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# Protection of Intellectual Property Rights in Software Products and How to Accomplish a Technology Transfer Transaction in China

Felix Miao\*

## INTRODUCTION

China possesses much strength in the production and export of computer hardware. It is the world's largest platform of hardware production, accounting for approximately 70 percent of the world's hardware base.<sup>1</sup> Software development and production in China, however, pales in comparison with its leading position in hardware production. Based on statistics from the year 2000, the size of China's software industry is only one-fifth of that of its hardware industry.<sup>2</sup> This discrepancy is largely based on disadvantages in labor cost.<sup>3</sup> China is gradually losing its comparative advantage in labor cost, as more countries in Southeast Asia, Eastern Europe and Latin America now can offer cheaper labor sources.<sup>4</sup> Thus, China needs to upgrade the technological level of its exports in order to maintain the rapid growth of its economy.

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<sup>1</sup> Bryan S.T. Tan & Benjamin Cheong, *Windows into the Middle Kingdom: A Peek into the Importation and Sale of Software in China*, 7 SING. J. INT'L & COMP. L. 127, 127 (2003).

<sup>2</sup> See *id.*

<sup>3</sup> See generally JUDITH BANISTER, U.S. DEPT. OF LABOR – BUREAU OF LABOR STATISTICS, MANUFACTURING EMPLOYMENT AND COMPENSATION IN CHINA, available at <http://www.bls.gov/fls/chinareport.pdf> (last visited Sept. 10, 2007).

<sup>4</sup> See *id.* at 50.

China currently needs to import a large amount of its software technology.<sup>5</sup> This presents a golden opportunity for many American software companies.<sup>6</sup> In 2002, the software market in China grew by 19.5 percent to reach \$1.98 billion.<sup>7</sup> “The steady growth of the economy, rapid improvement in IT (information technology) infrastructure and increasing demand from private enterprises will see the market grow at a CAGR (compound annual growth rate) of 25.8 percent up to 2007, when it will be worth \$6.24 billion.”<sup>8</sup> Therefore, many foreign companies have made great efforts to penetrate the Chinese market; for example, Microsoft “disclose[d] its entire source code to the Chinese government” to dispel security fears from high officials.<sup>9</sup>

China is well positioned to realize the benefits of technology transfers with several important factors working in its favor. The national domestic market for goods and services is fairly large and has been expanding.<sup>10</sup> Foreign investors also have access to the extensive regional markets. Due to the sheer size of the domestic market, China can attract competing horizontal foreign investments, counteracting to some extent its own economy’s tendency towards monopolies.<sup>11</sup> Therefore, consumers can benefit from the availability of foreign-technology-dependent products in the Chinese market. Furthermore, China also possesses significant natural resources and a large pool of educated low-wage labor.<sup>12</sup> The domestic industries have enormous manufacturing capabilities.<sup>13</sup> Meanwhile, because China encourages foreign investment to export products, the domestic market serves as a

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<sup>5</sup> Tan & Cheong, *supra* note 1, at 127.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *See id.*

<sup>9</sup> *Id.*

<sup>10</sup> *See generally* World Bank – China Data Profile, <http://devdata.worldbank.org/external/CPProfile.asp?PTYPE=CP&CCODE=CHN> (last visited Sept. 10, 2007).

<sup>11</sup> WILLIAM MILBERG, Trade and Competition Policy 6 (November 2002), *available at* [http://www.newschool.edu/cepa/research/workingpapers/0211\\_TradeandCompetitionPolicy.pdf](http://www.newschool.edu/cepa/research/workingpapers/0211_TradeandCompetitionPolicy.pdf) (last visited Sept. 14, 2007).

<sup>12</sup> *See generally* NATIONAL BUREAU OF STATISTICS OF THE PEOPLE’S REPUBLIC OF CHINA, CHINA STATISTICAL YEARBOOK – 2006, ch. 1 (2006), *available at* <http://www.stats.gov.cn> (last visited Sept. 10, 2007); BANISTER, *supra* note 3, at 20.

<sup>13</sup> *See generally* World Bank – China Data Profile, *supra* note 10.

base for regional distributions and is likely to attract vertical foreign investment.<sup>14</sup> With increases in foreign exchange, China has had surpluses in capital reserve to purchase “IPRs [intellectual property rights] from abroad . . . [and] invest[] extensively in domestic R&D [research and development], making it the highest investor in R&D in the developing world.”<sup>15</sup> “[I]n addition to both the size of [China’s] home market and accessibility to other markets in Asia, [the extent of its domestic R&D facilities] makes [it] a logical place for MNCs [multinational corporations] to invest in R&D.”<sup>16</sup> If the trend continues, “this source of foreign exchange will permit China to continue purchasing IPRs, engage in R&D and undertake the capital investment necessary to further its economic development.”<sup>17</sup> However, the legal regime governing the importation and sale of software in China differs from that of the United States. Without a thorough understanding of the prevailing laws and regulations of China’s legal system, an importer of software technology might incur both huge financial loss and legal liability.

## I. PROTECTION OF INTELLECTUAL PROPERTY RIGHTS IN SOFTWARE PRODUCTS IN CHINA’S LEGAL SYSTEM

### A. *China’s Legal System Has Been Reformed to Meet International Standards of Intellectual Property Protections*

Because English has become the “*lingua franca* of the world and the fact that computer programming language is predominantly in the English alphabet, China has been, and it is likely that China will remain for many years, a net importer of intellectual

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<sup>14</sup> See *China’s Economy*, THE ECONOMIST, Nov. 13, 2006, available at [http://www.economist.com/agenda/displaystory.cfm?story\\_id=8162102](http://www.economist.com/agenda/displaystory.cfm?story_id=8162102) (reporting that China plans to continue to pursue FDI in great volume); Eleventh Five-Year Plan for National, Economic, & Social Development of the People’s Republic of China, National Development and Reform Commission (NDRC) of the People’s Republic of China, Nov. 9, 2006, available at [http://en.ndrc.gov.cn/hot/t20060529\\_71334.htm](http://en.ndrc.gov.cn/hot/t20060529_71334.htm).

<sup>15</sup> Mikhaelle Schiappacasse, *Intellectual Property Rights in China: Technology Transfers and Economic Development*, 2 BUFF. INTELL. PROP. L.J. 164, 183 (2004).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

property.”<sup>18</sup> Against this backdrop, before the 1990’s China was preoccupied with how to import technology rather than how to protect intellectual property (IP).<sup>19</sup> An effective intellectual property system is the precondition for successful technology transfer.<sup>20</sup> “With one of the highest economic growth rates in the world, a population of 1.3 billion, and the fastest growing domestic market for goods and services,” as of 2003, China was “one of the largest recipients of foreign direct investment (FDI) in the world.”<sup>21</sup> “[F]oreign investment enterprises or multinational corporations (MNCs) are wary of transferring new and advanced technology to countries . . . where IP protection is weak.”<sup>22</sup> “China’s failure to enforce IPRs . . . has the potential to severely limit [its] ability to maintain its current rate of economic growth as it reaches higher levels of technological advancement.”<sup>23</sup> Countries that offer better protection of intellectual property tend to attract more foreign investment, which often brings in more advanced technology and production processes.<sup>24</sup>

Coming under increasing international pressure, China has committed itself to developing a legal system that protects intellectual property rights.<sup>25</sup> China is attempting to harmonize its protection regime with the rest of the world and is now a member of major international treaties on intellectual property.<sup>26</sup> It is required to meet its substantive obligations under the GATT

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<sup>18</sup> Tan & Cheong, *supra* note 1, at 130.

<sup>19</sup> See Schiappacasse, *supra* note 15, at 183.

<sup>20</sup> *Id.* at 166.

<sup>21</sup> *Id.* at 165.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> See David B. Dreyfus, *Confucianism and Compact Discs: Alternative Dispute Resolution and its Role in the Protection of United States Intellectual Property Rights in China*, 13 OHIO ST. J. ON DISP. RESOL. 947, 952 (1998).

<sup>25</sup> See Naigen Zhang, *Intellectual Property Law Enforcement in China: Trade Issues, Policies and Practices*, 8 FORDHAM INTELL. PROP. MEDIA & ENT. L.J. 63, 63 (1997).

<sup>26</sup> See *id.* at 64; Warren H. Maruyama, *U.S.-China IPR Negotiations: Trade, Intellectual Property, and the Rule of Law in a Global Economy*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 165, 189 (Mark A. Cohen et al. eds., 1999). For instance, China became a member of the World Intellectual Property Organization (“WIPO”) in 1980, see Paul B. Birden, *Technology Transfers to China: An Outline of Chinese Law*, 16 LOY. L.A. INT’L & COMP. L. REV. 413, 417 (1994), and a member of the World Trade Organization (“WTO”) in 2001. Schiappacasse, *supra* note 15, at 165.

Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights Including Trade in Counterfeit Goods (“TRIPs Agreement”).<sup>27</sup>

### 1. Copyright, Trademark and Patent Protection for Software Products

A software product can be protected by three types of intellectual property law.<sup>28</sup> Copyright law protects the expression of ideas and is applicable to the protection of source and object code that forms the software.<sup>29</sup> Trademark law protects the brand name associated with the software.<sup>30</sup> Patent law protects innovative programming techniques.<sup>31</sup> In this context, China’s patent law, copyright law, and trademark law have all been amended in the 21st century.<sup>32</sup>

### 2. Protection Under Other Complementary Laws and Regulations

The law in several other areas complements China’s intellectual property regime. The Chinese Constitution was promulgated in 1982 and was amended in 1988, 1993, 1999, and

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<sup>27</sup> Tan & Cheong, *supra* note 1, at 167.

<sup>28</sup> *See id.*

<sup>29</sup> *See id.*

<sup>30</sup> *See id.*

<sup>31</sup> *See id.*

<sup>32</sup> *See* Schiappacasse, *supra* note 15, at 177; *see generally* Trademark Law of the People’s Republic of China (promulgated by the Standing Comm. People’s Cong., Aug. 23, 1982, effective Mar. 1, 1983, last amended Oct. 27, 2001), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.), available at <http://www.chinalawinfo.com> [hereinafter Trademark Law]; Patent Law of the People’s Republic of China (promulgated by the Standing Comm. People’s Cong., Mar. 12, 1984, effective Apr. 1, 1985, last amended Aug. 25, 2000), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Patent Law]; Copyright Law of the People’s Republic of China (promulgated by the Standing Comm. People’s Cong., Sept. 7, 1990, effective June 1, 1991, last amended Oct. 27, 2001), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Copyright Law]; Shuk Ki Ella Cheong, *Copyright Law and Regulation in China*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 47, 47 (Mark A. Cohen et al. eds., 1999); Shuk Ki Ella Cheong, *Trademark Law and Regulation in China*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 25, 25 (Mark A. Cohen et al. eds., 1999); Flora Wang, *An Overview of the Development of China’s Patent System*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 3, 4 (Mark A. Cohen et al. eds., 1999).

2004.<sup>33</sup> It is the foundation of all legislation and represents the fundamental law of China.<sup>34</sup> The copyright law expressly states that it is formulated “in accordance with the Constitution.”<sup>35</sup> China’s Constitution now enshrines the right of the individual to own and inherit private property,<sup>36</sup> “rewards achievements in scientific research as well as technological innovations and inventions,”<sup>37</sup> and “promotes the development of art and literature,” and the use of media.<sup>38</sup> It also encourages creative endeavors in the fields of “education, science, technology, literature, art and other cultural work.”<sup>39</sup>

The General Principles of the Civil Law was promulgated in 1986.<sup>40</sup> It defines the civil rights of legal persons, protects such lawful rights, and regulates relations between private parties concerning property.<sup>41</sup> Section 3 of Chapter 5 includes intellectual property rights among the primary civil rights.<sup>42</sup> It protects the rights of legal persons to create and exploit copyrights, patents and trademarks.<sup>43</sup>

The Criminal Law was first promulgated in 1979 and revised in 1997.<sup>44</sup> As intellectual property has become significantly more important in the world economy, many countries, including China,

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<sup>33</sup> See generally Constitution of the People’s Republic of China (promulgated by the People’s Cong., Mar. 14, 2004, effective Mar. 14, 2004), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Constitution].

<sup>34</sup> *Id.* pmb1.

<sup>35</sup> Copyright Law, *supra* note 32, art. 1.

<sup>36</sup> Constitution, *supra* note 33, art. 13.

<sup>37</sup> *Id.* art. 20.

<sup>38</sup> *Id.* art. 22.

<sup>39</sup> *Id.* art. 47.

<sup>40</sup> See generally General Principles of Civil Law of the People’s Republic of China (promulgated by People’s Cong., Apr. 12, 1986, effective Apr. 12, 1986), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Gen. Principles of Civil Law].

<sup>41</sup> See *id.* ch. 1, arts. 1–2.

<sup>42</sup> See *id.* ch. 5, sec. 3, arts. 94–97.

<sup>43</sup> See *id.*

<sup>44</sup> See generally Criminal Law of the People’s Republic of China (promulgated by the People’s Cong., Mar. 14, 1997, effective Oct. 1, 1997), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Criminal Law].

have criminalized the infringement of intellectual property rights.<sup>45</sup> In Section 7 of Chapter 3 in Part II of the Criminal Law, any infringer violating the intellectual property rights of others may be punished with imprisonment of up to seven years and unspecified fines, based on the severity of the infringing acts.<sup>46</sup> It criminalizes the following infringing acts within the territory of China:

- (1) Using an identical trademark on similar merchandise without the permission of the registered owner,
- (2) Knowingly selling merchandise with a fake trademark,
- (3) Forging or representing a registered trademark without the authority of the owner,
- (4) Counterfeiting copyrighted work to reap illegitimate profit without the permission of the copyright owner,
- (5) Encroaching on business secrets by using illegitimate means, which causes significant losses to the right-holder, and
- (6) Mixing impurities into or adulterating products or passing off imitation goods as genuine, defective products as high-quality, or substandard products as standard.<sup>47</sup>

The Anti-Unfair Competition Law was promulgated in 1993.<sup>48</sup> It forbids feigning registered trademarks of famous or high quality commodities with intent to confuse consumers.<sup>49</sup> It also prohibits the improper acquisition of business secrets by theft or other unfair

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<sup>45</sup> See Tan & Cheong, *supra* note 1, at 131 (describing criminalization of IP infringement in China).

<sup>46</sup> See Criminal Law, *supra* note 44, arts. 213–20.

<sup>47</sup> See *id.* arts. 213–19, 140.

<sup>48</sup> See generally Anti-Unfair Competition Law of the People's Republic of China (promulgated by the Standing Comm. People's Cong., Sept. 2, 1993, effective Sept. 2, 1993), LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Anti-Unfair Competition Law].

<sup>49</sup> *Id.* art. 5.

means.<sup>50</sup> The culpable party may be fined and forced to compensate the victim, and the illegal profits may be confiscated.<sup>51</sup>

### 3. Judicial and Administrative Enforcement of Intellectual Property Rights

The State Intellectual Property Office (SIPO) administers China's intellectual property laws.<sup>52</sup> China actively participated in the negotiation of the TRIPs Agreement and has used this Agreement as the basis for forming and revising many of its own intellectual property laws.<sup>53</sup> Treaties are deemed part of Chinese law upon accession.<sup>54</sup> When intellectual property laws are not in conformity with international standards, China's courts look to the existing international rule.<sup>55</sup> China's IP laws are substantively some of the most comprehensive in the world.<sup>56</sup> However, ineffective enforcement measures, particularly in the area of copyright, are severely criticized by international communities.<sup>57</sup>

Special Intellectual Property Divisions and mediation centers have been established within China's court system.<sup>58</sup> The Supreme People's Court, the highest appellate court in China, set up an intellectual property division.<sup>59</sup> A foreign investor can bring an infringement case in the Intermediate People's Court.<sup>60</sup> Most Chinese perceive arbitration as less confrontational and consider it the most desirable method of settlement.<sup>61</sup> In addition to resorting

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<sup>50</sup> See *id.* art. 10.

<sup>51</sup> See *id.* arts. 20–30.

<sup>52</sup> See Patent Law, *supra* note 32, art. 19.

<sup>53</sup> See Tan & Cheong, *supra* note 1, at 142.

<sup>54</sup> Gen. Principles of Civil Law, *supra* note 40, art. 142; see also Zhang, *supra* note 25, at 65.

<sup>55</sup> *Id.*

<sup>56</sup> See Schiappacasse, *supra* note 15, at 164–65.

<sup>57</sup> See *id.* at 183–84; see also Kenyon S. Jenckes, Note, *Protection of Foreign Copyrights in China: the Intellectual Property Courts and Alternative Avenues of Protection*, 5 S. CAL. INTERDISC. L.J. 551, 551–52 (1997).

<sup>58</sup> Susan Finder, *The Protection of Intellectual Property Rights Through the Courts*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 255, 260, 266 (Mark A. Cohen et al. eds., 1999).

<sup>59</sup> *Id.* at 260.

<sup>60</sup> *Id.* at 263.

<sup>61</sup> See Jenckes, *supra* note 57, at 559.

to the judicial process in courtrooms, an intellectual property infringement action can be brought before either a court or administrative agency responsible for protection of intellectual property in a province, autonomous region, or municipality.<sup>62</sup> Administrative agencies have been set up to provide effective and swift remedies for intellectual property disputes. The Administrative Authorities for Patent Affairs administer the patent law, the Administrative Authorities for Trademark Affairs administer the trademark law, and the National Copyright Administration Office administers the copyright law.<sup>63</sup> Moreover, numerous departments at various local levels have been set up to administer intellectual property disputes.<sup>64</sup> These administrative agencies typically have the combined functions of law enforcement, management and administration.<sup>65</sup> They can order infringers to cease and desist from any wrongdoings, demand compensation for fines, and seize infringing copies and equipment that was used to manufacture infringing copies.<sup>66</sup> If a party disagrees with an administrative penalty imposed, it can appeal the decision to a court within the prescribed amount of time after receiving the written notice.<sup>67</sup>

### *B. Protection of Copyright*

China's Copyright Law was promulgated in 1991 and last revised in 2001.<sup>68</sup> The Regulation on the Implementation of the Copyright Law ("Copyright Regulation") was promulgated in 2002 and supplements the Copyright Law with more detail.<sup>69</sup> In

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<sup>62</sup> Alexander C. Chen, *Climbing the Great Wall: A Guide to Intellectual Property Enforcement in the People's Republic of China*, 25 AIPLA Q.J. 1, 44–48 (1997); see also Zhang, *supra* note 25, at 68–71.

<sup>63</sup> See Zhang, *supra* note 25, at 68–71; see also Finder, *supra* note 58, at 257–58.

<sup>64</sup> Chen, *supra* note 62, at 46–47.

<sup>65</sup> *Id.* at 44–48; see also Zhang, *supra* note 25, at 68–71.

<sup>66</sup> Copyright Law, *supra* note 32, art. 47; see also Xianwen Wu, *Intellectual Property Rights Protection in China and China's Efforts to Join WTO*, in CHINESE INTELLECTUAL PROPERTY LAW AND PRACTICE 141–42 (Mark A. Cohen et al. eds., 1999).

<sup>67</sup> Copyright Law, *supra* note 32, art. 55; see also Trademark Law, *supra* note 32, art. 53; Patent Law, *supra* note 32, art. 57.

<sup>68</sup> See Wu, *supra* note 66, at 133; see also Tan & Cheong, *supra* note 1, at 132–33.

<sup>69</sup> See Tan & Cheong, *supra* note 1, at 133; see generally Regulations for the Implementation of the Copyright Law of the People's Republic of China (promulgated by

October 1992, China joined the Berne Convention and the Universal Copyright Convention.<sup>70</sup> The Chinese Copyright Law provides the same protection that Chinese citizens enjoy to nationals of all member countries under these international treaties.<sup>71</sup> Citizens of member countries are entitled to automatic protection in China even if such works are published outside China.<sup>72</sup> The Copyright Law is consistent with the World Intellectual Property Organization Copyright Treaty of 1996 (“WIPO”).<sup>73</sup> Although China is still not a signatory to that treaty, it has adopted certain of its provisions relating to computer programs.<sup>74</sup> China’s Copyright Law clearly states that computer software is a type of copyrightable subject matter.<sup>75</sup> Article 58 of the Copyright Law also states that the State Council has the authority to establish separate regulations and lay out further details of protection.<sup>76</sup> The Regulations for the Protection of Computer Software (“Software Regulations”) were promulgated in 1991 and revised in 2002.<sup>77</sup> Under the Software Regulations, protectable computer software includes both computer programs and the relevant documentation.<sup>78</sup> As most software is accompanied by marketing materials and packaging that describe the use and maintenance of the software, the Copyright Law also protects such written materials as literary work.<sup>79</sup>

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the State Council, Aug. 2, 2002, effective Sept. 15, 2002), LAWINFOCHINA (last visited Sept. 9, 2007) (P.R.C.).

<sup>70</sup> Wu, *supra* note 66, at 133.

<sup>71</sup> Copyright Law, *supra* note 32, art. 2.

<sup>72</sup> *Id.*

<sup>73</sup> Zhang, *supra* note 25, at 72.

<sup>74</sup> Tan & Cheong, *supra* note 1, at 133 n.25.

<sup>75</sup> Copyright Law, *supra* note 32, art. 3.

<sup>76</sup> *Id.* art. 58.

<sup>77</sup> Regulations on the Protection of Computer Software (promulgated by the St. Council, Dec. 20, 2001, effective Jan. 1, 2002), LAWINFOCHINA (last visited Sept. 9, 2007) (P.R.C.) [hereinafter Regulations on the Protection of Computer Software].

<sup>78</sup> *Id.* art. 2.

<sup>79</sup> Copyright Law, *supra* note 32, art. 3(1).

### 1. Registration of Software Products for Priority Protection and Commercial Distribution

Under the Software Regulations, the software copyright owner may pay a fee to register the software product at a software registry vehicle, such as the China Software Registration Center designated by the Copyright Administration Department of the State Council.<sup>80</sup> In February 2002, the National Copyright Administration promulgated the Measures for the Registration of Copyright in Computer Software (“Software Registration Measures”) that provide the detailed rules for software registration.<sup>81</sup> The Software Registration Measures explain that the registration process is not mandatory before the software copyright owner can bring legal or administrative proceedings for infringement.<sup>82</sup> The registration procedure only gives priority protection to software that has been registered with the National Copyright Administration.<sup>83</sup>

In order to sell a software product within the territory of China, however, the software licensee *must* register his product.<sup>84</sup> In October 2000, China’s Ministry of Information Industries (“MII”) promulgated the Measures for the Administration of Software Products (“Software Administration Measures”).<sup>85</sup> The Software Administration Measures require that the software copyright owner conform to various registration requirements and conditions before he manufactures or sells software products in China.<sup>86</sup> The apparent purpose of the mandatory registration procedure was to enable the administrative agency, the MII, to examine and control the contents of software products.

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<sup>80</sup> Regulations on the Protection of Computer Software, *supra* note 77, art 7.

<sup>81</sup> Measures for the Registration of Computer Software Copyright (promulgated by the St. Bureau of Copyright, Feb. 20, 2002, effective Feb. 20, 2002), LAWINFOCHINA (last visited Sept. 9, 2007) (P.R.C.).

<sup>82</sup> Tan & Cheong, *supra* note 1, at 140.

<sup>83</sup> *Id.*

<sup>84</sup> Measures for the Administration of Software Products (promulgated by the Ministry of Info. Indus., Oct. 27, 2000, effective Oct. 27, 2000), art. 26, China Elec. Commerce Law, Measures for the Admin. of Software Products (Dec. 21, 2004), <http://www.chinaelaw.com/readArticle.asp?id=2385> (P.R.C.).

<sup>85</sup> *Id.* art. 1.

<sup>86</sup> *Id.* art. 26.

## 2. Ownership Rights in Software Products

Usually, the software copyright vests in the author who has developed the work.<sup>87</sup> The Software Regulations, however, indicate that software that has been developed by an employee shall be owned by his or her employer in the following circumstances:

- (1) The software is developed in accordance with a development objective expressly assigned as part of the employee's duties;
- (2) The developed software is a "foreseeable or natural result" of the employee's carrying on activities in the line of duty; or
- (3) The software is developed mainly through the use of "funds, special equipment, undisclosed special information," or other material and technical facilities of the employer.<sup>88</sup>

Therefore, as a matter of good practice, a software company should specify clearly in its contracts that when its employees or external consultants engage in any type of software development work, the copyright in the resulting products vests in the software company. Especially for a software company that imports foreign software products into China, it is important to retain the exclusive rights to work done locally, such as adapting the software or the accompanying documentation from English into Chinese.

## 3. Acts of Copyright Infringement and Legal Remedies

The Software Regulations outline the common acts of copyright infringement, such as reproduction, publication, and distribution of software without the consent of the copyright owner.<sup>89</sup> Furthermore, the Regulations explicitly state that "[i]ntentionally avoiding or breaching the technical measures adopted by the copyright owner to protect the software copyright"

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<sup>87</sup> Regulations on the Protection of Computer Software, *supra* note 77, art. 9.

<sup>88</sup> *Id.* art. 13.

<sup>89</sup> *Id.* art. 24(1)–(2).

constitutes an infringing act.<sup>90</sup> “Intentionally deleting or altering the electronic information of software right management” is also prohibited.<sup>91</sup>

Whenever a copyright owner obtains evidence showing that an infringing act has been or is about to be carried out, and failure to halt such activity would cause the copyright owner irreversible damage, he can petition the court for an injunction as well as an order to preserve the property and evidence even before the lawsuit is brought.<sup>92</sup> In cases of breach of contractual obligations or non-conformity with contractual terms, the remedy is civil under the Civil Law and the Contract Law.<sup>93</sup> The remedies for copyright infringement include cessation of infringing acts, payment of damages, issuing of an apology, and elimination of the effects of such activity.<sup>94</sup> When the infringement is serious or the public interest is harmed, the copyright administration department has the authority to stop the infringing acts, to seize illegal income, to confiscate and destroy infringing copies, and to impose a fine if necessary.<sup>95</sup> Damages payable to the copyright owner are calculated based on actual losses that he has suffered.<sup>96</sup> When such damages are difficult to quantify, compensation may be made based on the illegal gain reaped by the infringer.<sup>97</sup> The amount of compensation must include reasonable expenses paid by the copyright owner to stop the acts of infringement.<sup>98</sup>

### C. Protection of Trademarks

Because many well-known trademarks are closely connected with popular software available in the market today, such as Microsoft, Windows, Linux, Norton and Adobe, it is essential that any foreign software developer that plans to license its product in China be well informed of the legal issues relating to the protection

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<sup>90</sup> *Id.* art. 24(3).

<sup>91</sup> *Id.* art. 24(4).

<sup>92</sup> Copyright Law, *supra* note 32, arts. 49–50.

<sup>93</sup> *Id.* art. 53.

<sup>94</sup> *Id.* arts. 46–47.

<sup>95</sup> *Id.* art. 47.

<sup>96</sup> *Id.* art. 48.

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

of its brand names. The Chinese Trademark Law “was the first piece of intellectual property legislation that was enacted by the NPC [National People’s Congress]” since the late 1970s.<sup>99</sup> “[T]he State Council and the State Administration of Industry and Commerce have promulgated various administrative regulations, opinions and guidelines to supplement” the Trademark Law.<sup>100</sup> The most recent amendment to the Trademark Law was in 2001.<sup>101</sup> Its purpose was to eliminate the discrepancies between China’s Trademark Law and the TRIPs Agreement under the WTO.<sup>102</sup> The provisions of the Paris Convention for the Protection of Industrial Property (“Paris Convention”) relating to the recognition and registration of well-known trademarks were also incorporated into the amended Trademark Law.<sup>103</sup>

China acceded to the Paris Convention in 1985, the Madrid Agreement Concerning the International Registration of Marks (“Madrid Agreement”) in 1989,<sup>104</sup> the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (“Nice Agreement”) in 1994, and the Trademark Law Treaty in 1994.<sup>105</sup> Licensors of trademarks from signatory countries of the Madrid Agreement can designate China as one of the registered countries when first

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<sup>99</sup> Tan & Cheong, *supra* note 1, at 141–42; Wu, *supra* note 66, at 141 (discussing IP laws enacted since the Economic Reform and Openness Policy at the end of the 1970s). The Trademark Law was enacted in 1983, before the Patent Law in 1985 and the Copyright Law in 1990. *See supra* note 32 and accompanying text.

<sup>100</sup> Tan & Cheong, *supra* note 1, at 141–42 [internal citations omitted].

<sup>101</sup> *Id.* at 142.

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> Birden, *supra* note 26, at 416.

<sup>105</sup> Tan & Cheong, *supra* note 1, at 142.

applying for trademark protection outside China.<sup>106</sup> They do not need to independently register the trademark in China later.<sup>107</sup>

The Trademark Law indicates that if any natural persons, legal persons or organizations “want to acquire the exclusive right to use a trademark for the goods [they] produce[], manufacture[], process[],” or distribute, they must apply to register the trademark.<sup>108</sup> If they provide services, they may also register a service mark for the corresponding exclusive rights.<sup>109</sup> However, whereas Chinese trademark owners can directly register their trademarks with the trademark office, foreign trademark owners must appoint a Chinese organization as their agent.<sup>110</sup> The agent must be recognized by the State to act as trademark agent.<sup>111</sup> If the trademark is successfully registered, it is valid and will be protected for a period of ten years from the date of its approval.<sup>112</sup>

#### D. Protection of Patent Law

The Patent Law was first adopted in 1984 and became effective in 1985, and China has amended the law in order to harmonize it with international standards.<sup>113</sup> The latest amendment was in 2000.<sup>114</sup> China joined the Paris Convention in 1985<sup>115</sup> and became a member of the Patent Cooperation Treaty in 1994.<sup>116</sup> The

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<sup>106</sup> Madrid Agreement Concerning the International Registration of Marks (open for signing Apr. 14, 1891, amended Sept. 28, 1979), art. 4, *available at* [http://www.wipo.int/madrid/en/legal\\_texts/trtdocs\\_wo015.html](http://www.wipo.int/madrid/en/legal_texts/trtdocs_wo015.html) [hereinafter Madrid Agreement]; *see also* Trademark Law, *supra* note 32, arts. 17, 24 (providing that international agreements or treaties, such as the Madrid Agreement, control where a foreign entity applies for trademark in China).

<sup>107</sup> *See* Trademark Law, *supra* note 32, art. 24 (explaining that a party must simply submit an application in China “within six months from the date on which the application was first filed in the foreign country.”).

<sup>108</sup> *Id.* art. 4.

<sup>109</sup> *Id.*

<sup>110</sup> *Id.* art. 18.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.* art. 37.

<sup>113</sup> *See* Birden, *supra* note 26, at 419–20.

<sup>114</sup> *See* Patent Law, *supra* note 32 and accompanying text.

<sup>115</sup> Birden, *supra* note 26, at 416.

<sup>116</sup> PCT Applicant’s Guide – Volume I – Annex A: PCT Contracting States, [http://www.wipo.int/pct/guide/en/gdvol1/annexes/annexa/ax\\_a.pdf](http://www.wipo.int/pct/guide/en/gdvol1/annexes/annexa/ax_a.pdf) (last visited Sept. 13, 2007).

Chinese Patent Law affords a period of twenty years to protect inventions or innovation.<sup>117</sup> Utility models and design patents are protected for a shorter period of ten years.<sup>118</sup> Unlike the first-to-invent system of the United States, China has adopted a first-to-file system.<sup>119</sup> Application for a Chinese patent is made to the State Intellectual Property Office (“SIPO”).<sup>120</sup> A foreign licensor that does not have “an habitual residence or business office in China” must appoint a patent agent when applying for patent approval from SIPO.<sup>121</sup> Similar to the Trademark Law, the agent must be recognized by the patent administration department regarding the qualification to act as a patent agent.<sup>122</sup>

## II. STATUTORY REQUIREMENTS ON LICENSE OR REGISTRATION OF TECHNOLOGY TRANSFER CONTRACT

### A. *Legal Definition of Technology Transfer under the Uniform Contract Law*

In addition to “the new laws on patent, trademark, and copyright governing licensing and technology transfer,” there are several laws that govern international technology transfer, including

the 1994 Foreign Trade Law, the Unified Contract Law of 1999, the 2002 Regulations on Administration of Technology Import and Export by the Ministry of Foreign Trade and Economic Cooperation (MOFTEC), [the] 2002 Measures for Administration of the Registration of Technology Import and Export Contracts, and the 2001 Notice on How to Adjudicate Disputes on Technology Contracts by the Supreme People’s Court, the 2001 regulations on royalty remittance by the State

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<sup>117</sup> Patent Law, *supra* note 32, art. 42.

<sup>118</sup> *Id.*

<sup>119</sup> *See id.* art. 9.

<sup>120</sup> *See id.* art. 19.

<sup>121</sup> *Id.*

<sup>122</sup> *See id.*

Administration of Foreign Exchange (SAFE), [and the] 2003 Notice on Strengthening Patent Administration in Foreign Trade issued by the MOFTEC and the State Intellectual Property Office.<sup>123</sup>

Many of the Chinese laws and regulations on cross-border technology transfer that were promulgated from the mid-1980s until the late-1990s “were abolished or substantially modified.”<sup>124</sup> Therefore, “foreign companies must conduct even more careful research in evaluating current regulatory requirements.”<sup>125</sup>

#### 1. The Uniform Contract Law Moves More in Line with Free Trade

China’s contract law has a much longer history than the intellectual property laws that have been established only in the recent two decades. The National People’s Congress (“NPC”) passed the new Uniform Contract Law (“UCL”) on March 15, 1999, which became effective on October 1, 1999.<sup>126</sup> Over the years, local protectionism had substantial influence on Chinese legal concepts.<sup>127</sup> The UCL was most likely enacted for the purpose of conforming to the “WTO requirements of “an integral legal, system [that is] administered in a ‘uniform, impartial, and reasonable manner.’”<sup>128</sup> Combining existing laws, the UCL has achieved several improvements through legislation:

- (1) Supporting behaviors that are essential to develop a market-based economy;
- (2) Loosening up the requirements concerning contract formalities; and

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<sup>123</sup> Catherine Sun, *Technology Import and Export in Post-WTO China*, INTELL. PROP. L. NEWSL., Summer 2003, at 21.

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> James C. Hitchingham, *Stepping up to the Needs of the International Market Place: An Analysis of the 1999 ‘Uniform’ Contract Law of the People’s Republic of China*, 1 ASIAN-PAC. L. & POL’Y J. 8:1, 8:2 & n.5 (2000).

<sup>127</sup> See Nathan Greene, Note, *Enforceability of the People’s Republic of China’s Trade Secret Law: Impact on Technology Transfer in the PRC and Preparing for Successful Licensing*, 44 IDEA 437, 454 (2004).

<sup>128</sup> *Id.* at 458.

(3) Eradicating large discrepancies among previous laws.<sup>129</sup>

Most importantly, under the prior Foreign Economic Contract Law, only an “enterprise” could contract with foreign individuals, enterprises or other economic organizations.<sup>130</sup> In order to further open the Chinese market for foreign technology and to better comply with the WTO requirements, the Chinese law now allows trading by private enterprises and individuals.<sup>131</sup> Entitled to the same rights as state-owned enterprises, private enterprises and individuals now can engage in fair competition of free trade in goods and technology.<sup>132</sup> This will reduce and further eradicate the unfair advantage previously enjoyed by state-owned enterprises through governmental interference and protection.<sup>133</sup>

2. Definition of Technology Transfer under the Uniform Contract Law

Currently, a technology contract between two Chinese domestic parties is governed by Chapter 18 of the Uniform Contract Law (“UCL”).<sup>134</sup> The UCL states that the technology contract covers the subjects of “technology development, technology transfer, technical consultancy and technical services.”<sup>135</sup> Under the UCL, the term “technology transfer contract[] include[s] contracts on patent transfer, contracts on transfer of the right to apply for a patent, contracts on transfer of know-how and contracts on the licensing of patent exploitation.”<sup>136</sup> The term “technology transfer” generally means “the diffusion of practical knowledge from one enterprise, institution or country to

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<sup>129</sup> *Id.*

<sup>130</sup> See Li Mei Qin, *China's Post-WTO Goods and Technology Import and Export Legal System*, 7 SING. J. INT'L & COMP. L. 102, 125 (2003) (explaining that after China joined the WTO, it needed to enable individuals and enterprises with the right to trade).

<sup>131</sup> See *id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> Uniform Contract Law (promulgated by the Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), ch. 18, LAWINFOCHINA (last visited Sept. 9, 2007) (P.R.C.) [hereinafter Uniform Contract Law].

<sup>135</sup> *Id.* art. 322.

<sup>136</sup> *Id.* art. 342.

another.”<sup>137</sup> However, under the UCL, the term “technology transfer contract” includes both agreements of transfer and license.<sup>138</sup> The term “license” is used only with patents, while the term “transfer” is expressly permitted for patent rights, patent application and technological secrets.<sup>139</sup> The concept of technology transfer, if defined broadly, also includes managerial expertise and practical knowledge for making a business profitable. Further, the law requires that “[a] technology transfer contract shall be in written form.”<sup>140</sup>

*B. Protection of Chinese Domestic Licensee Violates Principle of Freedom of Contract*

Because the market mechanism did not operate effectively in its economy, the Chinese government assumed the essential role of regulating market functions prior to China’s accession to the WTO.<sup>141</sup> The Chinese government accomplished this objective by controlling and rationing the import of technology.<sup>142</sup> It promulgated a series of regulations governing the import of technology and established an elaborate regulatory framework primarily to protect Chinese domestic enterprises.<sup>143</sup> The Chinese officials scrutinized the terms of technology transfer contracts because most of the Chinese importers were state-owned and did not have experience with the sometimes unreasonable or unscrupulous conduct of foreign transferors.<sup>144</sup> At the time, the most effective way to control them was to require that all the foreign technology transfer contracts were valid only if registered and approved by the Chinese government.<sup>145</sup> However, a

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<sup>137</sup> Institute for Trade and Commercial Diplomacy – Glossary, [http://www.itcdonline.com/introduction/glossary2\\_q-z.html](http://www.itcdonline.com/introduction/glossary2_q-z.html) (last visited Sept. 14, 2007).

<sup>138</sup> Uniform Contract Law, *supra* note 134, art. 342.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> See Birden, *supra* note 26, at 124.

<sup>142</sup> See *id.* at 125.

<sup>143</sup> Qin, *supra* note 130, at 116–17.

<sup>144</sup> *Id.* at 109 (noting the presence of centralized management and subsidization for foreign trade export industries).

<sup>145</sup> See Stefanie Tetz, *Technology Transfer in the People’s Republic of China – A Foreign Investor’s Perspective*, in LEGAL RULES OF TECHNOLOGY TRANSFER IN ASIA, 55, 55–56 (Christopher Heath & Kung-Chung Liu eds., 2002).

technology transfer contract between two domestic parties was not subject to the same requirements for government approval.<sup>146</sup>

Depending on the scope of the agreement, the technology import contract was approved by either MOFTEC, the provincial or municipal commission for foreign trade and economic cooperation, or the relevant ministry.<sup>147</sup> The approval authorities were required to undertake substantive review of the technology transfer contract and had substantial authority to modify its contents.<sup>148</sup> During the review, the Chinese officials often demanded that the foreign transferor make amendments within a specified period to the contractual terms that both parties had agreed upon.<sup>149</sup> The typical reasons they gave to justify their decisions were that the authorities deemed the price of imported technology unreasonable, or that provisions on rights and obligations of contracting parties were ambiguous, unfair, or unreasonable.<sup>150</sup>

The authorities could also compel foreign technology transferors to limit the royalty period in the contract, to relinquish the confidentiality of technology at the expiration of contract, and to take on strict warranty obligations.<sup>151</sup> In the case of third party infringement claims against the transferee for using the imported technology, the transferor would be responsible for defending such claims and subsequently compensating any financial losses that the transferee had to bear.<sup>152</sup> These practices violated the principle of the freedom of contract. The review process actually turned out to be a negotiation between the foreign technology transferor and the approval authority after a contract had already been formally

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<sup>146</sup> See *id.*

<sup>147</sup> See Birden, *supra* note 26, at 441–42, 451 (describing the examination and approval process, and noting the change in name of the relevant ministry).

<sup>148</sup> See Tan & Cheong, *supra* note 1, at 153.

<sup>149</sup> See Tetz, *supra* note 145, at 56 (describing the subsequent levels of examination and reexamination when seeking approval for a technology import contract).

<sup>150</sup> See Tan & Cheong, *supra* note 1, at 153 (internal citations omitted).

<sup>151</sup> See *id.* at 155–56.

<sup>152</sup> Tetz, *supra* note 145, at 57.

executed.<sup>153</sup> This practice led to a long and costly import process, which discouraged the importation of advanced technology.<sup>154</sup>

The practices aimed at protecting domestic entities and thus restricting competition in technology transfer appeared to violate the principle of freedom of contract. Some scholars point out that article 1 of the UCL recognizes the sacredness of contracts and protects the “lawful rights and interests” of contracting parties.<sup>155</sup> Article 4 of the UCL asserts that no entities or individuals may unlawfully interfere with the contractual rights.<sup>156</sup> Reading these two provisions together, however, the UCL may create a loophole that opens the door for state interference in the future. The argument would be that, depending on how the term “unlawful interference” is interpreted, state interference can never be unlawful.

*C. Technology Import and Export Regulations Have Led to Improvements in Technology Transfer Transactions but Retain Vestiges of Domestic Protection*

In December 2001, the State Council and MOFTEC promulgated the Regulations on the Administration of Import and Export of Technologies (“Technology Import and Export Regulations”) conforming China’s regulatory system of technology transfer to the requirements of the WTO.<sup>157</sup> These regulations introduce a unified foreign trade administration system.<sup>158</sup> The Regulations specify that importation of technology includes:

- (1) Assignment or licensing of patent or other industrial property rights;
- (2) Technological secrets provided in the form of drawings, technical data, technical specifications,

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<sup>153</sup> See Tan & Cheong, *supra* note 1, at 153–54.

<sup>154</sup> *See id.*

<sup>155</sup> Uniform Contract Law, *supra* note 134; art. 1.

<sup>156</sup> *Id.* art. 4.

<sup>157</sup> Tan & Cheong, *supra* note 1, at 152.

<sup>158</sup> *See* Regulations on Administration of Import and Export of Technologies (promulgated by the St. Council, Dec. 10, 2001, effective Jan. 1, 2002), art. 2, LAWINFOCHINA (last visited Sept. 10, 2007) (P.R.C.) [hereinafter Technology Import and Export Regulations].

such as production processes, formulae, product designs, quality control and management skills;

(3) Technical services.<sup>159</sup>

According to the UCL, when the laws or administrative regulations specifically stipulate provisions for technology import and export contracts that are different from the UCL, such provisions shall prevail.<sup>160</sup> Therefore, for any technology import contract from a foreign entity, the specific provisions in the Technology Import and Export Regulations should be followed.<sup>161</sup> In the Regulations, the government has given up substantial control over technology import transactions.<sup>162</sup> The objective is to encourage cross-border technology transfers from foreign countries.<sup>163</sup>

#### 1. The Technology Import and Export Regulations Have Abolished Several Restrictions

##### a) Maximum Term of Ten Years for Technology Transfer Contract

Pre-WTO, all technology contracts could have a maximum term of ten years.<sup>164</sup> The Regulations now leave the choice of the term's length to the parties.<sup>165</sup> However, "a patent assignment or licensing agreement should not exceed the patent term."<sup>166</sup> Likewise, "a copyright assignment or licensing agreement should not exceed the copyright term."<sup>167</sup> Conversely, "[a] trademark assignment, or licensing agreement, or a trade secret or know-how

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<sup>159</sup> *See id.*

<sup>160</sup> Uniform Contract Law, *supra* note 134, art. 355.

<sup>161</sup> Tetz, *supra* note 145, at 56.

<sup>162</sup> *See id.* at 56 (describing the more lax standards for the examination and approval procedures).

<sup>163</sup> *See* Technology Import and Export Regulations, *supra* note 158, art. 5 ("The State permits free import and export of technologies, unless otherwise forbidden by laws and administrative regulations.").

<sup>164</sup> David W. Russell, *Technology Transfers from the United States to the People's Republic of China*, 3 J. INT'L BUS. & L. 81, 88 (2004).

<sup>165</sup> *Id.*

<sup>166</sup> Sun, *supra* note 123, at 23.

<sup>167</sup> *Id.*

assignment or a licensing agreement technically can be perpetual.”<sup>168</sup>

#### b) Time Limitation on Confidentiality Terms

Confidentiality is “crucial to a successful technology transaction.”<sup>169</sup> In order to obtain maximum protection and enforceability, technology transfer contracts typically specify a confidentiality clause.<sup>170</sup> Unlike the pre-WTO system, the Regulations now permit the contracting parties to “freely negotiate confidentiality obligations after the expir[ation] of the agreement.”<sup>171</sup> “[T]he confidentiality obligation can [now] last beyond the term of the underlying technology contract.”<sup>172</sup>

In addition, the Regulations also contemplate the three-party confidentiality commitment.<sup>173</sup> Government employees who are responsible for approving and registering technology import and export contracts must keep business secrets and know-how confidential.<sup>174</sup> Likewise, assignees and licensees must keep trade secrets and know-how received from assignors and licensors confidential during the term of the contract.<sup>175</sup> Yet, “should the confidential information be publicly disclosed through no fault of assignees or licensees during the validity of the contract, the confidentiality obligation would not be binding.”<sup>176</sup>

#### c) Continued Use of Technology and Royalty Obligations after Expiration of Contract

Generally, it is illegal to require the transferee to continue making royalty payments after the expiration or invalidation of a patent, copyright or trademark.<sup>177</sup> Pre-WTO, “after the contract

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<sup>168</sup> *Id.*

<sup>169</sup> *Id.* at 24.

<sup>170</sup> *See, e.g., id.* (making suggestions as to how to effectively contract “to obtain maximum protection and enforceability”).

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> Technology Import and Export Regulations, *supra* note 158, art. 26.

<sup>176</sup> Sun, *supra* note 123, at 24.

<sup>177</sup> *Id.* at 24.

term expire[d], the transferee would be free to exploit the technology without further royalty obligation.”<sup>178</sup> Under the new Regulations, the parties can freely negotiate continued use of the technology in accordance with the “principle of fairness and reasonableness.”<sup>179</sup> Although the approval or registration agencies in various industries might “internally administer” certain specific rules regarding royalty rates, “any rejection decision based on an exorbitant royalty under the new system is unlikely to survive judicial review.”<sup>180</sup> In addition to the legislation mentioned above, the Supreme People’s Court also periodically issues certain “important judicial interpretations with respect to these laws and regulations with the aim of standardization.”<sup>181</sup>

## 2. Prohibited and Restricted Technology Defined

The Technology Import and Export Regulations define three categories of technology import contracts: prohibited, restricted, and permitted technology.<sup>182</sup> When the imported technology is classified as restricted, a technology import license is required before the technology can be imported.<sup>183</sup> Such a license will not be granted for technology that has been classified as prohibited.<sup>184</sup>

The importer should refer to the Foreign Trade Law for the technologies that are restricted or prohibited.<sup>185</sup> The Foreign Trade Law lists eleven general classes of restricted or prohibited technology.<sup>186</sup> The list includes, *inter alia*, technology that endangers national security and the public interest,<sup>187</sup> or harms the

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<sup>178</sup> Tan & Cheong, *supra* note 1, at 155.

<sup>179</sup> Technology Import and Export Regulations, *supra* note 158, art. 28.

<sup>180</sup> Sun, *supra* note 123, at 24.

<sup>181</sup> Wei Zhi, *Technology Transfer in the People’s Republic of China – An Academic’s Perspective*, in *LEGAL RULES OF TECHNOLOGY TRANSFER IN ASIA* 47, 47–48 (Springer ed., 2002).

<sup>182</sup> See Technology Import and Export Regulations, *supra* note 158, arts. 8, 17 (separately enumerating the different categories of import contracts).

<sup>183</sup> *Id.* arts. 10–11.

<sup>184</sup> See *id.* art. 9.

<sup>185</sup> *Id.* art. 8.

<sup>186</sup> Foreign Trade Law of the People’s Republic of China (promulgated by the Nat’l People’s Cong., Apr. 6, 2004, effective July 1, 2004), art. 16, *LAWINFOCHINA* (last visited Sept. 9, 2007) (P.R.C.).

<sup>187</sup> *Id.* art. 16(1).

environment, life, or health of humans, animals or plants.<sup>188</sup> In addition, the Chinese government also restricts importation of certain technology in order to establish or accelerate a particular domestic industry<sup>189</sup> or to safeguard the international financial status of the state.<sup>190</sup> Some international treaties, to which China has acceded, also restrict importation of certain technology.<sup>191</sup> Moreover, “there are twenty-five categories of prohibited technology, ranging from steel mining technology, colored mineral mining technology, chemical technology, petroleum refinery technology, petroleum chemical technology, fire-fighting technology, electricity technology, light industry technology, printing technology, medical technology to construction materials production technology.”<sup>192</sup> “There are sixteen categories of restricted technology ranging from biotechnology, chemical technology, petroleum refinery technology, petroleum chemical technology, biochemical technology, to currency production technology.”<sup>193</sup> “Anything that is not [listed] in the catalogue, presumably, falls within the permitted category for import purposes.”<sup>194</sup> The software licensee must first check the catalogue carefully to ascertain the category into which the imported technology falls.

### 3. Import Licenses for Restricted Technology

To import a “restricted” technology, the importer is required to submit an application for approval to the directors of foreign trade and economic cooperation to either the central government or local governments at various levels.<sup>195</sup> The director has thirty working days to decide whether or not to approve the application and grant a technology import license.<sup>196</sup> “If the application is approved, the [director will] issue a [preliminary license]” to the importer and

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<sup>188</sup> *Id.* art. 16(2).

<sup>189</sup> *Id.* art. 16(7).

<sup>190</sup> *Id.* art. 16(9).

<sup>191</sup> *Id.* art. 16(11).

<sup>192</sup> Sun, *supra* note 123, at 22.

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

<sup>195</sup> See Technology Import and Export Regulations, *supra* note 158, arts. 6, 11.

<sup>196</sup> *Id.* art. 12.

both parties can execute the technology import contract.<sup>197</sup> Next, the importer must submit a duplicate copy of the signed contract with an application to the authority to secure a technology import license.<sup>198</sup> The director will approve or disapprove all materials of the application within thirty working days.<sup>199</sup> Upon approval of the contract, a technology import license will be verified and issued.<sup>200</sup> The importer should be aware that the contract becomes valid on the date when the technology import license is issued, not when the contract is executed.<sup>201</sup> Similarly, the licensee must apply for a new registration upon any material revision to a technology import contract.<sup>202</sup>

In some circumstances, “[t]he applicant may enter into a contract to import restricted technology prior to obtaining the letter of intent.”<sup>203</sup> In that situation, the applicant must “submit the application and a duplicate copy of the signed technology import contract to the competent authority at the same time.”<sup>204</sup> “Failure to obtain approval to import the technology” will render the contract void.<sup>205</sup> The importing party, having entered into the contract, “may be liable for breach of contract.”<sup>206</sup> Therefore, parties might “expressly provide in the contract that, in the event that the applicant fails to obtain approval to import the technology, both parties should bear responsibility for the breach.”<sup>207</sup>

#### 4. Contract Registration of Permitted Technology

“In order to reflect the principle of freedom to import and export technology, the Regulations on Technology create a contract registration system for technology that is freely imported

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<sup>197</sup> *Id.* art. 13.

<sup>198</sup> *Id.* art. 14.

<sup>199</sup> *Id.* art. 12.

<sup>200</sup> *See id.* art. 16.

<sup>201</sup> *Id.*

<sup>202</sup> *Id.* art. 21.

<sup>203</sup> Qin, *supra* note 130, at 121.

<sup>204</sup> *Id.* at 121–22.

<sup>205</sup> *Id.* at 122.

<sup>206</sup> *Id.*

<sup>207</sup> *Id.*

and exported.”<sup>208</sup> For technology that can be freely imported, the importer must register the technology import contract.<sup>209</sup> “Only when the contract is registered and a certificate obtained, can the contract be carried out and the applicant complete formalities in respect of foreign exchange, banking, taxation, customs etc.”<sup>210</sup> “Failure by the party under the obligation to register the contract results in the contract being rendered void, and the defaulting party becomes liable for breach.”<sup>211</sup> Under the Measures for the Administration of Registration of Technology Import and Export Contracts (“Technology Import and Export Registration Measures”), it is now acceptable for the importer to complete the registration over the internet without translating the contract into Chinese.<sup>212</sup> Within three days of successful registration, the director will issue a technology import registration certificate to evidence the registration.<sup>213</sup>

## 5. Vestiges of Protectionism from the Pre-WTO Legal Regime

The Technology Import and Export Regulations still preserve several provisions from the pre-WTO regime.<sup>214</sup> These provisions are aimed primarily at protecting domestic importers from unreasonable or unscrupulous conduct by foreign transferors.<sup>215</sup>

### a) Mandatory Warranty of Technology and Indemnification of Infringement Claims by a Foreign Assignor or Licensor

The assignor or licensor is required “to warrant that it is the ‘lawful owner’ or ‘authorized’ assignor or licensor of the

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<sup>208</sup> *Id.*

<sup>209</sup> *See* Technology Import and Export Regulations, *supra* note 158, art. 17.

<sup>210</sup> Qin, *supra* note 130, at 122.

<sup>211</sup> *Id.*

<sup>212</sup> Tan & Cheong, *supra* note 1, at 155; *see also* Measures for the Administration of Registration of Technology Import and Export Contracts (promulgated by the Ministry of Foreign Trade & Econ. Cooperation, Dec. 30, 2001, effective Jan. 1, 2002), art. 3, LAWINFOCHINA (last visited Sept. 11, 2007) (P.R.C.).

<sup>213</sup> *See* Technology Import and Export Regulations, *supra* note 158, art. 19.

<sup>214</sup> *See* Tan & Cheong, *supra* note 1, at 156–57.

<sup>215</sup> *Id.*

technology and that the technology is ‘complete, error-free, valid, and capable of accomplishing contracted technical objectives.’”<sup>216</sup> Accordingly, a technology transfer contract must include a mandatory indemnification clause.<sup>217</sup> “The technology supplier must bear the liability/indemnify the licensee if [the use of licensed technology] infringes a third party’s rights.”<sup>218</sup> “[P]resumably financial losses, litigation costs and attorneys’ fees” must be indemnified.<sup>219</sup> “Foreign suppliers can minimize the liability by arranging a limited liability intermediary to act as the supplier under the technology import contract.”<sup>220</sup> Except for those warranties concerning authority and technological effectiveness, the parties can freely negotiate warranty clauses.<sup>221</sup>

#### b) Prohibition Against Granting Licensee Improvements Back to Licensor

The Regulations mandate that during the validity of the contract, the ownership of improved technology shall be granted to the improving party.<sup>222</sup> However, a foreign transferor could “limit the geographical area of licensed technology and its improvements” and may “negotiate a nonexclusive license and an exclusive license outside China on improved technology.”<sup>223</sup> By prohibiting the grant back, the new Regulations “may hinder foreign licensors from licensing the most advanced technology to China. Eventually this provision will have to be phased out, . . . [and] replaced by free negotiation by the parties.”<sup>224</sup>

#### c) Prohibitions on Certain Restrictive Clauses

As in the pre-WTO regime, the approval authorities still retain the power to scrutinize whether the technology import contract

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<sup>216</sup> Sun, *supra* note 123, at 23–24 (citations omitted); *see also* Technology Import and Export Regulations, *supra* note 158, arts. 24–25.

<sup>217</sup> *See* Sun, *supra* note 123, at 24.

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> *Id.*

<sup>221</sup> *Id.* at 23–24.

<sup>222</sup> *See* Technology Import and Export Regulations, *supra* note 158, art. 27.

<sup>223</sup> Sun, *supra* note 123, at 24.

<sup>224</sup> *Id.*

contains certain restrictive clauses.<sup>225</sup> The Technology Import and Export Regulations clearly forbid using seven classes of restrictive clauses in the technology import contract:

- (1) Clauses requiring the assignee or licensee to accept such conditions which are not indispensable for the import of the technologies as purchasing unnecessary technologies, raw materials, products, equipment or services;
- (2) Clauses requiring the assignee or licensee to pay fees or assume certain obligations for using technologies the patented period of which has expired and the patent of which has been declared void;
- (3) Clauses restricting the assignee or licensee to make improvement on the technologies or to use such improved technologies;
- (4) Clauses restricting the assignee or licensee to obtain from sources other than the assignor or licensor technologies similar to or competitive with those provided by the assignor or licensor;
- (5) Clauses unreasonably restricting the channels or sources for the assignee or licensee to purchase raw materials, spare parts, products or equipment;
- (6) Clauses unreasonably restricting the quantity, type and price of the products of the assignee or licensee;
- (7) Clauses unreasonably restricting the export of the products produced by the assignee or licensee by using the imported technologies.<sup>226</sup>

Some scholars argue that the new Regulations not only ensure that China's foreign technology trade system is gradually moving toward the global trend of trade liberalization, but also strengthen

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<sup>225</sup> *See id.*

<sup>226</sup> Technology Import and Export Regulations, *supra* note 158, art. 29.

the protection of intellectual property owners' rights.<sup>227</sup> In terms of technology import contracts, restrictive clauses are closer to stipulations contained in some foreign countries' competition laws that are deemed reasonable.<sup>228</sup> These changes result in a balance of bargaining power between the transferor and the transferee, and will promote the introduction of foreign technology into China.

A drafted agreement should not contain these restricted terms.<sup>229</sup> "However, under the new system, the registration agency is not required to conduct a substantive review."<sup>230</sup> The court or arbitrator, not the governmental authorities, will most likely determine whether a particular provision falls into one of these categories of restrictive clauses.<sup>231</sup> Therefore, "the hurdle to registration is substantially lowered."<sup>232</sup> The implementation of the post-WTO technology import and export scheme is still at a very early stage, and the practitioners have to rely upon the current regulations and speculation to predict future development. Inevitably, China will continue to deregulate foreign trade and trade-related technology transfer so that the outcome will be more liberal and predictable in the future.<sup>233</sup>

## 6. Consequences of Contract Revocation and Criminal Offense for Noncompliance

The general rule is that technology transfer contracts with restrictive clauses impede technological progress and competition.<sup>234</sup> These contracts are revocable or void because the lawful interests of the domestic assignee or licensee have been

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<sup>227</sup> See, e.g., Sun, *supra* note 123, at 21 (explaining that China's previous legal regime was burdensome due to "prior approval and registration requirements for importing and exporting technology" and "inadequate intellectual property enforcement").

<sup>228</sup> See *id.* at 23 (listing several trade-restrictive varieties of technology contracts that could potentially be deemed unreasonable).

<sup>229</sup> See *id.*

<sup>230</sup> *Id.*

<sup>231</sup> See *id.* ("As a WTO commitment, China must offer judicial review of various administrative functions. Under Article 53 of the 2002 Regulations, approval or registration decisions are subject to judicial review.")

<sup>232</sup> *Id.*

<sup>233</sup> *Id.* at 24.

<sup>234</sup> See Uniform Contract Law, *supra* note 134, art. 329.

violated.<sup>235</sup> Numerous Chinese statutes incorporate the basic principle of contract law that invalid or revocable contracts are not legally enforceable.<sup>236</sup> When the disputing parties resort to the judicial system, courts or arbitration commissions may declare the contract invalid and thus rescind the contract.<sup>237</sup> The judicial officers can also compel the parties to modify the contract.<sup>238</sup> If the foreign transferor is found to have restrained technology competition, the restrictive technology transfer contract will be held null and void.<sup>239</sup> The breaching party must compensate for the financial losses incurred by the injured party.<sup>240</sup> In the event that the parties attempt to transfer prohibited technology or to transfer restricted technology without a license, their failure to comply with the Chinese law may amount to a criminal offense.<sup>241</sup> They will be criminally prosecuted for smuggling or unlawful commercial practices.<sup>242</sup> If the illegal conduct “is not serious enough to constitute a crime,” the parties will be fined and sanctioned under the customs law; illegal profits will be confiscated.<sup>243</sup> In addition, the Chinese government may bar the Chinese transferee from conducting any foreign trade in the future.<sup>244</sup>

#### *D. Technology Transfer in WTO-era China*

The Chinese legislature has taken major efforts to revamp the legal system for the protection of intellectual property rights and to make the Chinese law consistent with international standards.<sup>245</sup> The foreign software owner can exploit its creative work through licensing. Regulations have been promulgated to penalize copyright infringement, and software registration is used to

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<sup>235</sup> *See id.*

<sup>236</sup> *See id.* arts. 54, 56, 329; *see also* Gen. Principles of the Civil Law, *supra* note 40, art. 59.

<sup>237</sup> Uniform Contract Law, *supra* note 134, art. 54.

<sup>238</sup> *Id.*

<sup>239</sup> *Id.* art. 329.

<sup>240</sup> *See id.* art. 58.

<sup>241</sup> Technology Import and Export Regulations, *supra* note 158, art. 46.

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

<sup>244</sup> *See id.*

<sup>245</sup> *See* Greene, *supra* note 127, at 458.

establish priorities.<sup>246</sup> Moreover, for any trademark associated with the licensed software, the owner must register the trademark in order to enjoy the exclusive rights.<sup>247</sup> In addition to amending the intellectual property laws, the Chinese government has relinquished the tight controls and scrutiny for technology transfer transactions.<sup>248</sup> The newly amended UCL enshrines the principles of freedom of contract; the parties' equality and free will are respected in Chinese law.<sup>249</sup> No longer can only state-owned enterprises engage in the import and export of technology.<sup>250</sup> Private enterprises and individuals now have the same rights too.<sup>251</sup> Moreover, a series of regulations has been recently promulgated to abolish the license system for any transfer of foreign technology, although they still preserve several provisions allowing for domestic protection from the pre-WTO regime.<sup>252</sup> The transferring parties must apply for a license and obtain approval only with respect to restricted technology.<sup>253</sup> A contract registration system has been created under which most software technology can be freely imported and exported.<sup>254</sup> In accordance with its obligations under international conventions and the WTO, China has reformed its intellectual property laws and improved its regulatory system regarding technology transfer.

### III. CONSIDERATIONS FOR DRAFTING AGREEMENTS FOR THE TRANSFER OF TECHNOLOGY

#### A. *The Application of the Convention on Contracts for the International Sale of Goods*

As of January 2007, the United Nations Treaty Section reported that the Convention on Contracts for the International

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<sup>246</sup> See *supra* text accompanying notes 30–37, 66.

<sup>247</sup> See *supra* text accompanying note 90.

<sup>248</sup> See *supra* text accompanying note 125.

<sup>249</sup> See Uniform Contract Law, *supra* note 134, arts. 3–4.

<sup>250</sup> Technology Import and Export Regulations, *supra* note 158, art. 5.

<sup>251</sup> See *supra* text accompanying note 109.

<sup>252</sup> See *supra* Part II.C.

<sup>253</sup> See *supra* text accompanying note 142.

<sup>254</sup> See *supra* Part II.C.4.

Sale of Goods (“CISG”) had been adopted by sixty-nine countries, including China and the United States.<sup>255</sup> When contracts for the sale of goods are between parties who have business places in different states, and both states are member states, the CISG applies.<sup>256</sup> Alternatively, contracting parties may expressly agree in the technology license agreement that CISG does not apply.<sup>257</sup> However, the existing case law is murky regarding whether computer software can be categorized as “goods” under CISG.<sup>258</sup> In one case, after a French company delivered and installed a computer program to a German merchant, a dispute arose, and the German defendant refused to pay. A German court ruled that “the CISG applies to standard software.”<sup>259</sup> By contrast, a German court in another case refused to characterize a market analysis of software as CISG goods but rather as an intangible right.<sup>260</sup> On close textual reading of the convention, the software sales transaction is classified as a “sale of goods”—although the CISG has not defined clearly the terms “sale” or “goods,” Articles 2 and 3 expressly exclude certain transactions as sales of goods and transactions in computer software are not specifically excluded.<sup>261</sup>

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<sup>255</sup> See United Nations Commission on International Trade Law, Status: 1980 – United Nations Convention on Contracts for the International Sale of Goods, [http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html) (last visited Sept. 8, 2007).

<sup>256</sup> See Joseph Lookofsky, *In Dubio Pro Conventione? Some Thoughts About Opt-Outs, Computer Programs and Preemption Under the 1980 Vienna Sales Convention (CISG)*, 13 DUKE J. COMP. & INT’L L. 263, 264 n.5 (2003).

<sup>257</sup> See *id.* at 264.

<sup>258</sup> See *id.* at 279.

<sup>259</sup> UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, GERMANY: LANDGERICHT MUCHEI I, (Feb. 8, 1995), in UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, CASE LAW ON UNCITRAL TEXTS 3 (1996), available at [http://www.uncitral.org/uncitral/en/case\\_law/abstracts.html](http://www.uncitral.org/uncitral/en/case_law/abstracts.html) (download section titled “Case 130–149”).

<sup>260</sup> UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, GERMANY: OBERLANDESGERICHT KOLN, (August 26, 1994), in UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, CASE LAW ON UNCITRAL TEXTS 3 (1996), available at [http://www.uncitral.org/uncitral/en/case\\_law/abstracts.html](http://www.uncitral.org/uncitral/en/case_law/abstracts.html) (download section titled “Case 120–129”).

<sup>261</sup> Frank Diedrich, *Maintaining Uniformity in International Uniform Law via Autonomous Interpretation: Software Contracts and the CISG*, 8 PACE INT’L L. REV. 331, 335–36 (1996) (describing the “broad, autonomous definition of the term ‘goods/merchandises’”).

Moreover, under Article 3(1), even if the “value of the labor and services involved exceeds the value of the raw materials needed to manufacture the goods concerned,” the transaction is still a CISG sale.<sup>262</sup> The fact that the value of software is mainly attributed to the intellectual efforts of software developers does not render the transaction ineligible as a CISG sale of goods.<sup>263</sup>

The Chinese UCL generally recognizes the rights of private parties to choose the applicable law for their contractual relationship.<sup>264</sup> In addition, Article 126 stipulates that “[i]f the parties to a contract involving foreign interests have not made a choice, the law of the country to which the contract is most closely connected shall be applied,” which means that the applicable law will be that which has some kind of relationship to the contracting parties or the subject matter of the contract.<sup>265</sup> Only for contracts covering Chinese-foreign equity or contractual joint ventures located within China does the article mandate the application of Chinese law.<sup>266</sup>

In practice, however, when the parties have not specified the choice of law in the contract, and the litigation arises in China, Chinese courts usually consider the Chinese law as most closely connected and apply the UCL. Moreover, both China and the United States have made a reservation to § 95 of CISG and thus are not bound by subparagraph 1(b) of Article 1 under CISG, i.e., when the rules of private international law lead to the application of the law of a Contracting State.<sup>267</sup> The reservation is “against the extension of CISG to sales where one of the parties has its place of business in a non-contracting state but is faced with the application of CISG by virtue of a contract rule of the court having jurisdiction” which leads “to the application of the law of a contracting state.”<sup>268</sup> This may lead to a situation where either the

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<sup>262</sup> Lookofsky, *supra* note 256, at 275.

<sup>263</sup> *See id.*

<sup>264</sup> Uniform Contract Law, *supra* note 134, art. 126.

<sup>265</sup> *Id.*

<sup>266</sup> *See id.*

<sup>267</sup> Article 95 – Annotated Text of CISG Article 95: Guide to this article, <http://cisgw3.law.pace.edu/cisg/text/e-text-95.html> (last visited Sept. 1, 2007).

<sup>268</sup> *Id.* (enumerating the countries that have used this reservation variation, including the U.S. and China).

UCL or the Uniform Commercial Code (“UCC”), rather than the CISG, applies.

### *B. Recognition and Enforcement of Foreign Judgment*

Foreign licensors generally prefer to choose the law that they are familiar with to govern disputes under their contracts.<sup>269</sup> They usually require that Chinese transferees agree to foreign governing law.<sup>270</sup> When a Chinese licensee breaches the contract, the foreign licensor can sue the licensee and obtain the favorable judgment in, for example, a U.S. court.<sup>271</sup> However, even after the foreign licensor has obtained a judgment against the licensee and the licensee consents to U.S. jurisdiction, the licensee may not have any property in the U.S. to be levied upon.<sup>272</sup> Consequently, the foreign licensor would have to request that the Chinese court enforce the judgment obtained in the United States.<sup>273</sup>

A foreign licensor must first understand the Chinese law on the recognition of foreign judgments. “The applicable law consists of the Civil Procedure Law of the People’s Republic of China (CPL) and the Supreme People’s Court’s Opinion on the Application of the Civil Procedure Law of the People’s Republic of China (Opinion on CPL) . . . [and t]he Opinion on CPL provides important judicial guidance for the lower courts to follow.<sup>274</sup> The CPL characterizes the enforcement of foreign judgments in China as “judicial assistance” that includes service of process for a foreign proceeding, taking evidence for a foreign proceeding, and enforcement of arbitral awards rendered abroad.<sup>275</sup> The CPL and the Opinion on CPL do not automatically make foreign judgments

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<sup>269</sup> See, e.g., Terry W. Conner and Bradley J. Richards, *International Considerations in Licensing*, 762 PLI/PAT 681, 713 (2003) (“Licensors who first venture abroad sometimes believe that their legal risks will be limited by choosing a familiar law to govern their contractual relationships.”).

<sup>270</sup> See *id.*

<sup>271</sup> See Arthur A. Yuan, *Enforcing and Collecting Money Judgments in China from a U.S. Judgment Creditor’s Perspective*, 36 GEO. WASH. INT’L L. REV. 757, 764–65 (2004).

<sup>272</sup> See *id.*

<sup>273</sup> See *id.*

<sup>274</sup> Yuan, *supra* note 271, at 763–64 (internal citations omitted).

<sup>275</sup> Civil Procedure Law of the People’s Republic of China (promulgated by the Nat’l People’s Cong., Apr. 9, 1991, effective Apr. 9, 1991), ch. 29, arts. 262, 267, LAWINFOCHINA (last visited Sept. 8, 2007) (P.R.C.) [hereinafter Civil Procedure Law].

final and enforceable.<sup>276</sup> For acknowledgment of a foreign judgment, the foreign licensor may either make a request directly to a Chinese intermediate court, or the American court that has rendered the judgment may make such request.<sup>277</sup>

The foreign judgment must be first reviewed on the merits by Chinese courts, which is a precondition of recognition.<sup>278</sup> While Chinese courts will not question the foreign court's determination on the facts and application of law, they generally examine and review the foreign judgment on the basis of international treaties, the principle of reciprocity, and the "basic principles of the law of the People's Republic of China."<sup>279</sup> Yet, "'there is no bilateral treat[y] or multilateral convention in force' between the United States and China 'on reciprocal recognition and enforcement of judgments.'"<sup>280</sup> "In the absence of a treaty, [a foreign licensor] can still seek recognition and enforcement of a judgment entered by a U.S. court based on other customary international law principles, such as 'comity, reciprocity, and res judicata,' but the recognition and enforcement will be entirely determined by Chinese law and practice."<sup>281</sup>

The CPL standard of review provision does not specify the circumstances under which a Chinese court should refuse to enforce a foreign judgment.<sup>282</sup> A Chinese court will evaluate several factors based on general principles of international law in determining whether to enforce a judgment rendered by a foreign court and will only enforce a "legally effective judgment."<sup>283</sup> The criteria that a Chinese court often relies on are "(1) whether the foreign court had jurisdiction; (2) whether the defendant was properly served; (3) whether the proceedings were vitiated by fraud; and (4) whether the judgment is contrary" to China's public

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<sup>276</sup> See *id.*, ch. 29, art. 267.

<sup>277</sup> See *id.*

<sup>278</sup> See *id.*, ch. 29, art. 268.

<sup>279</sup> *Id.*

<sup>280</sup> See Fang Shen, *Are You Prepared for This Legal Maze? How to Serve Legal Documents, Obtain Evidence, and Enforce Judgments in China*, 72 UMKC L. REV. 215, 220 (2003) (internal citations omitted).

<sup>281</sup> See *id.* at 233–34 (internal citations omitted).

<sup>282</sup> See *id.* at 234.

<sup>283</sup> *Id.*

policy.<sup>284</sup> Furthermore, when a foreign judgment contravenes the basic principles of Chinese law, China's sovereignty, or its national and social interests, a Chinese court will not enforce it.<sup>285</sup> Therefore, in practice, a Chinese court may refuse to enforce a foreign judgment because the foreign judgment (1) is made by what it perceives to be an incompetent foreign court or (2) has not taken effect or has no effect under the law of such foreign country.<sup>286</sup> When the Chinese licensee is not given proper notice<sup>287</sup> of the proceedings, or the enforcement of the foreign judgment would be against public policy, a Chinese court will deny enforcement.<sup>288</sup>

If the foreign judgment is recognized by a Chinese court, it will be enforced in the same way as a domestic judgment.<sup>289</sup> The court compels the satisfaction of a recognized foreign judgment in a number of ways. The execution officers may direct inquiries to the licensee's bank account, and freeze and transfer the balance of the bank accounts.<sup>290</sup> The execution officers may also garnish the debtors' income, or seize and auction off debtors' property, subject to certain narrow exemptions, most of which cover basic personal items.<sup>291</sup> The CPL also imposes penalties on debtors who do not pay the money judgment voluntarily during the specified time period.<sup>292</sup> The penalties are double the accrued interest of the unpaid judgment amount.<sup>293</sup>

### C. Clear Drafting to Prevent Litigation and Future Disputes

Before a lawyer even starts to draft a technology license agreement, he must determine whether the technology license is

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<sup>284</sup> *Id.* (internal quotations omitted).

<sup>285</sup> *See* Civil Procedure Law, *supra* note 275, ch. 29 art. 268.

<sup>286</sup> *Id.*

<sup>287</sup> *See id.* art. 263 (specifying the circumstances in which documents may be served).

<sup>288</sup> *Id.* art. 268.

<sup>289</sup> *See id.*

<sup>290</sup> *See id.* art. 221.

<sup>291</sup> *Id.* arts. 222–23.

<sup>292</sup> *See id.* art. 232.

<sup>293</sup> *See id.* (“[T]he person subject to execution . . . shall pay a multiplied interest on the debt for the period of deferred fulfillment.”).

prohibited, restricted or permitted.<sup>294</sup> Based on the category of the licensed technology, the lawyer must follow different procedures by obtaining either a technology import license or a certificate of registration.<sup>295</sup> Careful drafting is particularly important in a technology license agreement. Unlike a sales transaction, in which the seller conveys what he owns and in which the law may provide gap-filler terms, a license agreement is more complicated.<sup>296</sup> The lawyer must not only cautiously carve out the rights granted to the licensee but also preserve certain rights for the licensor as well, such as the right to continue to use the technology or the right to license the technology to someone else.<sup>297</sup> For example, in a software license agreement, the software program might be licensed only for the licensee's own internal use. The lawyer should define terms and conditions of the rights granted to the licensee.

The Chinese licensee may be an engineer or "end-user" in an operations office, factory, or research laboratory. English could be his second language and in most cases the agreement that he uses is translated into Chinese. A lawyer should avoid using legal jargon and explicitly define rights and obligations of the contracting parties.<sup>298</sup> In practice, using headings with simple language, such as "Licensee's Obligations," or "Prohibited Uses of the Software or Technology," is an effective way to make the agreement easy to understand.<sup>299</sup> A successful license contract with Chinese companies should also incorporate cultural considerations.<sup>300</sup> To many Chinese, the relationship or connection between business partners is very important. Therefore, establishing a mutual trust from the first day is crucial.

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<sup>294</sup> See *supra* sections II.C(2)-(4).

<sup>295</sup> See *supra* sections II.C(2)-(4).

<sup>296</sup> Neal D. Goldman, *International Technology Transfer Agreements*, 458 PLI/COMM 251, 253 (1988).

<sup>297</sup> *Id.*

<sup>298</sup> *Id.* at 254.

<sup>299</sup> *Id.*

<sup>300</sup> See *id.* at 272.

## 1. Define the Key Contractual Terms and Identify the Intellectual Property Rights

A technology license agreement generally starts with a section defining contractual terms and follows with a separate provision to identify what is being transferred.<sup>301</sup> Definitions should be limited to the principal terms or concepts because too many technical definitions will make the agreement difficult to comprehend.<sup>302</sup> Because the Chinese culture and language are different from those of America, the same word may mean a different thing to the Chinese. A lawyer must be sensitive to all the key words that may fall into this area. In the definitions, he should carefully associate these key terms with the intended meaning and take care not to overlook a conflict between two definitions. Moreover, “defining key terms at the outset will lend clarity and, often, brevity to the agreement.”<sup>303</sup> The scope of the intellectual property definitions should be compared and analyzed with prudence.<sup>304</sup> For example, the license agreement might clearly describe the scope of licensed rights.<sup>305</sup>

## 2. Specify Nature and Scope of Intellectual Property Rights Granted

“This section of the agreement specifies the nature and scope of the [intellectual property] rights granted to the licensee . . . .”<sup>306</sup> The first step is “carefully defining the extent of the rights conveyed to the licensee. . . . It should state that the licensee’s rights are expressly limited solely to the rights granted. Implied rights should be excluded.”<sup>307</sup> A lawyer must ensure that the licensor reserves all rights in the technology that are not expressly granted.<sup>308</sup> The agreement should define specifically “whether the

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<sup>301</sup> See generally Klaus H. Burmeister, *International License Agreements Checklist & Drafting Suggestions*, 496 PLI/PAT 181, 185–86 (1997).

<sup>302</sup> *Id.* at 185.

<sup>303</sup> *Id.*

<sup>304</sup> See *id.* at 186.

<sup>305</sup> See *id.*

<sup>306</sup> *Id.* at 186–87.

<sup>307</sup> Goldman, *supra* note 296, at 254.

<sup>308</sup> *Id.*

rights granted are restricted as to duration, territory or technical field of use, and whether the rights therein are to be exclusive or nonexclusive.”<sup>309</sup> The agreement may “describe in detail what acts or activities are permitted.”<sup>310</sup> For example, the licensee may be allowed to “use, make, have made, sell and otherwise dispose of” the licensed technology.<sup>311</sup> In addition, the license agreement should also clearly specify “what methods or manners of exploitation are covered.”<sup>312</sup> For example, right of reproduction and right of display are usually covered for a copyrighted media product.<sup>313</sup>

“Clarity of the license grant is of the utmost importance.”<sup>314</sup> In a Chinese-U.S. technology license agreement, a lawyer may need to clearly differentiate two critical terms that might not look different to the Chinese licensee. What is being granted to the licensee must be explicitly identified, including what the licensee is authorized to do and what the limitations of the granted rights are. For example, “[t]he right to ‘have made’ . . . would authorize the licensee only to retain a contract manufacturer” to make the products exclusively for the licensee.<sup>315</sup> “The licensee, in turn, would then market and sell the products and pay a service fee to the contract manufacturer.”<sup>316</sup> In comparison, “[t]he right to ‘have products made’ would not allow the licensee to grant a sublicense” to a third party “in exchange for [the] license fee.”<sup>317</sup> The licensee must produce and sell the products on his own.<sup>318</sup> The licensor will retain the right to approve any sublicense to a third party.<sup>319</sup> Careful drafting is extremely important for the case in which a Chinese licensee enforces a judgment unfavorable to the foreign licensor in a Chinese court. If the Chinese court is influenced by

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<sup>309</sup> Burmeister, *supra* note 301, at 187.

<sup>310</sup> *Id.*

<sup>311</sup> *Id.*

<sup>312</sup> *Id.*

<sup>313</sup> *See id.*

<sup>314</sup> *Id.*

<sup>315</sup> *Id.*

<sup>316</sup> *Id.*

<sup>317</sup> *Id.*

<sup>318</sup> *See id.*

<sup>319</sup> *See id.*

the local protectionism,<sup>320</sup> any ambiguity would most likely be resolved in favor of the Chinese licensee.

### 3. Duration Provision of Technology License Contract

The prior Chinese laws prescribed the maximum term of a technology license contract as ten years.<sup>321</sup> The restriction was repealed after China's accession to the WTO in 2002.<sup>322</sup> Currently, the duration of a license agreement is a matter of negotiation.<sup>323</sup> Good drafting practice should include a separate duration provision in a license agreement.<sup>324</sup> For a license of patent rights or patent applications, the duration should be limited to the time period that the patent can be protected in China, because under Chinese law the license agreement is effective only during the validity of the patent rights.<sup>325</sup> However, for the license of any other technology, like software or trade secrets, the agreement may be termed for any duration, even an indefinite one.<sup>326</sup> "The licensor may want to limit the initial duration of the license to a relatively short period of time, in order to evaluate the licensee's performance and reassess the value of the licensed technology" in China.<sup>327</sup>

### 4. Licensor's Obligations and Rights

#### a) Licensor's Warranty of Legal Title to Technology

As vestiges from past local protectionism, the 2002 Technology Import and Export Regulations continue to request that the licensor warrant that he is the lawful owner of the licensed technology, and that such technology is complete, flawless,

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<sup>320</sup> Qin, *supra* note 130, at 124–25 (noting the influence of protectionism in China).

<sup>321</sup> David Williams Russell, Esq., Lecture at "Doing Business in China" Seminar at Ball State: Technology Transfers from the U.S. to the People's Republic of China (Oct. 31, 2003) (transcript available at <http://dla.org/downloads/RussellTechChina.doc>).

<sup>322</sup> *Id.*

<sup>323</sup> *Id.*

<sup>324</sup> See, e.g., Burmeister, *supra* note 301, at 198–99.

<sup>325</sup> Uniform Contract Law, *supra* note 134, art. 344.

<sup>326</sup> See Technology Import and Export Regulations, *supra* note 158, art. 5.

<sup>327</sup> Burmeister, *supra* note 301, at 198–99.

effective and capable of achieving the stipulated purpose.<sup>328</sup> Therefore, the license agreement must have a separate provision in which the foreign licensor guarantees that he has title and corresponding legal rights to the licensed technology.<sup>329</sup> The foreign licensor must also assume any legal liabilities arising out of ownership disputes.<sup>330</sup> It must ensure that no proprietary rights of any third party will be infringed by the license.<sup>331</sup> When the warrants required by Chinese law or those agreed upon are violated, the foreign licensor will fail to fulfill his contractual obligations and breach the agreement.<sup>332</sup> Under the UCL, the foreign licensor must refund part or all of the royalties and assume liability for the breach.<sup>333</sup> He can generally continue performance, remedy any failures, and pay the damages incurred by the licensee.<sup>334</sup> The licensor should not assert or warrant “that the licensee will derive any benefit from the licensed technology or its practice.”<sup>335</sup>

#### b) Infringement Involving Third Parties

Chinese laws have no specific provisions regarding infringement claims of the licensed technology between licensor and a third party. In the event that a third party infringes rights in the licensed technology, the licensor and licensee can freely agree upon what actions to take.<sup>336</sup> The domestic licensee is required to immediately inform the licensor of any third party’s infringing acts and provide reasonable assistance to the licensor in this matter.<sup>337</sup>

When the licensee’s use of the technology infringes the patent, copyright, or trademark rights of a third party, the licensor usually undertakes to defend the claim and indemnify the licensee for any

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<sup>328</sup> See Uniform Contract Law, *supra* note 134, art. 349; see also Technology Import and Export Regulations, *supra* note 158, art. 24.

<sup>329</sup> See Uniform Contract Law, *supra* note 134, art. 349.

<sup>330</sup> *Id.* art. 351.

<sup>331</sup> See *id.*

<sup>332</sup> See *id.* art. 350.

<sup>333</sup> *Id.* art. 351.

<sup>334</sup> See *id.* art. 107.

<sup>335</sup> Burmeister, *supra* note 301, at 195.

<sup>336</sup> See Tetz, *supra* note 145, at 67.

<sup>337</sup> See *id.*

losses and liabilities incurred.<sup>338</sup> The abolished regulations mandated such indemnification if the third party prevailed.<sup>339</sup> Under the 2002 Technology Import and Export Regulations, the contracting parties cannot freely agree how to allocate liabilities when the licensee's use of licensed technology infringes third party rights,<sup>340</sup> but in some special cases since 2002, MOFTEC has deviated from the prior rule that the foreign licensor assumes full responsibility.<sup>341</sup> When representing a licensor, a lawyer can draft the clause in a way so that:

If the licensee encounters certain parts in the documentation infringing the proprietary rights of a third party, the licensor will use his reasonable best efforts to obtain royalty-free rights for the licensee; if the licensor cannot obtain such rights, he will consult with the licensee and consider changes that the licensee makes in the product and the manufacturing process, at the licensor's expense.<sup>342</sup>

c) Limiting Scope of Licensor's Liability for Acts of Licensee

"The licensor will generally want to limit the scope of its liability . . . for the acts, errors and omissions of the licensee and its employees."<sup>343</sup> A lawyer should "specifically exclude liability on the part of the licensor for any incidental and consequential damages" caused by the licensee's use of the technology, and "all acts, errors or omissions of the licensee and its officers, agents and employees."<sup>344</sup> The licensee would hold the licensor harmless against all such damage claims.<sup>345</sup> Some license agreements even

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<sup>338</sup> *Id.*

<sup>339</sup> *Id.* at 68.

<sup>340</sup> See Technology Import and Export Regulations, *supra* note 158, art. 24 (failing to specifically indicate that licensor and licensee can freely agree upon the allocation of liabilities when the licensed technology infringes upon a third party).

<sup>341</sup> See Tetz, *supra* note 145, at 68.

<sup>342</sup> *Id.* at 67.

<sup>343</sup> Burmeister, *supra* note 301, at 195.

<sup>344</sup> *Id.*

<sup>345</sup> See *id.*

go as far as to “require the licensee to defend and indemnify the licensor against all [such] claims, losses and liabilities.”<sup>346</sup>

Chinese approval authorities are reluctant to accept a technology license agreement with a limitation-of-liability clause.<sup>347</sup> Whereas a limitation on direct damages for breach of contract is generally approved, a clause such as “the maximum aggregate amount of monetary damages for which the licensor may be liable to licensee should be limited to the value of technology or the technology license fee under this agreement” is not acceptable.<sup>348</sup> The local court or arbitration commission may even refuse to enforce a limitation-of-liability clause.<sup>349</sup>

#### d) Obligation to Provide Technical Documentation and Assistance

The licensor’s obligations extend beyond completion of the technology transfer.<sup>350</sup> For example, in a license to manufacture and distribute a product, the licensor could have provided the licensee with technological know-how to carry out the production.<sup>351</sup> The licensor could provide documentation that accurately reflects the licensor’s state-of-the-art technology, including “background materials on the technology, reports on feasibility studies and technological appraisals, [and] project descriptions and plans.”<sup>352</sup> Technological standards, technological specifications, and original designs and documents on technological processes can also be included.<sup>353</sup>

In addition, the licensor may need to provide the licensee with technical assistance and training services.<sup>354</sup> A lawyer should stipulate the extent to which the licensor agrees to provide such

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<sup>346</sup> *Id.*

<sup>347</sup> Tetz, *supra* note 145, at 67.

<sup>348</sup> *See id.*

<sup>349</sup> *See id.*

<sup>350</sup> Uniform Contract Law, *supra* note 134, art. 322.

<sup>351</sup> *See id.*

<sup>352</sup> *See id.* art. 324.

<sup>353</sup> *Id.*

<sup>354</sup> Jeffrey J. Blatt, *Considerations in Representing Western Companies in Technology Transfers to East Asia*, 19 HASTINGS INT’L & COMP. L. REV. 667, 687 (1996).

services.<sup>355</sup> He can also specify terms and conditions under which those services will be provided, including the amount, if any, that the licensee must pay.<sup>356</sup> For example, if the licensor has to send its employees to the licensee's country, the agreement should specify who will bear the expense.<sup>357</sup> The agreement may allow for a certain number of visits per year at the licensor's expense, with additional visits at the licensee's expense.<sup>358</sup> All of the technical information and assistance that the licensor provides on an on-going basis is an integral part of the technology license agreement.<sup>359</sup>

The licensee can request that the licensor guarantee the technical information to be accurate and comprehensive. For example, a licensor may have used the technical documentation to manufacture, assemble, and test component parts. In the licensing agreement, the licensee may need the licensor to warrant that the technical documentation delivered will be in the same form and will be as complete and accurate as what the licensor has used. For certain technology that has undergone rapid development, such as computer software, a licensee may require a licensor to disclose any technological improvements during the term of the license. The agreement may define the terms and conditions under which a licensee will be granted corresponding rights to use any such improvements and modifications. For example, a clause may be drafted as: After delivery of the technical documentation and during the term of the technology license, the licensor must also deliver to the licensee all revisions, changes, upgrades, improvements, and modifications that the licensor has made generally available. A licensor often delivers such revised technical documentation to a licensee at no additional charge.

Conversely, the same requirement is likely to be one of the licensee's obligations. That is, the licensee can be required to

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<sup>355</sup> *Id.*

<sup>356</sup> *Id.*

<sup>357</sup> See generally Thomas L. Shillinglaw, *Licensing and Technology Transfer Transaction*, 752 PLI/CORP 105, 112-13 (1991) (highlighting issues to be included in a contract provision which provides for technical assistance).

<sup>358</sup> *Id.* 112-14.

<sup>359</sup> See *id.*

deliver to the licensor all information developed by the licensee during the term of the agreement relating to improvement of the licensed technology.<sup>360</sup> A lawyer should also be sure to preserve the other rights not being exclusively transferred to a licensee. For example, a clause may be drafted as: The contract and the transactions contemplated hereby are not intended and shall not be deemed to affect the licensor's continued ownership and use of the technical documentation and other intellectual property provided to the licensee.

Successful negotiation of a technology license "involve[s] considerable effort and expense on the licensor's part."<sup>361</sup> A lawyer must analyze each "milestone," such as delivery of documentation, installation, training, and acceptance during the technology transfer process.<sup>362</sup> These milestones can even be "tied to installment payments."<sup>363</sup> After disclosure to the licensee, the value of the licensed technology and related trade secrets is exposed to greater risk.<sup>364</sup> Conversely, when the licensor is allowed to learn about the licensee's business and gain access to related trade secrets during the technology transfer, the licensor must warrant not divulging such confidential information to any third party.

A licensee may need certain crucial components on an on-going basis from a licensor and incorporate them into the technological products. Conversely, the licensor may want to ensure the quality of products made by the licensee. In this situation, the licensor generally prefers a separate agreement for supplementary supply arrangements of critical components. Compensation can be in the form of component sales revenues. However, if in order to receive the license the licensee is forced to buy components that he could easily buy from a third party, the 2002 Technology Import and Export Regulation considers this an unreasonably restrictive term.<sup>365</sup>

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<sup>360</sup> See *id.* at 124.

<sup>361</sup> Burmeister, *supra* note 301, at 188.

<sup>362</sup> *Id.*

<sup>363</sup> *Id.*

<sup>364</sup> *Id.*

<sup>365</sup> See Technology Import and Export Regulations, *supra* note 158, art. 29(5).

## 5. Licensee's Obligations and Rights

When a licensee breaches his obligations, a “licensor normally has the right to terminate the [technology] license agreement.”<sup>366</sup> The contracting parties generally are free to negotiate the contractual terms regarding the licensee's rights and obligations in the agreement.<sup>367</sup>

### a) Licensee's Affirmative Duty to Use Best Efforts to Exploit the Technology

When a licensor's compensation derives from royalties that are contingent upon how many products will be manufactured and sold by the licensee, the agreement often imposes on the licensee an affirmative duty to “use his best efforts” to exploit the technology.<sup>368</sup> The clause can be drafted in either a goal-targeted or open-ended way. In a goal-targeted clause, the lawyer specifically spells out the licensee's performance goals during the phases of manufacture, development, marketing, advertising, and servicing of the technological products.

### b) Licensee's General Obligation to Obtain any Necessary Government Approval

For prohibited or restricted technology,<sup>369</sup> a licensor may have to explain and justify to the Chinese government each questioned clause in the technology license agreement. Alternatively, the licensor may rescind the contract if the Chinese approval authorities insist upon modifications or amendments that the licensor deems unacceptable.<sup>370</sup> In order to better comply with the Chinese law of technology transfer, the agreement should stipulate the obligations on each side. A licensee generally assumes the principal obligations to obtain a license if the technology is restricted, or obtain a certificate of registration, if the technology is

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<sup>366</sup> Burmeister, *supra* note 301, at 190.

<sup>367</sup> *Id.*

<sup>368</sup> *Id.* at 189.

<sup>369</sup> See *supra* sections II.C(2)–(4) and accompanying notes.

<sup>370</sup> See generally Burmeister, *supra* note 301, at 198.

permitted.<sup>371</sup> Furthermore, the licensee may also be required to assist the licensor in obtaining all of the governmental approvals that are required for the licensor's personnel to provide technical services and bring any requisite technical information, material, tools and training aids into China. The licensee must inform the licensor if there is any additional governmental involvement during the term of the license. For example, for a license of restricted technology, the Chinese government may require the licensee to submit periodic reports regarding exploitations of the technology and royalties paid.

c) Licensee's Duty to Maintain and Provide Records of Activities

Most technology license agreements require the licensee to maintain and routinely provide records of its activities in exploiting the licensed technology.<sup>372</sup> If the license contains a royalty structure, it becomes particularly important for the licensor to use these records to calculate the exact amount due.<sup>373</sup> Moreover, the licensee may be required to regularly provide the licensor with periodic reports of production, sales, and prices charged.<sup>374</sup> The licensor usually needs the information to develop the comprehensive reports of worldwide production and sales operations. Based on the report, the licensor can carefully adjust and control the price of the product in order to establish a worldwide pricing structure. Depending on the nature of the licensing arrangement, the licensor may want to control sales efforts of the licensee. For example, if rights to market, but not manufacture, a product are licensed, the licensee's sales efforts become the heart of the agreement. The reports that the licensee is required to provide may include content and amount of advertising, participation in trade fairs and shows, and sales training. A lawyer may draft a clause that permits the licensor to ask for any further

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<sup>371</sup> See generally Sun, *supra* note 123, at 22–23 (detailing the approval process for importing or exporting restricted technology).

<sup>372</sup> Burmeister, *supra* note 301, at 193.

<sup>373</sup> See *id.* at 190 (basing the calculation of a royalty structure on “a percentage of the licensee's gross sales of the licensed products”).

<sup>374</sup> See *id.* at 193 (“[T]he license agreement may require the licensee to provide the licensor with regular reports of transactions involving the licensed products.”).

details at its discretion and requires the financial reports to be certified by a professional accountant.

Article 352 of the UCL also stipulates that if a licensee fails to make the required payments, it should compensate a licensor for defaulted payments and breach of contract damages.<sup>375</sup> If a licensee refuses to pay overdue royalties or breach of contract damages, it must cease exploiting the technology and return the technological materials.<sup>376</sup> If a licensee exploits the technology beyond the scope agreed upon, it will be in breach and liable for the consequential damages.<sup>377</sup>

#### d) Mutual Disclosure of Improvements Between Licensee and Licensor

For rapidly developing technology, “the licensee may seek to protect the value of its licensed rights by requesting access to any improvement technology developed by the licensor.”<sup>378</sup> Further, “to avoid losing its [existing] market position to the superior products of its own licensee,” the licensor may request “access to all improvements and modifications developed by the licensee.”<sup>379</sup> This is referred to as a “grant back” clause and is generally “non-exclusive.”<sup>380</sup> The UCL explicitly authorizes the contracting parties to “stipulate in a technology transfer contract, the method of sharing technological achievements obtained from the follow-up improvements made in the exploitation of a patent or the use of know-how in light of the principle of mutual benefit.”<sup>381</sup> A lawyer may need to draft a clause that requires the licensee to provide the licensor with access to and the right to use all improvements and modifications made by the licensee.

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<sup>375</sup> Uniform Contract Law, *supra* note 134, art. 352.

<sup>376</sup> *Id.*

<sup>377</sup> *Id.*

<sup>378</sup> Burmeister, *supra* note 301, at 195.

<sup>379</sup> *Id.* at 196.

<sup>380</sup> *Id.*

<sup>381</sup> Uniform Contract Law, *supra* note 134, art. 354.

e) Licensee's Affirmative Duty to Maintain the Confidentiality of Technology

A licensee should not disclose or make any technical information available to any third party for any reason.<sup>382</sup> A carefully drawn confidentiality clause is critical for protection of technology, particularly when the central elements of the license agreement are technological or trade secrets.<sup>383</sup> Trade secrets are a peculiar kind of intellectual property in the sense that they enjoy no statutory protection by the laws of China. Thus, they are protected in China only to the extent that a licensee is subject to a contractual duty of nondisclosure to keep them confidential to the public. The confidentiality clause imposes on the licensee an affirmative duty to limit access to trade secrets, and to implement comprehensive security measures and protection mechanisms.<sup>384</sup> The licensee can disclose the technological secrets to its employees and contracted manufacturers or suppliers only when they must know the confidential information to carry out operations. The agreement can even specifically list those employees and subcontractors who are entitled to such access and require each one of them to sign a written confidentiality agreement before they obtain it.

Confidentiality clauses should expressly stipulate that the licensee's duty of confidentiality continues, even after termination of the license agreement.<sup>385</sup> The Chinese Technology Import and Export Regulations provide a licensor with the right to freely negotiate the term of obligation.<sup>386</sup> When the licensee divulges the confidential information to any third party, it breaches the contract and is liable for any damages.<sup>387</sup> But when the secret information falls into the public domain and becomes public knowledge, the licensee's confidentiality obligation immediately terminates.<sup>388</sup>

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<sup>382</sup> Burmeister, *supra* note 301, at 196.

<sup>383</sup> *Id.*

<sup>384</sup> *See id.* at 196.

<sup>385</sup> *Id.* at 196–97.

<sup>386</sup> *See Tetz, supra* note 145, at 70.

<sup>387</sup> *See* Uniform Contract Law, *supra* note 134, art. 352.

<sup>388</sup> Technology Import and Export Regulations, *supra* note 158, art. 26; *see also* Sun, *supra* note 123, at 24.

Some exceptions must be carved out. The clause should exempt information that the licensee already knew before the transfer of technology and information that is made public through no fault or act by the licensee.<sup>389</sup> Chinese statutory provisions are silent regarding how to calculate damages when confidentiality obligations are breached.

f) Licensee's Duty to Notify of Infringement Claims and Acts of a Third Party

In the event that a third party claims compensation for infringement of its proprietary rights arising from a licensee's use of the technology, the licensee should immediately notify the licensor of any infringement allegations brought.<sup>390</sup> The agreement should spell out each step that the licensee must follow in case of such a claim. Subsequently, the licensor should consult with the licensee and consider changes that licensee can make in the products and manufacturing process to avoid such claims. The licensor will typically "provide the licensee with technical assistance" to make such changes at no additional cost to the licensee.<sup>391</sup>

The licensee has the same obligations to notify the licensor when any third party's use of the technology infringes the licensor's proprietary rights. A clause should spell out under what circumstances a party must pursue such actions. More importantly, the clause should specify how damages are to be allocated when the contracting parties prevail and the court awards damages. Such clause should also impose on the licensee an obligation to cooperate in the prosecution of any infringement action within the territory.

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<sup>389</sup> Burmeister, *supra* note 301, at 197.

<sup>390</sup> *Id.* at 193.

<sup>391</sup> *Id.* at 189; see also Lisa Wannamaker & E. Gail Gunnells, *Negotiating and Drafting International Software License Agreement (with Model Agreement)*, 46 NO. 4 PRAC. LAW. 45, 55 (2000).

## 6. Inadequate or Non-Performance

The Chinese laws do not have specific provisions for termination of technology license agreements. Unless the contracting parties agree upon a specific termination clause, the general termination provisions of the UCL apply.<sup>392</sup> Generally, the termination clause should specify the grounds for terminating the license agreement prior to its expiration. Even when the agreement does not have any express termination clause, the UCL enumerates several situations in which one party can rescind the contract.<sup>393</sup> Either party normally has the right to terminate the agreement when the other party breaches the contract by inadequate performance or nonperformance.<sup>394</sup> Courts usually apply an objective standard to assess evidence of lack of performance or nonperformance. For example, a license agreement for a restricted technology might state that it becomes effective upon approval and that the licensee has the duty to obtain such approval. The termination clause could stipulate that, if such approvals are not obtained within a certain amount of time after execution of the contract, either party may terminate the agreement upon notice to the other without incurring any liability. Termination of a technology license agreement should be recorded with MOFTEC.<sup>395</sup>

A licensee's breach of confidentiality obligations, for example, will not generally render performance under a license agreement impossible. To avoid relying on the statutory termination clause, a lawyer should draft the termination clause in consideration of various situations. The termination clause should clearly indicate that termination does not relieve the licensee of his ongoing obligations, such as maintaining the confidentiality of trade secrets or continuing to pay any outstanding balance of royalties. The clause should state that termination does not bar the injured party from seeking any other remedy against the breaching party, who

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<sup>392</sup> See Tetz, *supra* note 145, at 69; Uniform Contract Law, *supra* note 134, arts. 93–94.

<sup>393</sup> See Uniform Contract Law, *supra* note 134, art. 94.

<sup>394</sup> *Id.*

<sup>395</sup> Technology Import and Export Regulations, *supra* note 158, arts. 21, 43.

should also hold the injured party harmless for any loss or liability due to termination.

### 7. Postcontractual Rights and Obligations

Generally, a license agreement should specify the rights and obligations of both parties after expiration or termination.<sup>396</sup> “[T]he agreement should require the licensee[, immediately upon termination,] to return to the licensor all of the licensor’s proprietary data and other property [over which licensor has proprietary rights] immediately upon termination.”<sup>397</sup> Meanwhile, “the termination clause should require the licensee to cease using” the technological secrets and technical data.<sup>398</sup> The Chinese Technology Import and Export Regulations state that when the license agreement expires, the licensee may freely negotiate with the licensor for continuing use of the technology based “on the principle of fairness and reasonableness.”<sup>399</sup> However, it is difficult to interpret the ambiguous terms of “fair” and “reasonable.” We must await how practice establishes the essential meanings of these terms and how the Chinese courts will interpret them. In addition, both the UCL and the new 2002 Regulations also allow the contracting parties to freely agree upon the duration of the licensee’s confidentiality obligations.<sup>400</sup> The UCL particularly states that the confidentiality obligations that are freely agreed upon can be post-contractual.<sup>401</sup> In practice, the post-contractual confidentiality obligations typically last three to five years.<sup>402</sup>

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<sup>396</sup> Burmeister, *supra* note 301, at 199–200.

<sup>397</sup> *Id.* at 199.

<sup>398</sup> *Id.*

<sup>399</sup> Technology Import and Export Regulations, *supra* note 158, art. 28.

<sup>400</sup> See Uniform Contract Law, *supra* note 134, art. 324; see also Technology Import and Export Regulations, *supra* note 158, art. 26.

<sup>401</sup> See Tetz, *supra* note 145, at 70.

<sup>402</sup> *Id.* at 71.

## CONCLUSION

Good drafting is the best way to avoid costly and unnecessary litigation. When drafting a technology license agreement, the choice of law clause is extremely important. The CISG is a good default rule for the international transactions between two member states. CISG, however, is not a complete contract law, and the obligations and breaches must also be specified in the agreement. On one hand, when a foreign licensor litigates a dispute in China, it is still unpredictable how Chinese courts will interpret the parties' intentions and applicable law. On the other hand, if a foreign licensor obtains a favorable judgment in the U.S. courts, it still has to face the problem of how to enforce that judgment in Chinese courts. Moreover, the geographical territory, duration of use, scope of exploitation, and exclusive or nonexclusive rights are subject to open negotiation, as is the royalty to be paid for the intellectual property rights being transferred. These terms must be clearly delineated in the agreement. In order to comply with Chinese law, the license agreement must also have a separate guarantee provision that the foreign licensor has good title and legal rights to the licensed technology. In addition, a lawyer should pay close attention to other important interests of the licensor, such as limitation of liability, indemnification to the licensee for a third party's infringement claim, and provision of technical documentation, assistance, and training services.

In order to better protect the licensed software technology and to prevent the licensee's breach, the licensee's rights and obligations must be clearly described in the agreement. A licensee generally should assume the principal obligation to obtain the governmental approval because it is familiar with the Chinese language, local culture, and politics. Usually the foreign licensor is concerned most with maintaining the confidentiality of software technology and mutual disclosure of improvements. A lawyer must draft these clauses accordingly. Some agreements may impose other obligations on the licensee, such as routinely providing records of its activities in exploiting the licensed technology and reporting any third party's infringement allegations to the licensor.

The fundamental intellectual property rights of foreign licensors are recognized in Chinese law and promising progress has been made to expedite technology transfer transactions. However, because of lack of experience, due diligence input, and intellectual debate, the Chinese legislature has not contemplated many of the complicated situations that will be encountered. By stating only the basic guidelines and principles, most laws and regulations of China's civil code are simple and even sketchy, which creates many loopholes that unscrupulous parties might exploit. In addition, local favoritism and domestic protection are still popular in most Chinese courts. Ultimately, the foreign licensor may be treated unfairly to the advantage of the Chinese licensee. For example, damages for the infringement of intellectual property are largely illusory because the perpetrator may flee easily out of the district. The legal system is devoid of enforcement for a great number of infringing cases that are not severe enough to be penalized by criminal law. The Chinese legislature should close this huge loophole in intellectual property protection by using other effective mechanisms, such as the daily fine in European Union law. As China's economy becomes more integrated into the world economy, Chinese enterprises and individuals are more actively engaged in free trading with foreign counterparts. The rationale of domestic protectionism in earlier regulations will soon not exist. Maintaining such restrictions will prevent China from importing advanced technology by putting foreign licensors on an unequal footing relative to the Chinese party in negotiation. Being more open to free trade in technology transfer transactions and becoming more consistent with international customs are expected in future regulations. Many foreign software companies entering China's market will have to confront these ambiguities, discrepancies, and uncertainties, which create great opportunities for lawyers.

*Notes & Observations*