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Amendment to Tech I/E Regulation Showing a Friendlier Business Regime

By Xun Yang

On 2 March 2019, the State Council issued the Decision on Revising Certain Administrative Regulations, which became effective on the same date. Among others, the decision removes Art. 24 Subsection (3), Art. 27, and Art. 29 of the Administrative Regulation on Technology Import and Export (the "***Technology I/E Regulation***") effective in 2002. These articles were mandatory in the PRC legal system and played an important role in protecting interest of domestic technology licensees. During my assistance in negotiating tens of cross-border technology license agreements, they were often cited to for or against some critical positions.

Generally speaking, the removal of these articles from the Technology I/E Regulation resulting in the application of the provisions under the PRC Contract Law and, consequently, aligns the rules for cross-border technology transfers with those for domestic technology transfers.

1. Removal of Non-infringement Clause

Art. 24 Subsection (3) of the Technology I/E Regulation (the "***Non-infringement Clause***"), which

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has been removed, required that the technology licensor of a technology license agreement be responsible for infringement of third party rights arising from the use of the licensed technology by the technology licensee in accordance with the technology license agreement. This article looks reasonable as a technology licensor, as the party provides the technology and benefits from providing the technology, ought to be responsible for the legality and non-infringement of the technology it provides.

However, the Non-infringement Clause is not always commercially realistic because a proof of non-infringement of a technology is not a simple task --- the ownership of a patent does not mean that the implementation of such patent is non-infringing. The implementation of a technology developed independently may still be infringing a third party right in other aspects which the patent does not cover. An assurance of non-infringement of technology usually requires performance of a freedom of operation analysis, which is costly. For example, when an innovative company grants a technology license to a matured company for commercialization, the licensee is at a better position and has more resources to perform freedom of operation analysis and to clear the market. Another example is a business disposal where a batch of technology is transferred on an "as they are" basis without any warranties.

With the removal of the Non-infringement Clause, the default rule under Art. 353 of the PRC Contract Law will apply, under which, unless otherwise agreed, the technology licensor would be responsible for infringing third party rights. This default rule governs both domestic technology transfers and cross-border ones. Technology licensors and licensees would enjoy more freedom to negotiate for and courts would be able to exercise wider discretion in allocating responsibilities for infringing third party rights in specific circumstance.

2. Removal of Improvement Ownership Clause

Art. 27 of the Technology I/E Regulation (the "***Improvement Ownership Clause***") provides that, during the term of a technology transfer agreement, the right in the improvements on the licensed technology vests in the party which develops the improvements. The Improvement Ownership Clause, in line with the principles under the PRC Patent Law and other intellectual property laws, appears to be reasonable in most circumstances but not all situations. For example, in an umbrella licensing arrangement where a licensor grants licenses to multiple licensees where such licensees can benefits from all improvements made by all licensees, in which situation it makes sense for all improvements be assigned to the licensor and for the licensor to grant all improvements to all licensees.

The removal of the Improvement Ownership Clause does not change the default rule that the right in the improvements vests in the party which creates them but allow the parties to enjoy more freedom to allocate the right in improvement among parties. The removal does not allow licensor to compel licensees to surrender their improvements because Art. 329 of the PRC Contract Law still prohibits the abusing of intellectual property rights, of which unreasonable requirement on licensees to surrender improvements is one.

Consequently, by removing the Improvement Ownership Clause, the PRC Contract Law as well as other intellectual property laws governs ownership of improvements in context of both domestic and cross-border technology transfers. Courts will have wider discretion in deciding whether allocation of right in improvements is reasonable and thus enforceable.

3. Removal of Prohibition Clause

Art. 29 of the Technology I/E Regulation contemplates a prohibition (the "***Prohibition Clause***") on inclusion of certain restrictive clauses (the "***Restrictive Clauses***") into a technology transfer agreement. The activities under these Restrictive Clauses are similar to those which are presumed monopolistic under the EU Block Exemption Regulation. Courts apply a reasonable test on Restrictive Clauses so that only those Restrictive Clauses which cannot be justified commercially will be invalidated.

Despite of the removal of the Prohibition Clause, a technology licensor is not allowed to include whatever restrictive provisions it desires in a technology license agreement. Art. 329 of the PRC Contract Law will regulate both domestic and cross-border technology transfers, under which clauses which monopolize technology and impede technological improvements are considered invalid and unenforceable. Art. 10 of the *Judicial Interpretation on Technology Contracts related Disputes* sets out a number of restrictive clauses which, if not justifiable commercially, are considered "monopolizing technology and impeding technological improvements." The restricted clauses prohibited under the Technology I/E Regulation and those prohibited under the PRC Contract Law are summarized below:

Restrictive Clause	**Restricted Clauses prohibited under Technology I/E Regulation**	**Restricted Clauses prohibited under the Contract Law / Interpretation**
Requirement on procurement of unnecessary equipment, technology, personnel	Art. 29(1)	Art. 10(4) of the Interpretation
Requirement on payment of royalties for technology of which the IP is expired, invalidated or void	Art. 29(2).	Art. 344 of the Contract Law
Restricting the improvement on	Art. 29(3)	Art. 10(1) of the

licensed technology		Interpretation
Restricting the developing or sourcing of technology similar to or competing with licensed technology	Art. 29(4)	Art. 10(2) of the Interpretation
Restricting the channel for procuring raw materials or equipment	Art. 29(5)	Art. 10(5) of the Interpretation
Restricting the quantity, types, price, and export channels of products manufactured by using the licensed technology	Art. 29(6) and (7)	Art. 10(3) of the Interpretation
Prohibition on challenging the validity of the licensed technology	/	Art. 10(6) of the Interpretation

As such, all Restrictive Clauses are actually covered by the existing provisions in the PRC Contract Law and its interpretation. In other words, both domestic and cross-boder technology licensees are subject to the same rule under which restrictive clauses are rendered invalid and unenforceable unless they are justifiable.

4. Conclusion

The deletion from the Technology I/E Regulation the clauses which protect domestic licensees in a one-sided way may be an reaction to US' criticism of China's protection of domestic business. These clauses used to function to protect domestic business when domestic licensees were less sophisticated. However, these protections are no longer necessary --- domestic players are ready to embrace international business competition and, more importantly, these clauses provide for the rules which are largely covered by the PRC Contract Law.

In other words, the amendment of the Technology I/E Regulation does not substantially weaken the protections on technology licensees in cross-border technology transfers but align such protections with the protections in domestic technology transfers, which consider more commercial context.

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