controversial piece of Chinese legislation known as ***TIER***, which was last amended in March 2019:

> "The technology import and export as referred to in these Regulations refers to acts of transferring technology from outside the territory of the People's Republic of China into the territory of the People's Republic of China or vice versa by way of trade, investment, or economic and technical cooperation.
>
> The activities stipulated in the previous paragraph include assignment of the patent right or right to apply for patents, licensing for patent exploitation, assignment of technical secrets, technical services and transfer of technology by other means."

This definition is open to broad interpretation. Almost all forms of technological IP transactions between a Chinese party and a foreign party can fall within its scope. Under the definition, technology import is not concerned with the import of any tangible products or goods made using technology, but with the transfer of intangible IP to that technology.

TIER: legislative background

TIER was promulgated on 10 December 2001 and came into effect on 1 January 2002. It is a set of administrative regulations enacted by the State Council (that is, the executive branch of the Chinese government) not a statute passed by the Chinese legislature, the National People's Congress (NPC) or its Standing Committee. TIER superseded earlier Chinese regulations on technology import, including the *Technology Import Contract*

Administration Regulations 1985 (技术引进合同管理条例) and the *Implementation Rules for the Technology Import Contract Administration Regulations 1988* (技术引进合同管理条例施行细则) (*Article 55, TIER*).

TIER provided for several mandatory requirements which, generally speaking, protect the interests of the Chinese party to cross-border technology transactions (see ***What Chinese law mandates on technology import contracts***). Some of the TIER provisions have since been revoked (see ***Lingering effects of revoked regulatory provisions***).

Ever since its rollout and China's accession to the World Trade Organisation (WTO), TIER has been the target of much criticism from both foreign businesses and governments. For instance, in 2003, Japan raised questions to China's Permanent Mission at the WTO concerning the discriminatory nature of Article 24 of TIER. In 2018, both the US and the EU launched WTO cases against China citing TIER as a violation of China's treaty obligations.

However, in the 17 years after TIER's rollout, there is little published case law on TIER. This lack of precedents causes uncertainty about how a Chinese court might rule on technology import disputes and apply TIER. More importantly, despite (or perhaps because) of this lack of precedents, TIER has likely had a disproportionately large impact on the technology licensing practice of foreign businesses in China.

On 15 March 2019, the NPC enacted the ***Foreign Investment Law 2019*** (2019 FIL), which will come into force on 1 January 2020. The 2019 FIL includes a single provision prohibiting any executive government body or official from forcing foreign investors to hand over technology (*Article 22*) (see ***Legal update, China enacts unified Foreign Investment Law: Investment protection***).

On 18 March 2019, the State Council announced the revocation of some of the more offensive provisions of TIER (*Article 38,* ***State Council Decision on the Amendment of Certain Administrative Regulations 2019*** (2019 Amendments)), although they may still have some lingering effects (see ***Lingering effects of revoked regulatory provisions***).

Relevant terminology in other legislation

In addition to ***TIER's*** definition, several other terms in other Chinese legislation also apply to technology import into China. These include:

- **"Technology contracts" (技术合同).** A technology contract is a contract made by the parties to define their mutual rights and obligations for technology development, transfer, consultation or service (*Article 322,* ***1999 Contract Law***).
- **"Technology transfer contracts" (技术转让合同).** Technology transfer contracts include contracts for the transfer of patent rights, patent application rights, technical secrets and patent exploitation licences (*Article 342, 1999 Contract Law*).

Therefore, in addition to TIER, technology import contracts are also subject to certain provisions of the 1999 Contract Law on technology contracts and technology transfer contracts.

Additionally, the ***Implementation Regulations of the Sino-Foreign Joint Venture Law 2001*** (2001 EJV Regulations) use its own terminology, such as "imported technology" (引进技术) and "technology transfer agreements" (技术转让协议) (*Articles 40-43*). But these regulations only apply to onshore joint ventures set up within China (see ***Special rules for onshore joint ventures***).

WHAT CHINESE LAW MANDATES ON TECHNOLOGY IMPORT CONTRACTS

This section focuses on the essential details that one should be familiar with to competently draft a technology import contract for the Chinese market. The details of Chinese law that are discussed below are selected primarily based on how particular they are to Chinese law and how much they differ from the laws of other jurisdictions. These peculiarities are likely unexpected by the average common-law lawyer who is familiar with the technology licensing practice of another jurisdiction. Features of technology contract drafting that may be common to both Chinese law and foreign laws are omitted.

Prohibition against illegal monopoly of technology and obstruction of technological advancement

According to the ***1999 Contract Law***:

- Technology contracts that illegally monopolize technology, obstruct technological advancement or infringe the technical achievements of others is invalid (*Article 329*).
- The conclusion of a technology contract must be beneficial to scientific and technological progress, and must accelerate the transformation, application and dissemination of the fruits of scientific and technological endeavors (*Article 323*).
- Technology transfer contracts may not restrict technological competition or technological development (*Article 343*).

This rule applies broadly to all technology contracts alike in China, including both purely domestic agreements between two Chinese parties and technology import agreements between a foreign transferor and a Chinese transferee.

The SPC has interpreted the phrase "illegally monopolize technology or obstruct technological advancement" in Article 329 to mean any of the following:

- Limitations on the development of improvements to the transferred technology, and unfair exchange conditions on the improved technology, such as:
  - grant-back of improved technology without compensation;
  - non-reciprocal transfer of improved technology; or
  - sole or joint ownership of improved technology without compensation.
- Tie-outs, that is, limitations on the use of similar or competing technology from a third party.
- Limitations on a transferee's reasonable exploitation of the transferred technology according to market demand, including unreasonable restriction on sales quantity, type, price, channel, and export.
- Tie-ins and package licensing, that is, requirements to purchase additional technology, goods, or services that are unnecessary for the practice of the transferred technology.
- Unreasonable restrictions on the sourcing of raw materials, parts, equipment and so on.
- Prohibitions or restrictions on a transferee's ability to challenge the validity of the transferred IP.

(*Article 10,* ***Interpretations Regarding Issues Relating to the Application of Law to the Adjudication of Technology Contract Dispute Cases 2004*** (2004 Technology Contract Interpretations).)

Most of the limitations and restrictions listed by the SPC in the 2004 Technology Contract Interpretations can be generally described as anti-competitive contractual arrangements, which are typically only the concern of anti-trust authorities in most other jurisdictions of the world. However, under Chinese law, a people's court may find any of them sufficient for invalidating a technology transfer contract.

IP license agreements in many common law jurisdictions may often include provisions:

- Whereby ownership of any improvement made by the licensee vests automatically in the licensor.
- Whereby any improvement made by the licensee is assigned or licensed to the licensor for no additional consideration.
- That set a strict territorial scope and prohibit the licensee from exporting to certain territories.
- For package licensing of other technology.
- Whereby the licensee acknowledges the validity of, and the licensor's right, interest and title to, the licensed IP.
- That prohibit any challenge to the validity, or the licensor's ownership, of the licensed IP rights.

These provisions may be perfectly enforceable in their home jurisdiction. However, if included in a technology import contract for China, each of them could be found under the 2004 Technology Contract Interpretations to illegally monopolize technology or obstruct technological advancement, and therefore trigger the invalidation of that contract under Article 329 of the 1999 Contract law.

It is difficult to assess the exact risk of contract invalidation, as there is a lack of precedents that even cite the judicial interpretation of Article 329. See ***Dongguan Jifa Automation Equipment v Zhoukou Sanhe Automation Engineering Technology*** [2018] (Guangdong High People's Court) (distinguishing the present case of patent ownership contest from the SPC Article 329 interpretations, and declining to apply the 2004 Technology Contract Interpretations).

A prudent approach to avoid that risk altogether is to remove all the provisions that might trigger Article 329 from any technology contract for China. Instead, the technology contract may provide for, for example:

- Additional non-nominal consideration in exchange for the assignment of any improvement developed by the Chinese transferee, together with a grant-back license to the Chinese transferee for use within China.
- Additional non-nominal consideration in exchange for a license to any improvement developed by the Chinese transferee, which may be exclusive outside China, with a right to grant sub-licenses to third parties.
- A free assignment of, or royalty-free license to use, any improvement developed by the Chinese transferee in exchange for a license from the foreign transferor to use improvements, upgrades, or other future technology to be developed by the transferor.

- Mutual terms for joint ownership of improvements developed by either party, with or without additional consideration.

Statutory warranties of clear title and effectiveness

Chinese law requires any technology transferor, and more specifically any foreign party to a technology import contract, to warrant that:

- It is in lawful possession of the technology offered for transfer (that is, clear title).
- The technology is complete, error-free, effective, and capable of reaching the agreed upon technical benchmarks.

(*Articles 24-25,* ***TIER*** and *Article 349,* ***1999 Contract Law***.)

Article 22 of the ***2004 Technology Contract*** Interpretations broadly interprets "lawful owner" of technology as used in the 1999 Contract Law to also include licensees with right to sublicense the technology.

In addition, in any technology import, if a third party brings a claim of infringement arising out of the Chinese transferee's use of the imported technology pursuant to the technology import contract, and if the Chinese transferee gives notice of such third party claim to the foreign transferor, then the foreign transferor has a mandatory obligation to assist the Chinese transferee to resolve such third party claim (*Article 24,* ***TIER***).

The relevant statutory provisions are drafted in such categorical terms (and with no interpretation or further guidance from any authority) as to make them almost inapplicable to everyday commercial activities. For example, almost every mobile application or computer program nowadays requires from time to time bug-fixes, patches, upgrades, and the like. Therefore, practically every company that distributes software in China has breached its statutory warranty that its software is complete and error-free, and it will keep breaching that warranty every time it publishes a new patch or bug-fix.

Likewise, hardly any pharmaceutical technology could be said to be error-free. Admittedly, drugs can cause side-effects and adverse events. Contrary to making error-free warranties, drug companies are required by law to disclose side-effects in inserts, and to monitor and timely report adverse events (*Articles 49, 80 and 81,* ***Drug Administration Law 2019*** (2019 Drug Administration Law)). Despite the requirement for a warranty on effectiveness, it would be highly problematic for a pharmaceutical licensor to make any representation, let alone warranties, regarding the efficacy or safety of its drug technology (*Article 90, 2019 Drug Administration Law* and *Article 16*, ***Advertisement Law 2015***).

These statutory warranties appear to preclude the possibility of "as is" technology licenses, which includes virtually all open-source licenses, being viable under Chinese law. The relevant provisions of the 1999 Contract Law and TIER have raised significant questions and concerns about whether China has closed its doors to the open source movement and copyleft movement. Although there is a large amount of open-source software being used and developed in China every day, there is a considerable chance that they are all subject to licensing terms that are not in compliance with the 1999 Contract Law and TIER.

The statutory warranties have become more honoured in the breach than in the observance, especially in certain technology areas such as open source software. This gives cause for hope for their revocation in the foreseeable future. Therefore, foreign technology importers should not be too daunted by these warranties or the lack of case law thereon. When preparing a technology import contract, the foreign party should try to avoid expressly incorporating or restating the statutory warranties. Until the revocation of the relevant provisions in the 1999 Contract Law and TIER, a foreign technology transferor should remain mindful of the statutory warranties and the grave (albeit unlikely) potential consequence of contract invalidation for their violation. (See ***Consequences of violating mandatory rules***.)

Written contract requirement for technology transfer

The ***1999 Contract Law*** requires that all technology transfer contracts be in writing (*Article 342*). In addition, the ***Computer Software Protection Regulations 2013*** (2013 Software Protection Regulations) require software copyright licenses and assignments be in writing (*Articles 19-20*).

The ***Patent Law 2008*** (2008 Patent Law, effective on 1 October 2009), however, has removed a similar requirement of written patent licenses (*Article 12*), possibly indicating a policy shift toward a more lenient position on non-written technology licenses. However, some commentators still maintain that Chinese law does not allow any implied license to technical IP and that consequently, in so far as there is no express, written license between the parties, there is no license whatsoever under Chinese law for all intents and purposes. Therefore, it is highly advisable to put all technology licenses into writing in China and **not** to rely on any oral agreement. (See also ***Practice note, Patents (China): Overview: Licences***.)

Statute of limitations for technology import

Under Chinese law, technology import contracts are subject to a special statute of limitations. Whereas all other IP agreements, as well as most other contracts, has a limitation period of three years, technology import or export contracts are subject to a four-year statute of limitations. The limitation period starts when the plaintiff acquires actual or constructive knowledge of the breach. (*Article 188,* ***General Rules of the Civil Law 2017*** and *Article 129,* ***1999 Contract Law***.)

It is, therefore, possible for the statute to have run on other concurrent contracts, while claims arising out of the technology import agreement remain actionable.

Special rules for onshore joint ventures

Specifically with respect to Sino-foreign joint ventures (JVs) domiciled in China, Chinese law requires that any technology that a JV imports into China be advanced and suitable for China, so that the JV's products can generate significant social and economic benefits domestically and be competitive on the international market (*Article 41,* ***2001 EJV Regulations*** and *Article 5,* ***Sino-Foreign Equity Joint Venture Enterprise Law 2016***).

If the foreign JV partner provides its proprietary technology as capital contribution to the JV, then that technology must meet one of the following conditions:

- Significantly improve the performance and quality of existing products and boost productivity.
- Enable significant savings in raw materials, fuel or energy.

(*Article 25, 2001 EJV Regulations.*)

It remains to be seen how the biased provisions of the 2001 EJV Regulations are to be enforced in practice, as there appears to be no authoritative guidance in Chinese law on how courts should interpret the language therein.

One way to avoid these onerous provisions is to set up a JV offshore (and for it to invest into China in a wholly foreign-owned enterprise), rather than onshore in China.

No effective patent assignment without recordal

Unlike many other jurisdictions, no patent assignment is effective in China unless and until it is recorded with China National Intellectual Property Administration (CNIPA) (*Article 10,* ***2008 Patent Law***). Therefore, recordal of Chinese patent assignment is not simply a mechanism to impute constructive notice to bona fide third parties. It determines who owns the patent.

That means that the entity registered as patentee on CNIPA's records at any point in time is the legal owner of the patent at that time, until its name changes in CNIPA's records to that of its assignee. If a patent assignment is not recorded, then the assignee will not become the patentee in any sense under Chinese law, and the assignor will remain the patentee for all purposes. Therefore, recording patent assignments in a timely manner is important in China.

LINGERING EFFECTS OF REVOKED REGULATORY PROVISIONS

Articles 33 and 38 of the ***2019 Amendments*** revoked Articles 24(3), 27, and 29 of ***TIER*** and parts of Article 43 of the ***2001 EJV Regulations***. This section examines each of the revoked regulatory provisions in turn and discusses their effectiveness after the 2019 Amendments.

TIER Article 24(3) (revoked): statutory indemnity for third party claims

Unlike many real property rights, IP rights are, generally, nothing more than the right to exclude others from exploiting the IP.

For example, a patentee has an exclusive right to prevent others from practicing the patented invention, but the patentee's own practice of that invention might still infringe another person's dominant patent.

Consequently, a patent licensee always runs the risk of being sued for infringing a third party's IP rights, even if its licensor is the rightful owner of the licensed patent, and its use of the licensed patent adheres strictly to the terms of the license agreement.

Where parties to a technology transfer contract have no agreement on this issue of third party infringement claims, the ***1999 Contract Law*** provides a default rule that the transferor should indemnify the transferee for any third party claim arising out of the transferee's lawful use of the transferred technology that is compliant with the technology transfer contract. However, in purely domestic transactions, the parties are free to contract around that default rule (*Article 353*).

By contrast, the revoked Article 24(3) of ***TIER*** used to require the foreign technology transferor to indemnify the Chinese transferee for any third party claim that the Chinese transferee's use of the imported technology infringed such third party's lawful rights and interests. Unlike the default rule, this mandatory TIER requirement could not be contracted around, and it trumped all provisions on technology transfer contracts in the 1999 Contract Law (*Article 355,* ***1999 Contract Law***).

The biased indemnity requirement under TIER was particularly unfair to the foreign transferor in the light of the fact that China has the largest numbers of patent filings and issued patents in the world. More prior patent filings mean an elevated risk of third-party claims and higher costs for freedom-to-operate analyses. How such risk and costs should be allocated between the parties should be a purely commercial issue on which the parties are free to negotiate, not a point of mandatory legal rules. There may well be situations in which it makes more commercial sense to shift the burden to the Chinese party, such as where the Chinese importer is considerably larger and more resourceful than the foreign transferor (which is becoming more common).

The ***2019 Amendments*** revoked the indemnity under TIER for third party claims (*Article 38*). After the 2019 Amendments, parties to technology import contracts are free to negotiate the allocation of liability for third party claims between themselves.

TIER Article 27 (revoked): requirement for transferee ownership of transferee improvements

Another discriminatory revoked provision of ***TIER*** concerns the ownership of improvements to the imported technology. Generally with respect to IP contracts, Chinese law favours IP ownership of any improvement vesting in the party that makes such improvement. This however is just a gap-filling default rule that the parties may contract around (*Article 354,* ***1999 Contract Law***). See also:

- Article 11 of the ***2013 Software Protection Regulations*** (providing for the software developer's ownership of foreground copyright, in cases where there is no clear agreement).
- Articles 339 and 341 of the 1999 Contract Law (respectively providing for the commissioned party's ownership of any new patentable invention and for joint ownership of any new trade secret, in the absence of any contractual provision).
- Article 17 of the ***Copyright Law 2010*** (providing for the commissioned author's ownership of copyright, in cases where there is no clear agreement).

Conversely, the revoked Article 27 of TIER went against the numerous Chinese IP statutes that allow contracting around. Instead it imposed a mandatory requirement on technology import transactions that any improvement to the imported technology be owned by the party that made the improvement. This effectively rendered it impossible for the parties to negotiate the ownership of improvements, and it meant that ownership in any improvement by the Chinese transferee must vest in the Chinese transferee. Moreover, where the foreign and domestic parties have both contributed to the development of an indivisible piece of improvement technology (which is not an unlikely scenario in a JV or a joint development project), Article 27 would require joint ownership by both parties, which is typically inefficient, unpractical and a likely source of tension between the co-owners. The revoked Article 27 of TIER created a rule on improvement ownership for foreign technology transferors that is different from the general, more permissive rules for domestic technology transferors.

Following the revocation of the TIER requirement on improvement ownership (*Article 38*, ***2019 Amendments***), the issue is governed under the general statutory provisions of the 1999 Contract Law for all technology transfer agreements (*Article 354*). The SPC has read many extra constraints on the technology transferor into the phrase "illegal monopoly of technology or obstruction of technological advancement", including a requirement that improvements be subject to fair and reciprocal exchange conditions (see ***Prohibition against illegal monopoly of technology and obstruction of technological advancement***). However, there is now at a minimum some room for the parties to negotiate some reasonable terms on the ownership of improvements that may be different from the default rule.

TIER Article 29 (revoked): prohibition against anti-competitive contractual terms

Similar to the SPC's list under Article 10 of the ***2004 Technology Contract Interpretations***, the revoked Article 29 of ***TIER*** also used to include a list of anti-competitive contract terms that are impermissible for:

- Requiring the Chinese importer to accept any additional conditions unnecessary for the technology import, including the purchase of any unnecessary technology, raw material, product, equipment or service (that is, tie-ins and package licensing).
- Requiring the Chinese importer to pay royalties or other considerations for expired or invalidated patents.
- Restricting the Chinese importer from improving the imported technology or from using the improved technology.

- Restricting the Chinese importer from obtaining similar or competing technology from a third party.
- Unduly restricting the Chinese importer from purchasing raw material, parts and components, products or equipment from third parties (that is, tie-outs).
- Unduly restricting the quantity, variety, or sales price of the products the Chinese importer produces.
- Unduly restricting the Chinese importer's channels for exporting its products.

There is a lot of overlap between this list in the revoked Article 29 of TIER and the SPC's list that remains in force under Article 10 of the 2004 Technology Contract Interpretations. Therefore, the revoked TIER list presented much the same problems, and invited much the same solutions, as does the SPC's list for Article 329 (see ***Prohibition against illegal monopoly of technology and obstruction of technological advancement***). Accordingly, revocation of Article 29 of TIER will have little substantive impact, if any, on Chinese law governing anti-competitive terms in technology import contracts.

Certain requirements (revoked) on technology transfer agreements for onshore joint ventures

Moving on from ***TIER***, Article 33 of the ***2019 Amendments*** also revoked subclauses (3)-(4) of Article 43(2) of the ***2001 EJV Regulations*** where technology transfer agreements with any onshore EJV (that is, any equity JV) were subject to the following onerous requirements that:

- The term of the technology transfer agreement must generally last no more than ten years.
- The technology transferee be granted a right to continue its use of the transferred technology beyond the expiry of the technology transfer agreement.

These requirements are biased against the foreign JV partner, who often contributes technology to the EJV. As with the rest of the 2001 EJV Regulations, the requirements above were of limited applicability to only onshore JV projects within China, in which many foreign investors are disinclined to participate for many reasons other than pitfalls associated with technology import (see ***Practice note, Corporate governance and liabilities of senior management in China: overview: Bifurcated corporate governance administration***). Given the unpopularity of onshore JVs, the partial revocation of Article 43 of the 2001 EJV Regulations will probably prove even less impactful than any of the 2019 Amendments to TIER discussed in the foregoing subsections.

Uncertainty over the 2019 Amendments' retroactive effect

Generally, new Chinese legislation, including administrative regulations, such as TIER, the ***2001 EJV Regulations***, and their amendments, have no retroactive effect, except where the new legislation includes specific provision on its retroactive effect for the purpose of protecting people's rights and interests (*Article 93,* ***Legislation Law 2015***). Therefore, the ***2019 Amendments*** have no retroactive effect.

Accordingly, the 2019 Amendments do not affect any technology import transaction concluded before 18 March 2019. Therefore, those transactions are subject to all the TIER and 2001 EJV Regulations provisions that are revoked by the 2019 Amendments.

Technology import contracts that were entered into before the 2019 Amendments and that remain in force after the 2019 Amendments present a trickier problem. It seems to be an open question whether the revoked TIER and 2001 EJV Regulations provisions will apply to the ongoing performance of those contracts after the 2019 Amendments. The minimalist text of the 2019 Amendments offers no guidance on this issue, nor does the text of TIER or the 2001 EJV Regulations. A Chinese court may have to make a ruling of first impression, if this issue arises in court. Until then, it is probably advisable to be cautious and adopt the conservative position that the revoked regulatory provisions remain effective and applicable to future ongoing performance of technology import contracts executed before 18 March 2019.

CONSEQUENCES OF VIOLATING MANDATORY RULES

As most of the Chinese legal provisions on technology transfer contracts and all the Chinese regulatory provisions on technology import contracts are considered mandatory rules (see ***Mandatory application of Chinese law***), Chinese courts are bound to apply them to any technology import contracts, regardless of the parties' choice of foreign law (*Article 4,* ***2010 Foreign-related Civil Relationships Application Law***).

The violation of these mandatory rules could have severe repercussions. According to the ***1999 Contract Law***, a contract is invalid where the contract violates a mandatory provision of any laws or administrative regulations (*Article 52(5)*). This provision is certainly brief. Therefore, its interpretation and application can often become highly contentious. The SPC has sought to clarify Article 52(5) in an official judicial interpretation (*Article 14,* ***Interpretation II on Several Issues Concerning Application of Contract Law 2009*** (2009 Contract Law Interpretation II)):

> "Mandatory provision as in Article 52(5) of the 1999 Contract Law refers to mandatory provision on validity."

Also in the less formal ***Guiding Opinions on Several Issues Concerning the Adjudication of Cases of Disputes over Civil and Commercial Contracts under the Current Situation 2009***, the SPC wrote:

> "The correct understanding of, determination under, and application of, the phrase 'violation of a mandatory provision of any law or administrative regulations' as in the Article 52(5) of the Contract Law relate to the maintenance of the validity of civil and commercial contracts as well as the security and stability of market transactions. The people's courts must exercise due care in **distinguishing between mandatory provisions on validity and mandatory provisions on administration** in accordance with Article 14 of [2009] Contract Law Interpretation II. Where mandatory provisions on validity are violated, the people's courts should find the contract invalid. Where mandatory provisions on administration are violated, the people's courts should rule on the validity of contracts on a case-by-case basis.
>
> If the mandatory provisions on validity regulates the act of contracting itself, that is to say, if the formation of the contract would categorically harm national interests or **social and public interests**, the people's court should invalidate the contract. If the mandatory provision regulates the 'market entry' qualifications of the parties, rather than the act of contract of any particular type, or if it regulates the act of performing a contract of a certain kind, rather than the act of contract of any particular type, then the people's court must be cautious in making its conclusion on the validity of such type of contract and must seek advisory opinions, whenever necessary, from the relevant legislative body or from the people's court above."

This SPC guidance raises several questions such as:

- What are "mandatory provisions on validity" (效力性强制规定)?
- What are "mandatory provisions on administration" (管理性强制规定)?
- What exactly is the distinction between mandatory provisions on validity and those on administration?

Therefore, contract invalidation for violation of mandatory rules appears to be an unresolved question of Chinese law. Given such uncertainty, it would not be prudent to rule out the risk of Chinese courts invalidating technology import contracts for its violation of ***TIER*** or the relevant parts of the 1999 Contract Law.

Another unanswered question regarding contract invalidation is whether the application of Article 52 or Article 329 of the 1999 Contract Law would invalidate the contract in its entirety or only in its part that violates any mandatory Chinese law. The text of those provisions of the 1999 Contract Law states "the contract is invalid" (合同无效), as opposed to phrases such as "the provisions are invalid" (条款无效) or "the contract is invalid in part" (部分无效) as used elsewhere in the 1999 Contract Law (*Articles, 53, 56 and 214*), or as in other statutes (for example, Article 26 of the ***Labor Contract Law 2012***).

Therefore, a textual or contextual analysis of the statutory language seems to favour an interpretation of Articles 52 and 329 as requiring invalidation in whole (though there is another school of thought in favour of invalidation in part). Therefore, both invalidation in whole and invalidation in part are possible outcomes under Article 52 or Article 329 of the 1999 Contract Law.

Once a contract (or any part of it) is invalidated, it is deemed void ab initio (*Article 56, 1999 Contract Law*). Specifically, upon invalidation, the parties are discharged from performing the contract (or the invalidated part). If any performance is already under way, it should cease. If a contract has been fully performed, the Chinese court would try to restore the parties to their pre-contract state (that is, as if the contract had never been entered into). The party at fault for rendering the contract invalid is liable for damages caused to the other faultless party. However, even on invalidation, there are special rules for technology contracts that favours transferees (*Articles 11-12*, ***2004 Technology Contract Interpretations***):

> "Upon invalidation or cancellation of a technical contract, where both parties are unable to renegotiate and agree on ownership of, and sharing of benefits from, a new technical achievement completed in the performance of the contract or subsequent improvement of others' technical achievement, the people's court may rule that the party which completed the technical achievement should take ownership.
>
> Following the invalidation of a technology contract in accordance with Article 329 of the Contract Law for infringement of a third party's technical trade secret, unless the laws and administrative regulations provide otherwise, the party that acquired the technical trade secret in good faith may continue to use such technical trade secret within its scope of use at the time of its acquisition, provided that it pays reasonable royalties and maintains its confidentiality obligation to the right-holder."

In the light of the serious consequences that can follow from violating mandatory Chinese rules on technology import contracts, it is highly advisable for the foreign party to such contracts to avoid such violations.

CHINESE TECHNOLOGY IMPORT CONTROL REGIMES

Chinese law regulates technology import based on the type of the technology. This section summarises the technology import control regimes of China, including the registration and approval procedures for different categories of technology import into China.

Classification of imported technology

Chinese law divides imported technology into the following three categories:

- Prohibited.
- Restricted.
- Unrestricted.

(*Articles 14 and 16-17,* ***Foreign Trade Law 2004*** and *Articles 5, 8–10 and 45,* ***TIER***.)

The Ministry of Commerce (MOFCOM) maintains a catalogue of prohibited and restricted technology categories, that is, the *Catalogue of Technology Prohibited or Restricted from Import 2007* (2007 MOFCOM Catalogue) (禁止进口限制进口技术目录). Any technology not listed on that catalogue is deemed unrestricted under TIER (*Article 5*). The import of any prohibited technology is, as the name suggests, prohibited (*Article 9*). For the importation of restricted technology and unrestricted technology, different procedures apply.

MOFCOM registration of unrestricted technology

The importation of most technology is unrestricted, also known as free-to-import (自由类). For this category of technology, there is only a registration procedure for its import contract, and that registration is not a pre-requisite for the contract to take effect (*Article 3,* ***Measures for the Registration and Administration of Technology Import and Export Contracts 2009*** (2009 Contract Measures)). Specifically:

- **Registration authority: MOFCOM or its local branches.** For technology import contracts in any project covered by the ***Catalogue of Investment Projects Verified and Approved by the Government 2016*** or any project receiving government funding for which the State Council or its competent department has granted preliminary approval, their registration falls within the purview of the national MOFCOM. The local MOFCOM branches are responsible for all other unrestricted technology import contracts. (*Articles 4-5, 2009 Contract Measures.*)
- **Time for registration.** For contracts providing for royalties as a percentage of certain monetary benchmark, within 60 days after such benchmark becomes ascertainable for the initial payment; for all other contracts, within 60 days after the effective date (*Articles 6-7, 2009 Contract Measures*).
- **Two-step registration.** Each applicant must pre-register through the online ***MOFCOM Business System Uniformed Platform*** (商务部业务系统统一平台) and then submit hardcopy application materials (Article 8, 2009 Contract Measures).
- **Timeframe and certificate obtained.** MOFCOM offices must issue the Certificate of Technology Importation Contract Registration (技术进口合同登记证书) within three business days after the agency's receipt of all application materials (*Article 8, 2009 Contract Measures*).

This certificate (Registration Certificate) has no impact on the effectiveness of the technology contract (*Article 17,* ***TIER*** and *Article 3, 2009 Contract Measures*). However, it may be necessary for foreign exchange control, banking, tax and customs purposes (*Article 20, TIER*).

(For example, until 2013, the State Administration of Foreign Exchange (SAFE) required banks to review the Registration Certificate while processing any payment (for example, royalties and license fees) in foreign currencies under the technology import contract. This requirement was revoked in 2013. At present, for the import of unrestricted technology, it has been reported that banks no longer require the importer to produce the Registration Certificate for foreign exchange control purposes.)

MOFCOM approval for restricted technology

The importation of any technology listed as restricted in the 2007 MOFCOM Catalogue is subject to MOFCOM's prior approval. No contract for the importation of restricted technology is effective without this. (*Articles 3, 10 and 13,* ***Measures for the Administration of Technology Prohibited or Restricted from Import 2009*** (2009 Administration Measures).)

Though there is little similarity to the procedure for unrestricted technology, the application process for the importation of restricted technology also has two steps. The first step is supposed to take place before the parties sign any technology contract. If successful, the Chinese importer is allowed three years to negotiate and sign a technology import contract. In the second step, the signed contract is reviewed by MOFCOM, and it comes into

effect only if MOFCOM grants its final approval. Alternatively, the parties can execute the contract first, and initiate both steps of the application at the same time. (*Articles 9-13, 2009 Administration Measures.*)

Restricted technology import process: table

Details of the application process for the importation of restricted technology are set out in the ***2009 Administration Measures*** and summarised in the table below.

	Pre-execution	Post-execution
Regulatory authority	Provincial branches of MOFCOM, in consultation with technology experts and trade experts (*Articles 4 and 6*).	Provincial branches of MOFCOM (*Articles 10-11*).
Criteria	The government will consider the pre-contract execution application by the following trade criteria: • Whether the proposed importation will be beneficial to the foreign trade policy of China and to the development of foreign economic or technological co-operation. • Whether it will comport to any international obligation of China. • Whether it will have any adverse impact on to the development or growth of the particular domestic industries. (*Article 7.*) The pre-execution application will also be examined against the following technological criteria: • Whether the proposed importation will jeopardize national security, social and public interest, or public morality. • Whether it will present risks to human well-being, or the health of animal or plant life. • Whether it will harm the environment. • Whether it comports to national industrial policies and economic and social development strategies, helps promote the progress of Chinese technology and industrial upgrading, and furthers the economic and technological interests of China. (*Article 8.*) The requirement that MOFCOM should weigh the technological and trade considerations above, together with the requirement that it "organise technological and trade experts" (*Article 6*) to examine the pre-execution application, mean that, in practice, the local MOFCOM could seek advice from and directly involve the local branches of the Ministry of Science and Technology and the Ministry of Industry and Information Technology, as well as other local government departments that regulate the sectors to which the restricted technology in question relates.	The authenticity of the executed technology import contract (*Article 11*).
Timeframe	30 business days (*Article 6*).	Ten business days (*Article 11*).
Certificate	Letter of Intent to Approve Technology Importation (技术进口许可意向书) (LOI) (*Article 9*). The LOI is a preliminary document that allows the applicant importer to enter into an import agreement for the technology in question within the three years following its issues. The LOI by itself does not give effect to any technology import contract.	Certificate of Approval for Technology Import (技术进口许可证) (*Article 13*). This certificate is required for customs clearance when importing the restricted technology into China (*Article 17*). For any foreign currency payment of more than US$50,000 in exchange for the import of restricted technology, SAFE requires the Chinese importer to produce the Certificate of Approval for Technology Import to the bank for remittance of funds (*Article 6(7), Implementing Rules for the Guidelines for Foreign Exchange Control for Trade in Service 2013*).

Consequences of violating technology import control

The importer of any prohibited technology or of any restricted technology without MOFCOM approval may face indictment for the criminal offenses of smuggling, illegal business operation, and potentially other crimes (*Article 46, **TIER***).

Smuggling is the most serious of these offenses. Depending on the value of the technology smuggled, the punishment may be a prison sentence of a fixed term or (for serious offenders) for life (*Article 153, **Criminal Law 1997*** (1997 Criminal Law)).

Under the 1997 Criminal Law, a fixed-term prison sentence may be up to 15 years for any single offense, or up to 20 years for multiple offenses (*Articles 45 and 69*). Corporations may also be found collectively guilty for smuggling and fined, and its responsible management personnel and employee may be imprisoned (*Article 153*). For the lesser crime of illegal operation of business, a fine may be imposed of up to five times the illegal gains, in addition to generally up to five years of imprisonment (*Article 225*).

Apart from criminal prosecution, TIER also imposes administrative penalties for less severe offences. For example, fines, confiscation of illegal gains and revocation of administrative approvals by MOFCOM, and customs seizure are all possible consequences for importing prohibited technology, importing restricted technology without approval, or importing restricted technology beyond the scope of MOFCOM's approval (*Articles 46-47*). These administrative penalties are appealable to Chinese courts (*Article 53*).