



China Law Alert

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Technology Transfer Under the PRC Antitrust Framework

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Technology Transfer Under the PRC Antitrust Framework

In 2006, 10,538 technology contracts were registered with the People's Republic of China (PRC) Ministry of Commerce (MOFCOM), with an aggregate value of US\$22.02 billion, an increase of 15.6 per cent from 2005. Fees received by foreign transferors of technology accounted for 67 per cent of the total value (*i.e.*, US\$14.76 billion).

As the value of these technology contracts has increased, so has the PRC government's wariness of foreign participation in many key sectors and its perceived potential to create technology monopolies in China held by foreign interests. For example, it is common practice for a foreign transferor to try to place substantial restrictions on the use of the subject technology in technology agreements. Under this scenario, relevant PRC laws try to balance the benefits of having a free flow of technology against the risk that it will distort competition. As a result, foreign investors must pay more attention to competition and antitrust concerns in their Chinese technology transfer deals.

Definition of Technology Transfer

Under the current PRC legal framework, "technology transfer" is a very broad concept, covering both assignments that involve the transfer of intellectual property and licensing that does not involve the transfer of intellectual property. It includes the assignment of patent rights, patent licensing, and transfer of know-how or other technology. A considerable number of technology transfers are accomplished in separate transactions (*e.g.*, a business transaction to buy and sell technology with the direct payment of a transfer fee or a capital contribution in the form of a technology transfer), or as part of another transaction (*e.g.*, a technology transfer involved in the sale of goods or in an original equipment manufacturer contract).

Technology Transfer Framework

The starting point for technology transfer rules is the Contract Law of the PRC, which sets out the basic principles applicable to technology transfer contracts. Article 329 of the Contract Law states that any technology contract that illegally monopolizes technology, impedes technological progress or infringes upon the technological results of others is null and void. However, it is not clear what constitutes an illegal monopoly of technologies.

Additional rules regarding technology transfer are found in the Technology Import and Export Provisions (the Technology Provisions), which proscribe certain restrictions when a foreign technology transferor is exporting technology to a PRC party. Cross-border transactions subject to the Technology Provisions include patent assignments, assignments of a right to apply for a patent, patent licensing, assignments of know-how, the provision of technology services and other technology transfers. According to the Technology Provisions, the following restrictions are banned in technology import contracts:

- Requiring a transferee to accept additional conditions that are not indispensable to the importing of the technology, including requiring a transferee to purchase unnecessary technology, raw materials, products, equipment or services
- Requiring a transferee to pay royalties or assume relevant obligations for technology for which relevant patent protection has expired or been invalidated
- Restricting the improvement or use of the subject technology by a transferee
- Restricting a transferee's right to obtain similar or competing technology from other sources

- Unreasonably restricting the sources from which a transferee may purchase raw materials, parts, products or equipment
- Unreasonably restricting product output, variety or sales price
- Unreasonably restricting export channels for products based on the imported technology

The Technology Provisions do not specify the legal consequences of including such prohibited restrictions in technology import contracts. However, in practice, a technology import contract must be registered with the local branch of the MOFCOM for the remittance of foreign exchange (*e.g.*, transfer fee payment). Should a technology contract include prohibited restrictions, it will not be granted registration by the MOFCOM, and as a result, any transfer fee cannot be legitimately paid to a party outside of the PRC (*e.g.*, a foreign transferor).

The Supreme Court's Opinion on Application of Law in the Adjudication of Technology Contract Disputes (the Supreme Court Opinion) is widely recognized as a milestone in the regulation of technology transfer, particularly with respect to technology monopolies misused by multinational companies in the course of their cooperation with Chinese businesses. Further, the Supreme Court Opinion covers not only cross-border transactions, but also domestic technology transfer contracts. The technologies regulated by the Supreme Court Opinion include patent rights, the right to apply for a patent, a license to implement a patent, know-how, software and technology transferred through technical services or other means.

The Supreme Court Opinion specifies the following circumstances as illegal monopolies of technology or impediments to technological progress:

- Preventing a counterparty from conducting research and development on the basis of the subject technology; restraining that party from using improvements to the technology; creating non-reciprocal conditions for the exchange of improvements, such as requiring a party to share improvements that result solely from the efforts of that party without compensation; transferring improvements to the transferor on a non-reciprocal basis; or exclusively or jointly holding the rights to the improvements without compensation (this clause is hereinafter referred to as the Improvement Article)
- Preventing a counterparty from acquiring technologies similar to, or in competition with, those of the supplying party
- Preventing a counterparty from using the subject technology in a reasonable manner as required by the market, including unreasonably restricting quantity, variety, price, distribution channels and export markets of products or services
- Imposing additional conditions that are unnecessary for utilizing or applying the technology, including purchasing unnecessary technology, raw materials, products, equipment or services, or requiring a transferee to accept unnecessary personnel
- Unreasonably restraining a transferee's channels or sources of procuring raw materials, parts, products or equipment
- Prohibiting a technology transferee from filing oppositions against the validity of the rights in the subject technology, or imposing additional conditions on filing such oppositions

A literal reading of Article 329 of the Contract Law and Article 10 of the Supreme Court Opinion would likely lead to the harsh conclusion that the whole of a contract will be held void if the court finds any provision of a contract to constitute an unreasonable restraint on technological progress. However, in practice, PRC courts do not adopt such a strict, literal interpretation. The Chief Justice of the Intellectual Property Division of the Supreme Court, Jiang Zhipei, has offered comment on the Supreme Court Opinion, explicitly opining that only those parts of the contract which include illegal monopoly provisions would be held invalid and that other provisions in the contract would remain valid. Although Judge Jiang's comments have not been officially announced on behalf of the Supreme Court, it is anticipated that his explanation will be largely respected because of his key role in the PRC judicial system.

Analysis of the Improvement Article

In practice, the Improvement Article is perhaps the most controversial of the statutorily prohibited restrictions and has often troubled practitioners attempting to abide by it. It is helpful to analyze relevant issues frequently encountered in the practice.

It can be inferred without much difficulty that the following arrangements shall be prohibited:

- Prohibiting or restricting a transferee from conducting research and development on the basis of the subject technology
- Restraining a transferee from using improvements to subject technology made by said transferee
- Creating non-reciprocal conditions for the exchange of improvements, such as requiring a transferee to share improvements that result solely from the efforts of said transferee without compensation, transferring improvements to the licensor on a non-reciprocal basis, or exclusively or jointly holding the intellectual property rights to the improvements without compensation

Although the Supreme Court Opinion gives no explicit definition of “improvement,” and there are few discussions thereon in judicial practice, the Rules of Encouragement on Reasonable Advice and Improvement of Technology (the Rules) facilitate understanding. According to the Rules, an improvement means “any innovation made to machinery and equipment, tools, arts and crafts and technologies, which includes...innovation made to imported technology and equipment”. More specifically, “technical improvements” cover the following:

- Raising the qualities of industry products and projects, enhancing product structure, improving and cultivating biological species, and developing new products
- Utilizing and economizing on energies and raw materials as well as utilizing natural conditions more effectively
- Modifying production and testing processes; inspection methods; labour protection; environment protection; safety technology; medical and sanitation technology; transportation, storage and maintenance technology of materials; and design, statistics and computing technology, *etc.*
- Modifying tools, equipment, instruments and devices
- Promoting scientific and technological achievements, innovation and application of enterprises’ modernization management methods and measures, as well as absorption and renovation of imported technology and equipment

Acceptable Arrangements

As stated, the Supreme Court Opinion explicitly lists situations that the PRC courts would deem to constitute illegal monopolies of technology or impediments to technological progress. However, it is important to note that said list is not an exhaustive one and, therefore, practices that fall outside the specified situations may still be deemed null and void on a case-by-case basis.

As for technology improvements, the Supreme Court Opinion specifies that it would be an unreasonable restriction if a contract entitled a licensor to use improvements developed solely by the transferee without compensation or on a non-reciprocal basis. Put another way, an exchange of improvements or use in exchange for fair compensation will not be regarded as unreasonable.

A foreign party may ask whether it is possible to circumvent the aforesaid restraints by applying foreign law to the agreement. If a technology transfer contract is entered into by a foreign party and a PRC party, it is possible for the parties to choose the law of a jurisdiction outside the PRC as the governing law of the contract. However, choosing a foreign governing law will not necessarily allow the parties to include provisions in the contract that would otherwise be unenforceable. This is because contracts that do not comply with PRC law are not enforceable against a Chinese party in China.

Anti-Monopoly Law Concerns

In some countries (*e.g.*, those in the European Union), antitrust concerns have been raised about assignment or exclusive grant backs being anticompetitive for inhibiting innovation. China’s recently passed Anti-Monopoly Law (AML), which will go into effect on 1 August 2008, provides, *inter alia*, a general prohibition on monopoly agreements, a prohibition on the abuse of market dominance and a merger control regime. Further, it clearly sets forth that the misuse of intellectual property and the elimination or restriction of competition by any entity shall be subject to this law. However, at this point it is not clear what will constitute “misuse of intellectual property” or “elimination or restriction of competition”. Currently, the implementation rules for the AML are being formulated and are expected to be promulgated sometime in 2008. The above issues may be specifically discussed therein. However, it is likely that the release of the implementation rules will not override the sector-specific competition laws already in place, such as the prohibitions on illegal monopolies of technology in technology transfer contracts.

As analyzed above, the technology transfer regulations, especially the Supreme Court Opinion, are currently the only sources of law to be used when evaluating the validity of such restrictive clauses in technology transfer contracts. To date, there have been no important judicial cases on technology transfer regulations.