China's New Regulations on Technology Imports and Exports

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The Technology Import and Export Administrative Regulations of the People's Republic of China (the "Regulations") were promulgated on December 10, 2001 with effect from January 1, 2002. In a departure from the prior long-standing regulatory regime, which focused only on imports of technology and know-how, the Regulations cover both the import of technology into and the export of technology from the People's Republic of China ("PRC"). The Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") remains the principal approval authority for restricted technology trade, as well as the registration authority for permitted technology trade, but the Regulations also provide that MOFTEC shall delegate its approval and registration authority to provincial-level Commissions on Foreign Trade and Economic Cooperation ("COFTECs").

The Regulations abolish the Regulations of the PRC on the Administration of Technology Import Contracts\(^1\) and the Rules for the Implementation of the Regulations of the PRC on the Administration of Technology Import Contracts.\(^2\) However, the Regulations make no mention of the more recent Tentative Procedures for the Administration of Trade in the Importation of Technology and Equipment which were issued by MOFTEC on March 22, 1996 (the "Tentative Procedures").\(^3\) Presumably, therefore, the Tentative Procedures remain in effect and will co-exist with the Regulations. Note, however, pursuant to Article 54, that the Regulations will prevail in the event of any inconsistency with prior State Council regulations relevant to the administration of technology import and export.

As contemplated by and in accordance with the Regulations, the PRC Administrative Measures for Registration of Technology Import and Export Contracts (the "Registration Measures"), the PRC Administrative Measures on Prohibited and Restricted Technology Exports (the "Technology Export Measures"), the PRC Administrative Measures on Prohibited and Restricted Technology Imports (the "Technology Import Measures"), the PRC Catalogue of Technologies Prohibited and Restricted for Exports (the "Technology Export Catalogue") and the PRC Catalogue of Technologies Prohibited and Restricted for Imports (1st Batch) (the "Technology Catalogue")

\(^1\) Approved and promulgated by the State Council on May 24, 1985.


\(^3\) The Tentative Procedures provide a registration requirement for foreign transferors, as well as a system for registering entities that act as agents for imports of technology and equipment. It is not clear whether this registration requirement will be superseded by the registration/approval procedures provided in the Regulations.
Import Catalogue") were promulgated by MOFTEC on December 30, 2001, with effect on January 1, 2002. These administrative measures provide detailed guidelines in respect of the approval and registration procedures for technology imports and exports.

**Restricted and Prohibited Categories of Technology Imports and Exports**

The Regulations specifically reference Articles 16 and 17 of the *Foreign Trade Law of the People's Republic of China* to provide general guidelines for restricted and prohibited technology. Technologies generally prohibited for both import and export include:

- technologies that jeopardize State security or social and public interests;
- technologies that harm human life or health;
- technologies that damage the eco-environment; and
- technologies that are prohibited for import and export in accordance with international treaties or agreements to which China is a contracting party or signatory.

Imports of specific technologies may be restricted for the following reasons:

- to protect State security or social and public interests;
- to establish or accelerate the establishment of select domestic industries;
- if necessary for any category of agricultural, livestock or fishery products;
- to ensure the nation's international financial position and the balance of its international revenues and expenditures; and
- to comply with international treaties or agreements to which China is a contracting party or signatory.

Exports of specific technologies may be restricted for the following reasons:

- to protect State security or social and public interests;
- there is a shortage of domestic supply or to effectively protect against possible exhaustion of domestic supply;
- the market demand of the country or region to which technologies are to be exported is limited; and
- to comply with international treaties or agreements to which China is a contracting party or a signatory.

The above are merely general guidelines as to the categories of technology imports or exports that are prohibited or restricted. The Regulations call for MOFTEC to work with relevant departments under the State Council to formulate,

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4 Approved by the Standing Committee of the People's Congress on May 12, 1994 with effect from July 1, 1994.
adjust and publish import and export catalogues for restricted or prohibited technologies, which are embodied in the Technology Export Catalogue and the Technology Import Catalogue. These Catalogues specify which technology imports or exports are restricted, and as such, are required to undergo the approval process.

**Registration, Approval and Other Formalities**

Technology is classified under one of three categories: unrestricted technology may be imported or exported without approval, but the contract must be registered with the registration authority; restricted technology may be imported or exported upon approval; and technology that is categorized as prohibited may not be exported from or imported into China. A summary of the relevant documents and procedures for registration/approval of technology import/export contracts is set out below.

1. **Registration of Import/Export of Unrestricted Technology.**

   (a) Registration procedures are detailed in the Registration Measures. The registration process begins with on-line registration on the China International Electronic Commerce Network (http://info.ec.com.cn), followed by submission of paper documents to MOFTEC or the local COFTEC, depending on whether or not the transaction is considered a major project. A major project is defined as a project whereby the sources of project funding include the State fiscal budget, foreign government loans, loans from international financial organizations, or other projects that have been listed with, and preliminarily approved (lixiang) by the State Council.

   (b) Documents to be submitted:

   - Registration application;
   - Copy of the technology import/export contract; and
   - Identification documents showing the legal status of the contracting parties.

   (c) Registration takes three (3) working days from the time a complete application is submitted. The import/export contract takes effect once it is established in accordance with the law. Note that registration of the contract is not a condition of contract effectiveness.

2. **Approval of Restricted Technology Imports.**

   Approval procedures are detailed in the Technology Import Measures. Obtaining MOFTEC approval to import restricted technology takes up to forty (40) working days (assuming that the application is complete when submitted). After a technology import application is submitted, MOFTEC, in conjunction with the State Economic and Trade Commission, conducts commercial and technological examinations of the application. The commercial examination is for the purpose of ensuring that the subject technology import:

   - complies with the nation's foreign trade policy;
is beneficial to the development of foreign economic and technological cooperation; and
complies with the external obligations undertaken by China.

The technological examination is for the purpose of ensuring that the subject technology import:

- will not endanger national security or social and public interests;
- will not pose danger to human life or health;
- will not destroy the eco-environment;
- complies with State industrial policy and strategies for economic and social development;
- is beneficial to promoting China's technological improvements and industrial advancement; and
- is beneficial to maintaining China's economic and technological rights and interests.

Within thirty (30) working days after submission of the application by the importer (assuming that the application is complete when submitted), MOFTEC will issue either a rejection notice or a Proposal for Technology Import License ("Proposal for Import"). Upon receipt of the Proposal for Import, the importer of the technology may enter into the relevant technology import contract, which, together with other relevant documentation, must then be submitted to MOFTEC. MOFTEC then examines the contract for authenticity and within ten (10) working days decides whether to approve the application. If approved, a Technology Import License ("Import License") will be issued to the applicant. The contract to import the restricted technology becomes effective only upon issuance of the Import License.

Alternatively, the executed technology import contract can be submitted with the initial technology import application, and MOFTEC will conduct a combined examination of the technology import application and the technology import contract (following the procedures detailed above) and decide whether to approve within forty (40) working days.

Upon receiving the Import License from MOFTEC, the applicant logs on to the "People's Republic of China Import and Export Contract Administrative System" on the China International Electronic Commerce Network (http://info.ec.com.cn), and enters the contents of the contract in accordance with the stated procedures.

The Regulations provide that the registration or approval process for technology that is contributed as registered capital to a foreign-invested enterprise ("FIE") is to be handled in accordance with the relevant procedures for examination and approval of establishment of the FIE. (This appears to mean that one examination and approval suffices for the establishment of the FIE and the import transaction.) However, if the contribution involves the import of restricted technology, the Technology Import Measures provide that the importing party must submit a separate application for approval of the importation along with the approval documents for the foreign-invested project.
3. Approval of Export of Restricted Technology

Approval procedures are detailed in the Technology Export Measures. Obtaining MOFTEC approval to export restricted technology takes up to forty-five (45) working days (assuming that the application is complete when submitted). After a technology export application is submitted, MOFTEC, in conjunction with the Ministry of Science and Technology ("MOST"), conducts commercial and technological examinations of the application. The commercial examination is for the purpose of ensuring that the subject technology export:

- complies with China's foreign trade policy;
- is beneficial to the promotion of exports in foreign trade;
- complies with China's industrial export policy;
- is beneficial to promoting national economic development; and
- complies with the external obligations undertaken by China.

The technological examination is for the purpose of ensuring that the subject technology export:

- will not endanger national security;
- complies with China's technological development policy; and
- is beneficial to technological improvement; and
- is mature, reliable and has undergone examination and acceptance or has been tested and appraised, or substantiated proof of its successful use in practice can be provided.

Furthermore, the Technology Export Measures provide that immature industrial technologies to be exported should also be in conformity with China's industrial policy, and have the capability to provide an impetus for the manufacture of large-scale and complete sets of equipment, and hi-tech products as well as economic and technological cooperation. The Technology Export Measures further provide that laboratory technology shall first be developed within China, and exported only after it is transformed into industrial technology, and if the conditions for transforming such technology into applications are not available in China, then such technology may be exported if the proper intellectual property rights are obtained and no harm is done to State interests.

MOFTEC must issue either a rejection notice or a Proposal for Technology Export License ("Proposal for Export") within thirty (30) working days of submission of a complete application. The Proposal for Export has an effective term that ranges between one and three years, and if necessary, such term may be extended by filing an application with MOFTEC at least thirty (30) days prior to expiration. A technology exporter may commence substantive negotiations with the foreign purchaser and conclude a technology export contract only upon receipt of the Proposal for Export.

Upon receipt of the Proposal for Export and conclusion of a technology export contract, the exporter then submits to MOFTEC an application for a Technology Export License ("Export License"). The application package must include the following documents:
- Proposal for Export;
- Copy of the executed technology export contract;
- List of the technology materials (documents, data, drawings, etc.) to be exported;
- List of the equipment to be exported;
- List of related products to be exported; and
- Identification documents showing the legal status of the contracting parties.

MOFTEC will examine the technology export contract for authenticity and decide within fifteen (15) working days whether to approve the application. If approved, an Export License will be issued to the applicant. The contract to export the restricted technology will become effective upon issuance of the Export License.

Upon receiving the Export License from MOFTEC, the applicant logs on to the "People's Republic of China Import and Export Contract Administrative System" on the China International Electronic Commerce Network (http://info.ec.com.cn), and enters the contents of the contract in accordance with procedures.

4. Other Matters Related to Registration/Approval under the Regulations:

(a) Registrations and licenses are necessary and are promised to be sufficient for foreign exchange, banking, taxes, customs, etc., procedures relating to trade in technologies.

(b) When amendments or other changes are made to key provisions of the technology import or export contract, the application process for registration or a license must be repeated.

(c) The termination or cancellation of a technology import or export contract must be promptly reported to the authorities for the record.

(d) If one is dissatisfied with an administrative approval, license, registration or penalty issued by MOFTEC, administrative appeal in accordance with the law or a lawsuit in the People's Court are the avenues for relief.

(e) The Technology Import Measures and the Technology Export Measures are not applicable to imports and exports of specialized national defense and military use technologies, which are regulated by the National Defense Science and Technology Industrial Committee of the People's Republic of China.

**Terms of a Technology Import Contract**

The Regulations contain the following requirements regarding the content of technology import contracts; export contracts are not subject to these requirements.

1. Statutory Representations and Warranties

The foreign technology provider is required to:
warrant that it is the lawful owner or licensee of the technology, and has the right to transfer or license such technology;

undertake responsibility for claims of infringement from third parties;

undertake responsibility for harm to the lawful interests of others; and

warrant that the technology provided is complete, error-free, effective and capable of achieving its intended purpose.

2. Confidentiality Obligations

Confidentiality obligations will remain effective for the contractually stipulated scope and duration and therefore are not limited to the term of the contract;

A party will be released from its confidentiality obligations if the confidential information is made public through no fault of that party.

3. Improvements made to technology during the term of the contract belong to the improving party.

4. The following restrictive provisions are prohibited in technology import contracts:

Requiring that the transferee accept ancillary conditions that are not indispensable to the technology import, including the purchase of unnecessary technologies, raw materials, products, equipment or services;

Requiring the transferee to pay royalties for or undertake corresponding obligations with respect to expired or invalidated patents;

Restricting the transferee from improving the technology provided by the transferor or using such improved technology;

Restricting the transferee from obtaining from alternate sources technology which is similar to or competes with that provided by the transferor;

Unreasonably restricting the transferee from freely choosing channels or sources for procuring its raw materials, spare parts, products or equipment;

Unreasonably restricting the production volume, product types or sale prices of the transferee's products;
Unreasonably restricting the transferee's export channels for products made by the transferee using the imported technology.

Legal Liability

1. Penalties may be imposed on the parties to a technology import/export contract for the following violations:

   - Import/export of prohibited technology
   - Unauthorized import/export of restricted technology without requisite licenses
   - Import/export of restricted technology exceeding permitted scope
   - Forging, altering or selling licenses or registration certificates
   - Obtaining licenses or registration certificates by fraudulent or other improper means

   Depending on the specific circumstances, such sanctions may include criminal penalties for smuggling, illegal operations, leaking State secrets, forging, altering or selling of official State documents, identification documents, seals and other crimes; civil penalties as provided for in the customs regulations, issuance of a warning, confiscation of illegal gains, imposition of fines ranging from one (1) to five (5) times the illegal gains, cancellation of the license or registration certificate and suspension or cancellation of the entity's foreign trade rights.

   2. Penalties may be imposed on administrative personnel involved in tasks relating to technology imports/exports for the following violations:

   - Disclosure of State secrets or trade secrets received in the course of duty;
   - Abuse of authority;
   - Dereliction of duty;
   - Use of job privileges to receive bribes or to extort the property of others

   Depending on the severity of the violation, such violations may be punished in accordance with criminal law provisions in relation to State secrets, other offenses relating to infringement of trade secrets, abuse of power, dereliction of duty, bribery or other crimes, and administrative penalties may also be imposed in accordance with law.

Commentary

The Regulations allow a great deal more freedom to contract among relevant parties, particularly in the area of technology imports, as compared to the pre-existing regime. Unlike its predecessors, the Regulations reduce the mandatory provisions in a technology import contract and the provisions which would be considered deficient and require correction. For example, an equivalent exchange of improvements between the transferor and transferee and continued use of the technology after contract expiration are no longer mandatory requirements for technology imports, and the ten-year limit on contract term has been eliminated.
Extension of confidentiality clauses beyond the contract term no longer requires special permission from the authorities, and on the face of the Regulations, it appears that the authorities will no longer impose their views on prices or royalties or require that a technology transferor guarantee technological or economic outcomes, only warranty as to capability is required. These changes will provide the relevant parties with greater autonomy in negotiating the contractual terms for the subject technology, rights to future improvements and post-contractual use of the technology.

The Regulations still include provisions governing representations and warranties of the transferor and confidentiality obligations of the relevant parties, but these merely reflect relevant provisions of the PRC Contract Law, and as such, are also applicable to contracts exclusively among domestic entities. The Regulations do not address the issue of governing law, therefore, choice of a foreign governing law remains an acceptable alternative for the contracting parties. The Regulations also do not address transitional issues, for example, how existing contracts entered into under the predecessor regime will be governed. Presumably, existing contracts with terms of ten years or less will still be governed by their terms unless the parties agree to amend the contract.

However, the requirement that improvements belong to the party that made such improvements may present challenges, particularly in determining ownership of improvements in the area of technology licensing, wherein improvements may well be a product of at least two parties, the licensor and the licensee. Although this requirement dates back to the previous regime and does not appear to have been a frequent sticking point in contractual negotiations for technology imports in the past (in practice, contracting parties have been known to agree on contractual terms in relation to ownership of improvements contrary to this requirement), it is one of the few requirements that have survived this recent revision of the Regulations, and may receive greater attention as a negotiating point from the Chinese purchaser's standpoint and a compulsory requirement on the part of the government authorities. This requirement, coupled with the prohibition against restricting the technology recipient from improving the technology or using the technology it has improved, may make it difficult to implement the standard practice of requiring PRC licensees to "license-back" such licensee improvements to the foreign licensor gratis (which may also be impacted by the approval/registration requirements applicable to technology exports). Furthermore, the issue of how to sublicense to third parties the right to use the fundamental technology upon which the improvement is made if such use is necessary to utilize the improvement is not addressed in the Regulations.

In practice, particularly in the context of foreign-invested joint ventures, the most logical solution may well be joint ownership or reciprocal license-free grants to all improvements. However, maintaining control of the original technology and improvements that are made upon that technology may be problematic for a foreign licensor in a pure licensing context or who does not have majority control of its Chinese licensee. Of course, notwithstanding the requirement of Article 27 providing that improvements must belong to the improving party, it is possible that contracting parties may continue to do what they have done before---provide specific contractual terms spelling out how the subject technology will be used and improved upon, as well as terms for use and ownership of any future
improvements. However, that begs the question of whether such contractual terms conform with the Regulations and will pass muster with the courts in the event of a contractual dispute. A possible argument is that a licensee, having ownership rights to the improvements that it makes, should not be prohibited from transferring such rights to the licensor. There is also the question of whether the prohibition against restricting the technology recipient from improving the technology or using the improved technology and the requirement that improvements belong to the improving party are consistent with China's intellectual property laws, since they essentially limit the scope of use granted to a holder of intellectual property rights, for example, the right of a patentee to exclude all others from using its patented invention.

Another issue of concern concerns sales of computer software from a foreign entity to a Chinese consumer, since the question of whether such sales should be considered as copyright licenses constituting technology imports or treated as mere sale of goods has long been a subject of debate in the software industry. The Regulations have not, now or even in its predecessor regime, included any provision expressly addressing this issue. However, the Tentative Procedures expressly provide that imports of computer software are within the scope of technology imports under MOFTEC's control. Furthermore, Article 22 of the newly revised Regulations on Protection of Computer Software provide that Chinese citizens, legal persons or other organizations that license or transfer software copyrights from foreigners must comply with the Regulations. This raises significant issues of great concern to software vendors, particularly those that sell consumer software to the general public. For example, would the long-standing industry practice of characterizing the sale of software as a sale of goods instead of a license or transfer of technology in order to circumvent technology import requirements still pass muster with the government authorities, or would each individual end-user software license agreement be subject to the registration/approval requirements provided for in the Regulations? Implementing the latter arrangement would surely impose transactional costs as well as substantial administrative burdens on MOFTEC to process such applications, unless an arrangement can be made allowing an "umbrella" registration certificate or license for each type of software product that would cover all end-users. Furthermore, the prohibition in the Regulations against restricting the technology recipient from improving the technology or using the technology it has improved raises a whole host of other complex issues specific to the use of computer software. Are standard software license agreements prohibiting reverse-engineering of the source code in violation of the Regulations? Should each end-user be allowed to develop improvements and claim ownership over such improvements? Given the large number of end-users of consumer software and the strong likelihood of duplication in improvements, how would ownership of such improvements be determined in the event of a conflict, e.g., first-to-invent, first-to-patent, or by other means? These are all issues that must be resolved, and to the satisfaction of foreign software vendors, who otherwise may very well be discouraged from licensing their software to Chinese consumers.

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5 Approved and promulgated by the State Council on December 20, 2001, with effect from January 1, 2002.
The Regulations do not spell out how specific requirements on the contents of the contract (i.e., the prohibited provisions in Article 29) will be enforced. In response to our inquiries, a MOFTEC official in the technology import office indicated that import contracts for restricted technologies would be examined merely to ascertain that the contents of the contract are consistent with the subject matter of its corresponding import/export application, and that registration of import contracts for unrestricted technologies would be a mere formality. Furthermore, the MOFTEC official asserted that with respect to imports, the examination process would not be used as a mechanism to police compliance with the Regulations, and specific contractual terms would be entirely up to the relevant parties. However, a MOFTEC official in the technology export office indicated that terms of export contracts for restricted technology would still undergo examination. However, given that most of the statutory prohibitions and restrictions on contractual terms apply only to import contracts and not to export contracts, this will probably not have too much negative impact on the contracting parties' freedom to contract. Further detail awaits supplementary guidance from the State Council or Supreme People's Court rulings.

The Regulations, the Registration Measures, the Technology Import Measures and the Technology Export Measures provide specific deadlines for registration and approval of technology imports and exports, as well as for the issuance of registration certificates and export licenses, but in the case of the Technology Import Measures, there appears to be some ambiguity as to whether an Import License will be issued at the time of approval of that technology import, or at a later date. Given that the relevant contract takes effect upon issuance of such a license and that a license is required to conduct to conduct procedures for customs, foreign exchange, banking, tax, etc., this is likely to be an issue of concern to the contracting parties.

It appears that the approval process for exports (which will take five days longer than for imports) may be more stringent than that for imports, as evidenced by the State's position of encouraging the export of "mature" industrialized technologies, the additional expectations with respect to laboratory technology, the designation of the Ministry of Science and Technology to cooperate with MOFTEC in examining technology export applications, and the requirement that a list of the technology materials to be exported be submitted with the application for an technology export license. This is consistent with the provisions of the revised Patent Law of the People's Republic of China ("Patent Law")\(^6\) and its Implementing Rules ("Implementing Rules")\(^7\), which stipulate that the transfer of a patent right, a patent application or the right to apply for a patent should be approved by the relevant government authorities, MOFTEC and MOST.\(^8\) These developments may be relevant to FIEs establishing research and development centers in China with expectations of exporting the developed technologies back home or to other countries.

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\(^7\) Promulgated by the State Council on June 15, 2001, and effective as of July 1, 2001.

\(^8\) Article 10 of the Patent Law, Article 14 of the Implementing Rules.
It is also noteworthy that the provision addressing exports of military and other sensitive technologies appears to indicate that China intends to fulfill its international obligations in these respects.

While the Regulations appear to have made significant advances in loosening existing regulatory controls, foreign transferors are still held to more stringent standards than domestic transferors in some aspects, for example, the mandatory exclusion of "prohibited provisions" from technology import contracts, the requirement that improvements to the imported technology belong to the improving party, and the fact that a registration certificate or license is still needed to conduct customs, foreign exchange, banking and tax procedures. The fact that no effort is made to impose conditions of fairness or reciprocity on the domestic transferor in the export context reveals at least a modest mercantilist bias with respect to technology trade on the part of the authorities. The extent to which the technology transfer/licensing regime will truly be liberalized awaits actual implementation of the Regulations.