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Technology Transfer in China: Policies, Practice and Law

Stanley B. Lubman

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CONTENTS

SUMMARY

The legal and practical aspects of technology transfer are of increasing importance as China's international economic relations expand. Chinese legislation on aspects of such transfers are beginning to appear and this paper discusses relevant regulations particularly the Technology Import Contract Regulations of May 1985. Practical issues include Chinese interest in up-to-date technology and comprehensive technical documentation, valuation of the tech-

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nology to be transferred, payment terms, the terms and costs of technical training, and acceptance tests of the products manufactured using the transferred technology. Patent infringement and protection of proprietary information are also issues of concern to companies involved in technology transfer transactions. Such transactions may also be complicated by the blurred lines of authority that exist in China. The new Chinese Trademark Law provides more comprehensive protection to both the foreign investor and the consumer than its predecessor. The recently promulgated Patent Law also eases some of the previous uncertainties, but careful negotiation of contract clauses remains essential. If China sustains a long-term commitment to import technology, the legal framework for transactions should continue to develop and increase in definition. However, problems arise from differences in the legal cultures of the participants.

A. Introduction

As Chinese interest in importing foreign technology continues to grow, legal and practical aspects of technology transfer to the PRC require increased attention. This discussion draws on the experience of the author and others in negotiating transactions in the PRC involving the transfer of technology, and discusses both the developing legal framework and practical considerations in such transactions.

Limitations of space make it impossible to discuss general characteristics of the Chinese economy and of Chinese policies as they affect technology importation, but foreign businessmen and policymakers interested in practical possibilities in China ignore these at their peril.[1] Important, too, is an awareness of the flux in the Chinese bureaucracy which has appeared as a result of frequent extensive reorganizations and ongoing tensions between increased local autonomy and the maintenance of central supervision.[2]

A partial recentralization of foreign trade occurred in early 1984,[3] but later in the same year plans were announced to endow the foreign trade corporations under the jurisdiction of the Ministry of Foreign Economic Relations and Trade ("MFERT") with greater independence.[4] Further impetus for trade decentralization has been given by the designation of fourteen major cities, most of them coastal ports which were the centers of the pre-1949 China trade, as special economic zones endowed with considerable auton-

[1] It is important, for instance, to understand the evolution of Chinese policies toward technology transfer. See, Stanley B. Lubman, "Technology Transfer to China: Policies, Law and Practice," in Michael J. Moser, ed., *Foreign Trade Investment and the Law in the People's Republic of China*, Oxford University Press, 1984; Denis Fred Simons, "China's Capacity to Assimilate Foreign Technology: An Assessment," in *China Under the Four Modernizations-Selected Papers Submitted to the Joint Economic Committee*, U.S. Congress, Washington: Government Printing Office, 1982, pp. 514-552.

[2] See, e.g., Stanley B. Lubman, "Trade Contracts & Technology Licensing," in *Legal Aspects of Doing Business in China*, 1983, New York: Practicing Law Institute, 1983, pp. 9-64, at pp. 12-27, and "Equity Joint Ventures in China: New Legal Framework, Continuing Questions," in this volume.

[3] See, Amanda Bennett, "Peking Exerts Control on Foreign Trade," *Asian Wall Street Journal* (AWSJ), March 16-17, 1984, p. 3 and "China '85," *Far Eastern Economic Review* (FEER), March 21, 1985, p. 75.

[4] See "China Carries Our Reforms on Foreign Trade System," *China Economic News*, September 24, 1984, pp. 2-3; "Laxer Laws Attract Foreign Technology," *China Daily*, October 10, 1984, p. 1.

omy to attract and make agreements with foreign investors. While the precise content of the new policy toward these cities has not yet fully emerged, the extent to which investment incentives in the "14 cities" will differ from those in the existing Special Economic Zones in Guangdong and Fujian is becoming clearer.[5]

The Chinese leadership has been aware of the need for legislation to provide a framework for transactions which have only in recent years become common. The first rules specifically applicable to non-tax aspects of technology transfer, the "Provisional Regulations for Importing Technology into the Shenzhen Special Economic Zone" ("Shenzhen Provisional Technology Regulations"), were promulgated by the Guangdong Provincial People's Congress in February, 1984. In addition, "Regulations Involving Foreign Economic Contracts for the Shenzhen Special Economic Zone" ("Foreign Economic Contracts Regulations"), also promulgated in February 1984, set forth rules applicable to all contracts involving foreign and Chinese enterprises in the Shenzhen SEZ. "Regulations for Importing Technology of the Xiamen Special Economic Zone" were adopted in July 1984. In May, 1985, the "Technology Import Contract Administration Regulations of the PRC" were promulgated ("Technology Import Contract Regulations").

B. Contract Practice in Technology Transfers

Enough transactions involving technology transfer have occurred in recent years to permit useful generalizations about practice in such matters. The discussion which follows is focused principally on contracts for technology licenses, but is generally relevant also to other transactions involving technology transfer such as contracts for the establishment of a joint venture.

It has become less easy in recent years to generalize about the Chinese participants in licensing transactions. Although in the past virtually the only Chinese organization involved in such negotiations was the China National Technical Import Corporation ("Techimport"), other Chinese organizations have appeared recently as counterparts in negotiations involving technology transfer with foreign parties. Techimport has built up a considerable amount of expertise over the years in negotiating technology transfers with foreign parties, and has developed a customary practice which is followed with considerable consistency.

From the perspective of the foreign party, the implications are mixed. Techimport negotiators are familiar with legal and business concepts and concerns which foreign negotiators bring to the table. However, Techimport negotiators have also developed firm attitudes toward certain issues that frequently arise in technology transfer negotiations, and are sometimes aggravatingly rigid. As other Chinese entities become involved in technology transfer nego-

[5] The "Interim Provisions of the State Council of the PRC on Reduction in and Exemption from Enterprise Income Tax" and the Consolidated Industrial and Commercial Tax for the Special Economic Zones and the Fourteen Coastal Cities" ("Special Area Provisions") were promulgated in November, 1984. The Special Area Provisions provide, for the first time, a comprehensive framework of preferential tax treatment for both the 14 cities and the Special Economic Zones. The 14 cities are divided into "Economic Development Zones" and "original urban areas." Different sets of tax incentives are provided for these two kinds of Special Areas and for the SEZ's. The tax treatment in the Economic Development Zones is slightly more favorable than in the Special Economic Zones and both these Special Areas provide more favorable tax treatment than the Original Urban Districts.

tiations, they will bring their own attitudes to the table, which may result in both new opportunities and new obstacles for foreign parties negotiating technology transfers.

(1) COVERAGE OF THE CONTRACT

As in many developing countries, both end-users and commercial negotiators in China are likely to be concerned that the technology which they purchase is up-to-date and, furthermore, will not soon become outmoded or outdated. Chinese buyers require the seller to provide the Chinese party with all updates and improvements which are developed during the period of the license. If sellers are unwilling to include improvements developed during the term of the license without requiring any additional technology fee, the Chinese side may insist that the royalty rate should decline after the expiration of the period during which improvements will be transferred. At the same time, Chinese buyers are sometimes unwilling to cross-license improvements which they may develop.

The Chinese buyer [6] will attempt to define the scope of the contract and the technical documentation which the licensor is expected to deliver as broadly as possible. Chinese negotiators may want to include documents which a licensor does not ordinarily supply, such as engineers' notebooks and design information. In some negotiations, however, Chinese buyers have agreed to accept clauses which require sellers to supply only material that is readily available.

(2) PRICE, PAYMENT, AND VALUATION

Chinese transferees commonly offer to pay a lump-sum contract price in installments. The first installment is payable after the signing of the contract and receipt of an export license. Other subsequent installments are usually tied to deliveries of the technical documentation and to equipment, if any, with the final payment linked to successful completion of the acceptance test. The percentages of the contract price to be paid at each interval are subject to some negotiation.

An alternative method of payment that has been acceptable to Techimport involves a "small" down-payment, and royalties—computed according either to an agreed number of planned units or to the number of units actually produced.[7] It has also been possible to negotiate a paid-up royalty. A seller can expect Chinese negotiators to propose quite low royalty calculations, often supported by insistence that they are more in tune with "world market" levels. Chinese buyers usually prefer to key royalties to net profits or to actual sales, although transferors may be more interested in establishing a minumum royalty without regard to either of these factors.

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[6] The Chinese negotiating team will normally be comprised of representatives of a trade corporation and an end-user. The "buyer," as the Chinese insist on calling the transferee, will nominally be the trade corporation, except in relatively rare instances in which the end-user possesses the authority to enter into licensing transactions itself, or if the transaction involves countertrade, which many Chinese enterprises may engage in directly with foreigners. The Chinese characterization of the transaction as a "purchase" of technology tends to distort the nature of technology transfer as a *process*.

[7] See Moga, "Making Foreign Things Serve China: A Master Licensor's Guide to the Chinese Market," *St. Louis University Law Journal*, no. 28, 1984, at p. 774.

Negotiations are often marked by considerable differences of opinion regarding valuation of the technology to be transferred. The Chinese inevitably and understandably prefer low fees and low royalty rates. They express considerable antipathy to even considering the cost of the licensor's research and development efforts. In recent discussions with the author, several Chinese negotiators and law professors have expressed a preference for calculating the cost to the Chinese side of developing the technology without a license, or, put another way, the value of the benefits to be gained from using the imported technology. Negotiations, however, do not suggest that such a practice is in use.

An important recent expression of continuing Chinese concern with overvaluation of technology can be found in the Shenzhen Provisional Technology Regulations, which provide that when technology is capitalized as part of the establishment of a joint venture, the value of the technology may not exceed 20 percent of the registered capital of the enterprise, and the foreign side must also supply an equivalent amount of "cash or materials as investment capital." [8] According to statements reported by other Americans, similar percentages have been invoked by Chinese negotiators in other parts of China. At the same time, considerable disagreement has been encountered among Chinese experts on foreign trade as to whether the Shenzhen regulations will or should be taken as a model.

(3) BUY-BACK AND EXPORT CLAUSES

Chinese desires to save foreign exchange can be expected to play an important role in the negotiations. The Chinese may want the seller to buy back some quantity of the licensed product. The problem in this regard may be especially thorny: The licensor may not want the product at all, and even if he is willing to accept some shipments the Chinese may not be able to sell to him competitively. Price may be difficult for the parties to agree on, especially if the Chinese want to sell at a fixed price for what the seller regards as a long period, since the seller will probably want the price to reflect changes in world market prices.

Foreign sellers who contemplate obtaining Chinese products from a Chinese enterprise other than the one at which the licensed technology will be used are likely to be disappointed. The Chinese economic system does not currently permit such flexibility, although Chinese officials are sometimes hopeful of being able to achieve it and the approval of sweeping changes in the structure of the economy at the third plenary session of the Twelfth Central Party Committee, in October, 1984, makes it likely that such flexibility is indeed imminent.[9]

Chinese buyers frequently attempt to obtain rights to export products manufactured along with the licensed technology, and internal regulations apparently make it mandatory or near-mandato-

[8] "Provisional Regulations for Importing Technology into the Shenzhen Special Economic Zone," *China Economic News*, October 22, 1984, pp. 1-3, Article 23 at p. 3.

[9] The thrust of the changes is to loosen the state-controlled price system and to transform state-owned industrial corporations into independent companies. See "China Sets Historic Revision of Economy," AWSJ, October 22, 1984, p. 1.

ry for Chinese licensees to exact *some* export rights. Despite these requests, it has usually been possible for the parties to agree that the Chinese party will export to markets about which the licensor is not greatly concerned.

(4) DURATION

Chinese buyers usually want to limit the time during which they must pay for the technology to be transferred. They also want to limit their dependence on sellers for components and raw materials. In this author's experience, a five year contractual relationship has been common, although longer periods are possible. The Technology Import Contract Regulations provide that the period of the contract must be suitable to the purchaser mastering the imported technology and shall not exceed ten years without special approval of the approving authority.[10] At the same time, end-users are often realistic about the length of time it may take them to begin serial manufacture and sale of products incorporating licensed technology, and may be willing to buy considerable quantities of such subassemblies, parts and components.

(5) TRAINING AND TECHNICAL ASSISTANCE

Chinese buyers have not been consistent in their attitudes about foreign training and technical assistance. Even when they are willing to accept it, Techimport negotiators are usually reluctant to pay more than a limited *per diem* fee (several hundred dollars has been common) for such assistance.[11] Whatever the parties finally agree to, standard Chinese documentation requires specifying the number of man days to be spent in either country by the personnel of the other side. Responsibility for international travel and for living expenses is negotiable.

It is essential to reach a specific agreement on living and working conditions of foreign personnel in China. Sometimes conditions for foreign personnel are not discussed in detail by the two sides at the time the contract is negotiated. The burden of resulting misunderstandings then falls on the personnel sent to the site, not the negotiator who has returned to the comforts of home.

(6) ACCEPTANCE TESTS

At the heart of the contractual relation is the "acceptance test," which is intended to demonstrate to the satisfaction of both sides that the agreed-upon technology has been transferred to the point where the Chinese recipient is able to manufacture one or more

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[10] Technology Import Contract Regulations, *Guoji Shangbao,* May 30, 1985, Article 8. The Shenzhen Regulations provide that "the term of the contract must, in general, not exceed five years, except in a case where technology is regarded as investment capital although the term may be extended with the approval of the Shenzhen government." *China Economic News,* October 22, 1984, Article 19 at p. 2. Where the technology is contributed to a joint venture, the ten-year limit is not applicable because, according to an interview with an unnamed official of MFERT, the laws on equity joint ventures apply when technology is capitalized *(Guoji Shangbao,* May 30, 1985). Since the joint venture law permits ventures to have durations longer than ten years, presumably these longer terms are possible.

[11] There may also be disagreement on *when* the payment for technical training is to be made. See "Starts and Stalls on the Road to Successful Licensing," *Business China,* Vol. X, No. 2, June 27, 1984, p. 90.

prototypes or trial batches of the products involved, and that the products thus produced conform to contract qualification.

Clauses on acceptance tests commonly provide that the tests shall be conducted in China in the presence of the sellers' technicians, with test methods and other technical aspects to be provided for in detail in an appendix. If the acceptance test demonstrates that the product conforms to the specifications agreed on in advance, then the parties are required to sign an acceptance certificate.

If, however, the product fails to pass the acceptance test, the clause requires both parties to consult together, analyze the causes, conduct another acceptance test, and "clarify the responsibility." The clause may also require that in such an event, the period for which the seller is required to keep its technicians in China may be extended for an agreed upon number of weeks.

If responsibility for the failure of the acceptance test is determined by the parties to lie with the Buyer, the parties shall sign a certificate of acceptance tests "termination," but standard Techimport language requires the Seller to "assist the Buyer in taking means to eliminate the defects". If responsibility lies with the Seller, Techimport contracts require the Seller to "correct his mistakes as soon as possible, supply the Buyer with the correct documentation, and assist the Buyer in taking measures to eliminate the defects." If the defect cannot be remedied within an extended time period agreed to by the parties, the Seller must pay a penalty under the penalty clause in the contract, to which the acceptance test clause cross-refers, and which is normally expressed in terms of a percentage of the contract price. Since the penalty clause is by its terms directly addressed to the problems of incompleteness, incorrectness and unreliability of the *documentation* rather than the product or process which may be involved, the cross-reference is somewhat misleading. Techimport negotiators are usually very reluctant to change this wording, which seems to assume that an unsuccessful acceptance test is due to a defect in the transferee's documentation.

It is important to note that negotiations over the language of this clause are sometimes difficult and affect other aspects of the contract such as price, because of the very different emphases of the parties. The Chinese side wants the licensor to take as much responsibility as possible for a successful transfer of technology, while limiting costs to the Chinese side to a fixed amount. Licensors, while they also want to accomplish a successful transfer, are frequently concerned about their inability to choose technicians for training and their lack of control over infrastructural problems, such as poor quality of Chinese materials employed, delays caused by bottlenecks in the domestic economy, or poor workmanship in the course of erection of facilities. Out of concern for such problems licensors frequently want to limit the time spent in China by their personnel, or charge at a per diem which is very high by Chinese standards, or both.

It is essential to define the test methods that will be used, and the standards that will be used to measure conformity of tested samples or prototypes to contract specifications. If the end-user's representatives are technically competent, it should not be too diffi-

cult to reach agreement with them on these matters, which are normally the subject of a detailed appendix.

(7) THE GUARANTEE AND PENALTY

The lengthy guarantee clause in the standard Techimport contract requires the Seller to guarantee that the documentation "shall be the latest technical achievement possessed by the Seller" at the effective date or while the contract is in effect, and makes performance of the product a function of the "correctness" of the documentation. Penalties (a negotiated percentage of the contract price) are theoretically applicable to "incorrect," "unreliable" or delayed delivery of the documentation. Since it is the product or process being transferred to which the guarantee is really meant to refer, the confusion noted above in the discussion of acceptance tests is repeated here.

The standard Techimport contract has in the past provided for a ceiling on all the above mentioned penalties at five percent of the contract price. Since, as noted above, the penalties are cross-referred to in the clause covering acceptance tests, this ceiling presumably also applies when the Chinese manufactured sample product does not pass the acceptance test.

Since the quality of materials and equipment used by the Chinese side, the technical level of the personnel on both sides, and the test methods may influence the performance of the tested product there are numerous opportunities for delays and setbacks, and it may be impossible to pinpoint who is responsible for them. Chinese negotiators emphasize the desire of both sides to assure a satisfactory outcome, and cooperation seems to be the keynote.

In practice, Techimport and other Chinese licensees are likely to be most reluctant to invoke penalty clauses, preferring first to investigate and decide the nature of the defect and the best method of eliminating it, and then to concentrate on bringing the quality of the product up to contract specifications. At work here is the pervasive and basic Chinese assumption that the transferor has entered into a long-term relationship with the Chinese transferee, and that both parties have a primary duty to see that relationship through to fruition. The Technology Import Contract Regulations provide that the supplier must guarantee that it is the owner of the technology, that the technology is complete, good and effective, and that it can achieve the goals stated in the contract.[12]

C. The License Agreement and Third Parties: Patent Infringement, Confidentiality, Restrictions on Use, and Approval of the Transaction

(1) PATENT INFRINGEMENT

The standard Techimport clause on patent infringement has in the past required the licensor to bear full "relevant legal and economic responsibilities" arising out of alleged patent infringement. Lately, Techimport has insisted on more specific language requiring the licensor to assist the licensee and defend at its expense any

[12] Technology Import Contract Regulations, supra note 10, Article 6.

claim against the licensee for patent infringement. The Shenzhen Provisional Technology regulations state that,

> If the patent rights are invalidated halfway through the process or if the applications for patent rights are refused, the recipient will have the right to revise or terminate the contract.[13]

Some licensees have insisted on contract clauses that would give them the same rights.

(2) CONFIDENTIALITY AND UNAUTHORIZED USE

The problem of protecting proprietary information in China is a legitimate concern for any company considering a transaction involving technology transfer. China's new patent law, discussed below, provides for damages for patent infringement, and the Technology Import Contract Regulations require the purchaser ". . . within the time period and the scope agreed by the parties to be responsible for preserving the secrecy of that portion of the technology provided by the supplier which has not been publicly disclosed".[14] Whatever the legal framework, foreign companies should also obtain clear contractual expressions of the obligations of the Chinese partner not to disclose or duplicate licensed technology or other proprietary information without the licensor's consent. It is also necessary to insist that the licensee agree to require key employees to sign agreements obligating them not to disclose or transfer the protected technology.

Although Chinese courts can enforce contractual stipulations prohibiting technology transfer, foreigners would be well advised to look initially to extrajudicial remedies. They should try to contact the Chinese party whom they suspect may be breaching the agreement to keep the technology concerned confidential. Tactful expressions of concern that duplication of the company's technology would violate a prior agreement may be convincing. If problems persist, the company should contact either a high-level agency such as a ministry, whose authority runs *vertically* downward to the Chinese organization involved, or other organizations that can approach the bureaucratic hierarchy involved *horizontally*. These choices are not mutually exclusive. For example, a licensor might complain to the superiors of a Chinese enterprise, such as a provincial chemical industry bureau or a Beijing ministry, to the local government (the horizontal route), and also to the Ministry of Foreign Economic Relations and Trade.

Settlement of disputes involving foreigners is more likely to be accomplished through negotiation than through any form of third-party adjudication. Until the Chinese court system, and the legal system generally, achieve a greater degree of stability and reliability, foreigners will do best to eschew recourse to courts and to appeal to Chinese administrative agencies with a large stake in China's commercial credibility abroad.

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[13] *China Economic News*, October 22, 1984, Article 12 at p. 2.
[14] Technology Import Contract Regulations, supra note 10, Article 7.

(3) APPROVAL

All transactions involving foreign parties will require at least one, and often several, approvals from various Chinese governmental entities. Given the blurred lines of authority that exist, a foreign firm may have to discount assurances by Chinese organizations that claim to possess the authority not only to enter into technology transfer agreements, but to protect the foreign firm in certain necessary ways.[15] The U.S. company should adopt an attitude of healthy skepticism towards such claims. Sometimes the foreign company may be confronted with a choice between accepting a local organization's assurances at face value, or seeming to be impolite or mistrustful. It is probably wise to try and obtain fuller assurances and support at the central level, and to tell the local Chinese organization that such action is being taken. It behooves the foreigner to risk embarrassment in order to avoid disaster further down the road.

The Technology Import Contract Regulations provide that after the contract is signed it must be submitted to the approving authority, which is stated to be MFERT or any agency designated by MFERT. A decision must be made by such approving authority within 60 days after the contract has been submitted to it. If no decision is made within that period, the law provides that the contract shall take effect "automatically." [16] This last provision seems intended to prod a sluggish bureaucracy into prompt action. However, it is doubtful that the policies of strictly supervising both imports of technology and expenditures of foreign exchange could be so easily frustrated through bureaucratic inaction.

D. DISPUTE SETTLEMENT

Techimport has often agreed to third-country arbitration, and a standard Techimport arbitration clause calls for arbitration in Stockholm under the rules of the Stockholm Chamber of Commerce, or of the United Nations Commission on International Trade Law [UNCITRAL] Agreement on the applicable substantive law may be more difficult. In a relatively small number of transactions not involving technology transfer, particularly loan transactions involving the Bank of China, Chinese parties have accepted clauses providing that a foreign law would govern. Sometimes Chinese negotiators prefer that the Contract not refer to any governing law, but allow the arbitrators to choose that law, an approach that creates rather than reduces uncertainty. Recently, in a variety of negotiations, Chinese negotiators have insisted on the applicability of Chinese law.

Chinese legislation has begun to deal with the issue of the applicable law. The Shenzhen Foreign Economic Contract Regulations provide that in arbitrations arising out of contracts performed in the SEZ, cooperative activities, contracts relating to natural resources, and other contracts which have a "close relationship to Chinese sovereignty," Chinese law must be applied. Under the law

[15] See Ruben Kraiem, "The All-Too-Easy Path to Misunderstanding in China," AWSJ, October 10, 1984, p. 10.

[16] Technology Import Contract Regulations, supra note 10, Article 5.

on foreign economic contracts, the parties may choose the law to be applied except in a contract for a joint venture in China or for exploitation of Chinese natural resources.[17] The Technology Import Contract Regulations make no reference to dispute settlement, but indicate that technology import contracts must comply with the Foreign Economic Contract Law.[18] The Shenzhen legislation emphasizes Chinese sovereignty while the later nation-wide legislation emphasizes party autonomy to choose the governing law. To the extent that Chinese law is applicable, the obvious problems of ascertaining its content and the extent to which practice may shade the implementation of legislation are likely to persist in the forseeable future.

Chinese legal officials continue to advocate compromise and conciliation as the most desirable methods of settling disputes.[19] Indeed, at the moment of writing, although perhaps thousands of contracts between Chinese and foreign parties containing Swedish arbitration clauses have been signed, no trade dispute involving the PRC has yet been brought to Stockholm.

E. Taxes

Since the new Foreign Enterprises Income Tax Law ("FEITL") was enacted, income earned in China by foreign companies is subject either to taxation at a progressive rate up to 40 percent if the foreign company has an "establishment" in China, or at a 20 percent withholding rate on interest, royalties and other passive income if the company does not have an "establishment". As a result, foreign companies stand to be taxed at one or the other rate on royalties paid under license agreements. A variety of methods are available for enabling a licensor without an "establishment" to escape the withholding tax on royalties.

In some transactions, especially just after the new tax law was promulgated, foreign licensors and Chinese licensees have agreed that the Chinese side would pay the tax. This practice has met the disapproval of the Ministry of Finance. Although the Chinese side may sometimes offer to agree to reimburse the foreign side after withholding tax is withheld from royalty payments, Ministry of Finance officials have stated that although this practice is not illegal, it violates Ministry policy.

In order to promote import of advanced technology, in January 1983 the Ministry of Finance adopted regulations which provided that the tax rate could in some cases be halved to 10 percent, and certain transactions, "where the technology is advanced and the

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[17] "Regulations of Shenzhen SEZ on Economic Contracts with Foreign Elements," *China Economic News*, October 15, 1984, pp. 1-5, Article 35 at p. 5; "Law of The PRC on Foreign Economic Contracts," Articles 5, 6, *Renmin Ribao*, March 22, 1985, p. 2, *Business China*, March 28, 1985 at pp. 44-45.

[18] Technology Import Contract Regulations, supra note 10, Article 5.

[19] Their adoption of this attitude in the area of foreign trade agreements is an expression of a deep-seated and long-standing Chinese preference for compromise and conciliation, which is expressed in domestic contract disputes as well. A recent expression of current Chinese views on this subject is Shao Xunyi, "Conciliation Is a Good Method for Settling International Economic and Trade Disputes—An Introduction to China's Practice of Conciliation," paper presented to the 7th International Arbitration Congress, Hamburg, West Germany, June 7-11, 1982. *Cf.*, Tang Houzhi, "Arbitration—A Method Used By China to Settle Foreign Trade and Economic Disputes," *Pace Law Review*, Vol. 4, No. 3, 1984, pp. 519-536. See also "Law of the PRC on Foreign Economic Contracts," *ibid.*, Article 37.

terms preferential," would be wholly exempt from FEITL.[20] These cases involve fees for the use of "proprietary technology" in certain named activities. The regulations state that the fees which may fall under the exception include fees for technical documentation, technical services and training. Also exempt are fees for consulting services for Chinese "engineering or construction enterprises," "technology instruction fees" arising out of instruction in or seminars on "enterprise management and application of production technology," "technical assistance fees" related to assistance for "present equipment or products of Chinese enterprises," and technical services and design or documentation fees for construction sites or equipment.[21]

Under the new regulations, the agencies charged with approving the transactions must submit relevant documents to the local tax authorities. Tax *reductions* will be decided locally, but complete tax *exemptions* will be decided by the Ministry of Finance upon application from local tax bureaus. Prospective foreign licensors desiring tax reductions or exemptions must at the moment rely on informal interpretations and suggestions from local tax bureaus and the Ministry of Finance. Contract negotiations are often affected by the need to submit applications for tax reductions to local tax bureaus or to the Ministry of Finance. It seems to be increasingly possible to obtain opinions in a reasonable timely fashion, at least in Beijing.

It should be noted that some problems under FEITL may legally be avoided if payments by a Chinese party to a foreign one are not denominated as "royalties" and are not otherwise classified as a type of passive income to which the withholding tax applies. The Ministry of Finance has confirmed, for instance, that where the foreign side is repaid for its know-how in products, such payments are not taxable under the Foreign Enterprise Income Tax Law.[22] Thus, a considerable tax incentive exists to meld technology transfer into co-production or countertrade transactions, rather than to enter into pure technology licensing agreements.

F. Chinese Patent Law

The new Patent Law now extends legal protection of industrial property rights beyond the protection afforded by contract, which previously was all that was available to foreign parties. After many years, marked first by neglect of patent matters and then by slow and patient study of foreign patent legislation and administra-

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[20] "Provisional Regulations on the Reduction and Exemption of Income Tax on Fees for the Use of Proprietary Technology," East Asian Executive Reports, April 1983, pp. 24-25, Article I at p. 24.

[21] Chinese tax officials have recently been willing to grant tax rulings *prior* to contract approval.

[22] "Finance Ministry Spokesman on Income Tax Reduction & Exemption for Foreign Companies," *China Economic News* 1983, No. 11, March 21, 1983, pp. 3-4.

tion,[23] the PRC has enacted a patent law, whose salient points are summarized below,[24] as well as implementing regulations.[25]

(1) PATENTABILITY

The new law affords protection to three classes of property, namely "inventions," "utility models" and "designs,"[26] to which are applied general tests of patentability. "Inventions" must meet criteria of "novelty," "inventiveness," and "practical applicability."[27] It should be noted that "novelty" is measured on a *world-wide* basis; the law provides that,

> no identical invention or utility model has been publicly disclosed in publications in the country or abroad, or has been publicly used or made known to the public by any other means in the country, nor has any other person filed previously with the Patent Office an application which described the identical invention or utility model and was published after the said date of filing.[28]

As a consequence, foreigners will be able to apply for patents only on their newest inventions, subject to the 12-month priority discussed below.

Different standards of "inventiveness" are applied to "inventions" and "utility models," respectively: "inventions" must have "prominent substantive features" and represent "a notable progress," while a utility model need only have "substantial distinguishing features and represent an improvement".[29] The distinction between these two levels of creativity, while permitting embodiments of both to be patented, is not recognized by the U.S. patent system, but is familiar to some other foreign systems. The concept of "practicality" is not clearly defined in the patent law, nor is "exterior design," the third category of patentable property.

(2) APPLICATION, EXAMINATION, AND APPROVAL[30]

The application and examination process hinges on the date the Patent Office receives the application (or, if it is sent by mail, the date the application is postmarked).[31] Publication must occur

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[23] A series of articles published the past few years by Chinese observers explaining the importance of a new patent law have been collected together in "China Report: Science and Technology: Formulation of China's First Patent System Debated," Joint Publications Research Service (JPRS), February 21, 1984. A major theme of the Report is the importance of the patent system to technological progress.

[24] The law was promulgated on March 12, 1984, and is to become effective on April 1, 1985. For the text of the patent law and a discussion of the history of the law's preparation, see "China's New Patent Law and Other Recent Legal Developments," report prepared by the Far Eastern Law Division of the Library of Congress, 1984; Xue Yipin, Sun Xueyin, "Chinese Invention Award & Patent System," in *International Economic Law Seminar: Proceedings of Shanghai Conference on International Transfer of Technology*, 1984; Timonthy A. Gellatt and Ruth O. Sweetman, "China's Patent Law Needs Clarification," AWSJ, April 2, 1984, pp. 6–7; Michael J. Moser, "China's New Patent Law," in Michael J. Moser, ed., supra note 1.

[25] "Implementing Regulations of the Patent Law of the People's Republic of China," approved by the State Counsel and Promulgated by the Patent Office of the People's Republic of China, January 19, 1985, *China Economic News*, February 18, 1985, Supplement No. 2 ("Implementing Regulations").

[26] "Patent Law of the PRC," in "China's New Patent Law and Other Recent Legal Developments," supra note 24, Article 2.

[27] *Ibid.*, Article 22.

[28] *Ibid.*

[29] *Ibid.*

[30] The outlines of the procedure provided by the Patent Law have been supplemented in great detail by the Implementing Regulations, which are not discussed here due to lack of space.

[31] "Patent Law of the PRC," supra note 24, Article 28.

within 18 months of the filing date, after a preliminary examination by the Patent Office.[32] Applicants for invention patents must request an examination within three years of the filing date. If they do not, their application shall be deemed to have been withdrawn.[33] Opponents of registration have three months after the announcement of the pendency of a particular application to file notice of their opposition;[34] procedures for filing opposition and standards will presumably be detailed in further implementing regulations. The Patent Office will grant the patent, issue a certificate and announce its action if its review has yielded no cause for rejection.[35] A patent Reexamination Board is established by the statute, to which disappointed applicants may appeal a decision of the Patent Bureau rejecting their applications.[36]

(3) PATENTEES

Patentees of "service invention-creations" may be state-owned organizations (in the language of the Patent Law, "entities under ownership of the whole people"), collectives or individuals.[37] If inventors have done their creative work in execution of tasks for state organizations or using the "material conditions" of such organizations, those organizations become the patentees; when patents are filed for by collectives, the patentee may be either the collective or an individual.[38] A further distinction is drawn between state-owned units, which "hold" patent rights, and collectives and individuals, which "own" such rights, although the significance of the distinction is not clarified by the Patent Law. Individuals may also apply for and own patents on "non-service-invention creations."

(4) NATURE OF PATENTEES' RIGHTS; COMPULSORY LICENSING AND ASSIGNMENT

The statute gives patentees the exclusive right to use the patented technology, subject to a provision that allows "competent departments concerned" of the State Council and the people's governments at the central and provincial levels and in autonomous regions of cities directly under the central Government to decide that any state-owned entity within their system or under their administration must allow designated entities to exploit the invention-creation, subject to a patent fee according to a schedule that is yet to be established.[39] Patents owned be collectives may be subject to compulsory licensing if they are "of great significance to national or public interests".[40] Individual inventors are to receive economic

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[32] *Ibid.*, Article 34.
[33] *Ibid.*, Article 35.
[34] *Ibid.*, Article 41.
[35] *Ibid.*, Article 44.
[36] *Ibid.*, Article 43.
[37] *Ibid.*, Article 6.
[38] *Ibid.*
[39] *Ibid.*, Article 14. According to James V. Feinerman, "the curious wording of Article 14 suggests that there may be the possibility of local government involvement in granting rights . . . This could lead to considerable confusion in local practice, although it is hard to know how many 'local' patents may be applied for or issued once the patent system is established," "PRC Patent Law Offers Basic Protection, But Questions Remain," *East Asian Executive Reports*, June 1984, pp. 9-11
[40] "Patent Law of the PRC," supra note 24, Article 14.

rewards from organizations which hold or own patents on their inventions, and, after the inventions are exploited, should be rewarded according to the "extent of spreading and application and the economic benefits yielded".[41]

If patentees of an invention or utility model fail to make the patented product or "use" their patents for a period of three years after registration "without justified reason" and an entity which is qualified to exploit the invention or utility model requests permission to use such a patent, the Patent Office is authorized to grant a compulsory license, subject to a fee to be agreed upon by the parties or, if no such agreement is reached, decided by the Patent Office.[42] Disputes related to such a license or fee may be heard by a People's Court.[43] Although the statute does not specify which courts shall have jurisdiction over patent matters, interviews with patent authorities before the Patent Law was promulgated suggested that basic-level courts were not meant to have such jurisdiction. This as well as a number of other administrative and enforcement questions will have to await further clarification by implementing regulations.

Patent rights may be assigned, subject, as to state-owned entities, to higher level approval.[44] The patent office is to register and announce the assignment of the patent right. It is not clear if this means that the patent office must approve the assignment. Chinese entities may not transfer patents to foreigners without approval by the "competent department concerned of the State Council".[45]

(5) DURATION

Inventions are to be protected for fifteen years counting from the date of filing; the duration of the patent right for utility models and designs is five years (also counted from the date of filing) with the possibility of a single three-year renewal period.[46] In any case, patentees must pay an as yet unspecified annual fee.[47]

(6) EXCLUSIONS

Excluded altogether from patent protection are "scientific discoveries," "rules and methods for mental activities" and "methods for the diagnosis or treatment of diseases".[48] Processes but not products are protected for foods, beverages and flavorings, animal and plant varieties, and substances obtained by means of "nuclear transformation," as well as pharmaceutical products and chemical compounds.[49] Separate regulations, in existence or being drafted, apply to scientific discoveries, while some of the other types of excluded products are regarded as too essential to health and welfare to be allowed to become the exclusive property of anyone, even of their inventors.

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[41] *Ibid.*, Article 16.
[42] *Ibid.*, Articles 52, 53, 57.
[43] *Ibid.*, Article 58.
[44] *Ibid.*, Article 10.
[45] *Ibid.*
[46] *Ibid.*, Article 45.
[47] *Ibid.*, Article 46.
[48] *Ibid.*, Article 25.
[49] *Ibid.*

(7) PROTECTION OF PATENT RIGHTS OWNED BY FOREIGNERS

Non-resident foreigners may file patent applications in China, provided that reciprocity exists between the applicant's country and the PRC by virtue of a bilateral treaty, adherence to an international convention (such as the Paris Convention), or otherwise.[50] Foreign applicants are given a 12-month right of priority in China beginning with the date on which they first filed a foreign application for the same invention or utility model (six months for an exterior design), subject to the same qualifications stated above with regard to reciprocity.[51] Applications by foreign applicants who are "not usually residents" or who have "no business office in China" must appoint a Chinese patent agency designated by the State Council, of which one will be CCPIT, which has functioned in a similar manner in trademark matters for many years;[52] others designated since the law was promulgated include the Shanghai Patent Agency and China Patents Ltd, a Hong Kong affiliate of CCPIT. The law does not state the criteria for determining whether a foreigner is a "resident" or has a "business office" in China.

(8) INFRINGEMENT

Patentees may request "the administrative authority for patent affairs" to enjoin a violator who commits "any action that infringes upon the patent right without the knowledge of the patentee," and to order payment of damages.[53] The implication that some organization other than the Patent Bureau is to be created or that an existing body shall act as a super-agency with respect to patent matters is suggested by use of this term in some places in the statute, rather than uniform reference to the Patent Bureau. Implementing regulations are needed here, as they are to define the "infringing act" which may be punishable under the new law.

Another provision in the law excludes from patent violations "use or sale [of] a patented product [by someone] not knowing that it was made and sold without the authorization of the patentee".[54] The standard of "knowledge" that will be applied remains to be clarified both in connection with "use or sale," and in connection with "passing off," defined as the intentional or knowing replication of another's patents, and which is punished by fines and, possibly, criminal prosecution and punishments, including imprisonment for up to three years.

(9) GENERAL COMMENTS

In some respects, the Chinese patent law differs from U.S. patent law, especially in placing emphasis on priority in filing the patent application rather than on the date of actual invention, and in providing for a deferred-examination system. These differences from U.S. patent law are common elsewhere in the world. Common, too, in the patent legislation of other developing countries, is the exclu-

[50] *Ibid.*, Article 18.
[51] *Ibid.*, Article 29.
[52] *Ibid.*, Article 19.
[53] *Ibid.*, Article 59.
[54] *Ibid.*, Article 62.

sion from patent protection of products perceived to possess an especially important relationship to the general health and welfare. Plant materials, for instance, are not patentable in the Soviet Union or in many developing countries.

Of greater concern to some foreign companies is the denial of patentability to pharmaceutical products and chemical compounds. If Chinese enterprises or research organizations succeed in differentiating their process from one used abroad to produce a similar compound—and the degree of variation between the processes remains to be defined—they can presumably patent their process in China. In addition to threatening valuable proprietary knowledge, this provision of the new law may also vary from U.S. law enough to raise a question of whether the Chinese law gives "equivalent" protection to that afforded under U.S. law, which China is bound by its Trade Agreement with the United States to accord to U.S. nationals.

Although some concepts and provisions of the patent law require clarification,[55] and although careful negotiation of contract clauses remains essential to prevent unauthorized disclosure or replication of proprietary technology (as it is elsewhere in the world), the new law should be welcomed. It is another affirmation of Chinese intentions to participate in trade and investment as a member of the international economic community, and to recognize widely accepted rules and practices of that community.[56]

G. Trademarks

A new Chinese Trademark Law came into effect on March 1, 1983, replacing an earlier statute which need not be discussed here.[57] Implementing Regulations for the new Trademark Law were promulgated on March 10, 1983. The new Trademark Law protects the registrant's right to exclusive use of his duly registered trademark.[58] The registration of trademarks is voluntary except for certain kinds of goods which must bear a registered trademark before they are sold.[59] So far, only pharmaceutical products fall into this category.[60]

Trademarks may be registered if they are "characteristically distinctive." They may not be registered if they are identical with or similar to marks that have already been registered for use in the same or similar goods. Certain names and symbols may not be registered, including the names, flags, and national emblems of coun-

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[55] See Michael Kirk and David Denny, "Recent Developments in China's Treatment of Intellectual Property," in *China Under the Four Modernizations*, Vol. II, supra note 1, p. 290, 302-305.

[56] A growing body of descriptive literature on the patent system has followed the publication of the Patent Law. For a recent Chinese example, see *Products and Technology Abroad*, Special Issue on Patents, September 1984.

[57] For a recent Chinese view of the new Trademark Law, see Zhu Yunjian, "On the Trade Mark Law of the People's Republic of China," in *International Economic Law Seminar: Proceedings of Shanghai Conference on International Transfer of Technology*, 1984. The new Trademark Law is discussed in Jerome Alan Cohen and Jamie D. Horsley, "The Trademark Law of the Peoples Republic of China," in *Private Investing Abroad* at pp. 211-225; *cf.*, Timothy A. Gelatt, "China's New Improved Trademark Law," AWSJ, October 22, 1982, p. 6.

[58] "Trademark Law," *Patent and Trademark Review*, February 1984, pp. 79-84, Article 1 at p. 79.

[59] *Ibid.*, Article 5.

[60] "Detailed Regulations for the Implementation of the Trademark Law of the PRC" ("Implementing Regulations"), *China Economic News*, October 3, 1983, pp. 1-3, Article 4 at p. 1.

tries, intergovernmental international organizations, the Red Cross and the Red Crescent, the commonly used names of the commodity in question. In addition, marks which "directly indicate the quality, main raw materials, functions, uses, weight, quantity and other characteristics of the commodity," "contain [material of] a racially discriminatory nature," "promote in an exaggerated manner and contain [material of] a deceptive nature," "are harmful to the customs of socialist morality or have other bad influences," or "promote in an exaggerated manner" may not be registered.[61]

Officially the Trademark Bureau is responsible for all matters concerning trademarks, but foreigners are not permitted to deal directly with the Bureau[62] and must apply to the China Council for the Promotion of International Trade (CCPIT), which has been designated as the attorney-in-fact for foreigners in all matters before the Bureau.[63] In addition to the required application documents and files, foreigners must submit a power of attorney in favor of CCPIT, stating the scope of its powers and the nationality of the applicant (or principal).[64] All documents submitted must be in Chinese or accompanied by a Chinese translation.[65]

Article 9 of the Trademark Law permits registration applications in accordance with any agreement concluded between the PRC and the applicant's country, or according to international treaties to which both countries are parties, or on the basis of the principle of reciprocity. Reciprocity has formed the basis of U.S. registration in China in recent years, and does so at present.

There is no requirement of prior use of a trademark before it can be registered. The Chinese give priority to the date the application is filed, regardless of the first date of "use."[66] After the application is given a preliminary approval and published, there is a three-month period within which objections to the registration can be made.[67] If there are no valid objections, the registration is approved for ten years and renewable for ten-year terms.[68] If an application for registration is rejected or opposed, procedures for reexamination or opposition proceedings before a Trademark Review and Adjudication Board are provided for by the Law. Unless approval of registration is ultimately obtained, the registrant is not protected by the Trademark Law.[69] The relationship between the Board and the Trademark Bureau itself is not clearly explicated by the Law.

The Trademark Bureau retains the right to cancel the registration if the mark has been changed or assigned without notification, or if the registrant has not used the mark for over three years after registration, or has passed off inferior goods bearing the mark.[70] Publication or advertising in certain Chinese periodicals appears to constitute "use" for the purposes of this provision.

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[61] "Trademark Law," supra note 55, Article 8.
[62] *Ibid.*, Articles 9 and 10.
[63] Implementing Regulations, supra note 57, Article 30.
[64] *Ibid.*
[65] *Ibid.* Article 31.
[66] *Ibid.*, Article 5.
[67] "Trademark Law," supra note 58, Article 19.
[68] *Ibid.*, Articles 23 and 24.
[69] *Ibid.*, Articles 20 to 22.
[70] *Ibid.*, Articles 30 and 31.

It should be noted that contracts for license of trademarks must be filed with the Trademark Bureau, and the new law both imposes on licensors the obligation of supervising the quality of the commodities bearing the registered mark, and also requires the licensee to "guarantee" the quality of these commodities.

The new Chinese Trademark Law protects trademarks more comprehensively than its predecessor. Infringement is defined as unlicensed use of an identical or similar mark on the same or similar goods, unauthorized manufacture or representation of another person's registered mark, or other injury to the registrant's right to exclusive use of the mark.[71] Again, as in matters of registration, the foreign owner of a registered mark must apply to CCPIT for protection against infringement.[72] Domestic Chinese applicants, as well as registrants complaining about infringement, deal with county-level or other local bureaus of the General Administration of Industry and Commerce (GAIC).[73] In cases of alleged infringement of foreigners' trademarks, after CCPIT has reviewed the matter it will turn to the State Administration for Industry and Commerce ("SAIC"). In a number of cases which have not been publicized, the SAIC has investigated infringement. In one such case, it stopped a Chinese factory from counterfeiting a consumer product bearing a registered trademark.

The Patent Law also makes consumer protection a factor in enforcing its trademark law.[74] The Trademark Bureau, in addition to overseeing the registration of trademarks, is supposed to insure that trademarked goods are of satisfactory quality and are not misrepresented to the consumer.[75] Indeed, it may revoke the mark if the goods are "manufactured in a rough and slipshod way" and are used to "pass off" inferior goods.[76] It is not entirely clear how this consumer-oriented part of the law will be applied, if at all, for foreign marks.

Some questions remain unanswered about the role to be played by CCPIT, the Trademark Bureau and local county departments of the SAIC in enforcing the Trademark Law both against abuse by registrants and against trademark infringement by others. There are a number of junctures at which the rights of foreigners are not made clear. In the two years since the Trademark Law was first promulgated, these have been the subject of much discussion in foreign and domestic publications, and the Chinese have addressed and clarified certain areas of concern to foreign businesses.

Over time some of the questions which remain, particularly regarding applicability of the economic protection aspects of the law and the mechanics of enforcement of the law, will become more settled. For the moment, though, of greatest importance to foreign companies is the need to register their marks. Since no prior use need be shown by a registrant, true owners of valuable marks would be well advised to register them in China to avoid their registration by others.

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[71] *Ibid.*, Article 38
[72] Implementing Regulations, supra note 57, Article 29.
[73] "Trademark Law," supra note 55, Article 39.
[74] For a discussion of this point, see Gellatt, supra, note 22.
[75] *Ibid.*, Article 31.
[76] *Ibid.*, Article 34.

H. Conclusions

The foregoing discussion has touched on only some of the problems that may arise in the course of the parties' negotiations and other relations with each other. Other forces may shape transactions or their outcomes. For example, the influence of U.S. export controls on technology transfer to the PRC has not been considered here. During the summer of 1983 the Reagan Administration decided to loosen the controls on sales of strategic goods to China, but only time and continued scrutiny will tell whether the U.S. Department of Defense will become less of an obstacle than it has been in the past.[77]

This chapter began with reference to changing Chinese policies, which will no doubt continue to show variations that will affect transactions of the type discussed here. At the same time, though, if any current Chinese policy is likely to be a long-term one, it is the commitment to import technology. China's leaders could not contemplate carrying out a genuine effort to modernize Chinese industry without continuing that commitment. If this perception is accurate, the legal framework for transactions giving expression to this policy should therefore continue to develop and increase in definition.

Yet even if policy remains consistent and new laws add greater certainty to the expectations of the parties to technology transfer transactions, some problems in negotiations between foreign transferors and Chinese transferees of technology are likely to continue to appear, particularly problems of style. The legal cultures of the negotiators on each side of the table differ greatly, and these differences sometimes matter.

It has been common in the past for Chinese negotiators to prefer broader, often imprecise expressions of licensors' obligations in contracts, and to disdain detailed documentation, especially if they regard it as legalistic. Although foreign licensors would be doing themselves and their Chinese counterparts a service if they rendered some of their favorite legalisms into plain English, at the same time they should insist on documentation that covers the contingencies which most concern them.[78] Unfortunately, it is not easy to generalize about the reactions to such clauses by the Chinese side. Techimport negotiators in particular seem to insist on using their standard clauses, which are often unclear, incomplete, or both, on such issues as liability of the licensor to licensors or to third persons.

Perhaps the greatest source of problems between licensors and licensees in the PRC is the frequent gap between high Chinese expectations and the inadequacy of the Chinese infrastructure to pro-

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[77] See Stanley B. Lubman, "Technology Transfer to China: Policies, Law and Practice," in Michael J. Moser, ed., supra note 1, and Richard Holbrooke, "The Drag on Sino-U.S. Trade," *Wall Street Journal*, February 15, 1985.

[78] The foregoing advice seems especially appropriate in light of the fact that the Chinese side, viewing the contract as a document that creates a strong and ongoing relationship between the parties, may later request favors or other actions by the licensor which the licensor may view as imposing added and sometimes costly burdens on him. Also, as elementary as it may seem, unwritten commitments by either side should be avoided as much as possible. This is particularly true in view of the fact that the Chinese side may have difficulties in performing obligations which involve the participation of other Chinese organizations which were not consulted when the contract was drafted. See the discussion of such matters in Lubman, supra, note 2.

vide support for the realization of such expectations. This is reflected in many aspects of transactions involving transfers of technology, ranging from Chinese hopes about the speed and effectiveness with which the technology can be transferred, learned and applied to such mundane but important details as the availability and adequacy of Chinese utilities, transportation, goods and services and living quarters for expatriate employees.

Responsibility for misunderstandings which may arise because of the distance between Chinese hopes and the limited resources of the Chinese economy should not be laid exclusively on the Chinese side. Foreign businessmen are frequently inexcusably ignorant about the realities of the Chinese economy simply because they have not taken the trouble to inform themselves adequately. Perhaps because China is so distant and is assumed to be unknowable, Western businessmen often take less trouble to inform themselves about China than they would if they were going to another Western nation to discuss a similar transaction. At the same time, the flow of information is increasing, not only in English but also in other Western languages. The failure to follow recent developments in China has even become more unwarranted than it was before. Especially because of the consequences of decentralization and economic reform, the foreign businessman who takes China as an impenetrable monolith does so at his peril.

For all the uncertainties noted above and the risks they create, the PRC promises to be an attractive market for foreign technology in the near future, especially if the transfers can be accomplished in the context of transactions that especially fit with Chinese needs and limitations. The ideal transaction, from a Chinese point of view, involves advanced technology, a substantial amount of labor, and a product for which there are considerable export markets. The absence of any of these factors does not necessarily mean that the transaction will not be consummated, but the presence of all of them would enhance the possibilities for success.

Little additional certainty has been contributed by the regulations on technology transfer contracts of May 1985, although some points have been clarified. For example, recognition has been given to the protection of proprietary know-how and trade secrets. The Technology Import Contract Regulations specifically include "proprietary technology" among the forms of transferable technology which are covered by the Regulations and which the purchaser is bound to protect under Article 6.

At the same time, the new Regulations contain provisions which can be used to buttress the negotiating power of Chinese importers of technology. Article 9 states that the supplier "shall not force the purchaser to accept unreasonable restrictive requirements," and enumerates certain restrictions which cannot be included without special permission of the approving authority. The supplier may not:

—require the purchaser to purchase unnecessary technology or technical services, raw materials, products or equipment unrelated to the transferred technology;
—restrict the purchaser from buying from other parties;
—prevent the purchaser from developing or improving the imported technology;

—prevent the purchaser from obtaining from other sources similar or competitive technology of the same type;
—impose "unequal terms" of technical exchange or improvements between two parties;
—restrict the categories, types or sales price of products manufactured using the imported technology;
—"unreasonably restrict" the purchaser's sales channels or export markets;
—prevent the purchaser from continuing to use the imported technology after the expiration of the terms of the contract; or
—request the purchaser to make payments for, or accept responsibility for, technology which is unusable or on which the patents have expired.

The implications for the future of these requirements should be discussed in the context of certain general standards which the Regulations require imported technology to meet. Article 3 states that the imported technology must be "advanced and reliable" and must be capable of:

—Developing new products;
—Improving product performance, reducing the cost of products and conserving energy of raw materials;
—Facilitating the effective use of Chinese resources;
—Enhancing export earnings of foreign exchange, and facilitating environmental protection, production safety, economic management, and the raising of the "level of science and technology."

It is readily evident that these last-enumerated requirements could be mutually inconsistent in many cases. Plainly too, interpretations of what may be "unreasonable" restrictions under Article 9 could vary extensively. Both of these sets of standards are so general that they will be given meaning only through interpretation, often couched in terms of exceptions to the standards. As is so often the case with the making and enforcement of Chinese laws, tentativeness and flexibility promise to mark the evolution of these regulations. Tentativeness is not inconsistent with the eventual appearance of clear tendencies—so long as basic policies do not change. At the time the regulations were promulgated no policy changes seemed in the offing that pointed to an intent to have the regulations alter the established contract practices which have been discussed previously here.

The legal framework will evolve only gradually, however. Interpretive regulations are slow to follow the general laws they supplement, and practice usually moves faster. Regardless of the precise course of legal development we can be sure that technology transfer to China, like other areas of trade and investment in that country, will continue to reflect the nuances of endlessly changing encounters among law, policy and practice.