

THE US-CHINA "TRADE WAR" AND LIBERALISATION OF CHINA'S TECHNOLOGY TRANSFER RULES

China's technology transfer regime has been put into the spotlight in the context of the US-China "trade war." Shortly after China's state legislature passed the landmark Foreign Investment Law (FIL)¹, the Chinese government quietly announced amendments to the *Administrative Regulation on Technology Import and Export* (TIER), which became effective on 18 March 2019. TIER is the primary regulation in the field of technology transfers into and out of China. The latest revisions remove certain provisions in respect of foreign technology transfer into China that were subject to the US criticism of China's "forced technology transfer" policy and have caused substantial confusion over the years.

WHAT IS TIER?

TIER came into force on 10 December 2001 and is administered by the Ministry of Commerce. It mainly governs inbound and outbound patent, trade secret and software licensing and assignment, whether via investment, trade or technological co-operation. To date, the TIER regime has been an area benefiting from little guidance from either the central authority or the Chinese courts. It is however relevant to almost every cross-border technology transaction as the TIER provisions are mandatory and cannot be bypassed by, for example, contracting under a foreign governing law.

WHAT ARE THE AMENDMENTS TO TIER?

The latest amendments have removed the following requirements which previously applied to an inbound technology arrangement:

- *Article 24(3), mandatory third-party infringement indemnity* – Before the amendments, TIER required a foreign technology owner to indemnify a Chinese counterparty where the use of its technology infringed third party IP.
- *Article 27, improvements made by a licensee vested in the licensee* – TIER used to restrict parties' freedom to contract for the ownership of

Key issues

- China recently revoked the TIER provisions that were cited in the Trump administration's Section 301 report.
- The TIER amendments echo the new Foreign Investment Law, which expressly outlaws "forced technology transfer."
- The TIER amendments afford the parties more freedom of contract, as well as confidence to agree on some key issues in a technology contract.
- Caution should still be exercised when drafting and negotiating a technology contract with a Chinese counterparty.

¹ See our earlier briefing: https://www.cliffordchance.com/briefings/2019/03/china_s_new_foreigninvestmentlawwhatdoe.html.

improvements to technology licensed by a foreign technology owner. Instead, it provided for ownership by the Chinese licensee that makes the improvements with no regard to the legitimacy of grant-back arrangements.²

- *Article 29, licensee restrictions* – Before the amendments, there were a number of broadly worded restrictions which could not be imposed by a foreign licensor in a technology import contract with a Chinese licensee including:
 - purchase of unnecessary technology, equipment or service;
 - payment for expired or invalid patents;
 - restrictions on the licensee's rights to improve technology or to use improved technology;
 - restriction on procurement of similar or competing technology;
 - unreasonable restrictions on source of equipment or materials used by the licensee;
 - unreasonable restrictions on production volumes, models and sales price; and
 - unreasonable restrictions on export channels for products made with licensed technology.

Notably, the above provisions were cited in the Trump administration's Section 301 report for unfairly discriminating against US companies in favour of Chinese companies.

WHAT CAN PARTIES DO NOW?

For nearly two decades, TIER caused confusion over drafting and negotiating a technology import contract as TIER was not fully aligned with the PRC Contract Law, and the consequences for non-compliance were unclear. The TIER amendments now afford parties more freedom of contract, as well as confidence to agree on some of the key issues in a technology contract.

It is worthwhile noting that certain other mandatory provisions under PRC law remain relevant. In particular, Article 329 of the PRC Contract Law voids contracts under PRC law that "*illegally monopolise technology and impede technological progress.*" Article 10 of the Judicial Interpretation concerning the Adjudication of Technology Contract Disputes (JI) interprets Article 329 of the Contract Law and lists provisions that a licensor cannot impose. Most of those restrictions under Article 10 of the JI mirror those under the former Article 29 of TIER and are still in force in respect of a technology import contract. Therefore, despite the TIER amendments, caution should still be exercised in ensuring compliance with mandatory provisions of PRC law when entering into a technology contract with a Chinese party.

Notably, unlike former Article 27 of TIER, the PRC Contract law does not categorically prohibit grant-back arrangements. Article 10 of the JI, however, prescribes impermissible grant-backs which constitute "unfair exchange conditions on improved technology", such as "grant-backs of improved technology without compensation, non-reciprocal transfer of improved technology, or sole or joint ownership of improved technology without

² Grant-back arrangements require a licensee to grant back improvements in the licensed technology to the licensor.

compensation." From a licensor's perspective, it would thus be crucial to enhance reciprocity and to allow access to the improvements by the licensee so as to justify a grant-back clause.

Furthermore, despite the TIER amendments, it remains unclear whether, and in which circumstances, parties can effectively contract out of the other mandatory provisions of PRC law (e.g., Article 329 of the PRC Contract Law) by stipulating a foreign governing law. Where enforcement in China may later turn out to be necessary, uncertainty still abounds as to whether contract terms inconsistent with those mandatory provisions would be enforceable before the Chinese courts. Therefore, it would be advisable to consider optimising one's licensing position along with suitable dispute resolution mechanism early on in a transaction.

WHAT IS "FORCED TECHNOLOGY TRANSFER"?

The FIL expressly outlaws "forced technology transfer" under Article 22. It provides that "administrative agencies and their employees shall not force technology transfer through administrative measures." The TIER amendments have revoked provisions that conflicted with Article 22 of FIL.

More importantly, similar to the TIER amendments, Article 22 appears to reiterate a "hands-off" approach by allowing parties the freedom to contract without local protectionist intervention. It not only enshrines into law fair and equal negotiation between the parties, but also goes on to state that "the State shall encourage technology cooperation based on voluntary principles and business practices" in the process of foreign investment.

Implementing regulations to the FIL are currently in the making and would be expected to give more substance to the broad FIL language, including what may constitute a "forced technology transfer". It is hoped that Article 22 of the FIL will mark a shift to a more liberalised technology transfer regime in practice and during dealings with Chinese counterparties.

CONCLUSION

Undoubtedly, the recent revisions to TIER have brought some long-overdue clarity. Given the significance and frequency of technology transfers and their elevated role in the race to control new or emerging technologies, this is likely to be an evolving and ever increasingly important regime.

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