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# Licensing across borders: Chinese prospects

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For companies that embark on cross-border licensing, an awareness of cultural and language issues is as important as legal knowledge in addressing and avoiding potential problems

By **Jay Sha**, Liu Shen & Associates

In centuries gone by, as crowds watched a fleet of ships leaving port with their cargoes of goods, some cheered and some cried – the adventure and uncertainty inspired a mix of desires, hopes, fears and joy. Today, technology licensing across borders requires the type of knowledge on which pioneering merchants once relied: knowledge of the destination, and some basic information about it and the possible routes by which to reach it.

Licensing is a kind of vessel that carries the commodity of technology across borders. Convenient, high-speed internet access now provides us with almost any information that we need when considering cross-border licensing – a background to the destination's people, culture, society, politics and economy, as well as its laws and regulations. We face far fewer unknowns than our ancestors did, provided that we do our research.

This chapter presents some of the key issues in IP licensing in China, primarily focusing on technology transfers and trademark licences.

## Dealing with the right party

China remains the world's most populous country. Its most widely used language is Chinese, but this is spoken in various dialects and people from different regions may be unable to communicate clearly unless they speak Mandarin Chinese. Many companies and

other entities are owned by the state and some key industries remain state-controlled monopolies, despite the 'open-door' policy that was introduced in 1978. This highlights one of the key differences from India – the other main emerging force among Asia's economies – which is more westernised, and where the government exerts a less powerful hold on industries and technologies.

When dealing with state-owned entities in China, it is vital to identify the correct party with which to deal. In particular, the meaning and implications of the term 'affiliate' should be made as clear as possible. In China, not everyone has official authorisation to do business with a foreign entity. Therefore, foreign parties to a potential licensing arrangement must be sure to deal with the appropriate counterparty. For instance, a real licensee may be described as a 'third-party beneficiary' or 'co-signatory' merely because it does not have rights to do business directly with foreigners, whereas an intermediate party with official authorisation for foreign business is shown as a 'contracted or named licensee'.

Many people have heard the term '*guan xi*' (meaning 'relationship' or 'connection') mentioned as a key factor in doing business in China. However, *guan xi* may help when everything is running smoothly, but prove a serious drawback when it is not. Precautions are necessary and can be achieved through legal measures or other arrangements. At minimum, a party should ensure that its ownership of IP rights is clearly stated, that its own IP rights are registered in China in a timely manner, and that it adopts measures to protect its confidential information. Otherwise, technology that is disclosed in what are presumed to be conditions of confidence may be

misappropriated by the recipient and used against the real owner. For instance, the recipient may seek to register the disclosed technology (or any improvements to it) in China in its own name, thereby crucially gaining possession of official records that attest to its purported rights. Therefore, IP owners would be well advised to ensure that not only formal technology licensing agreements, but also purchase or sale orders and original equipment manufacturer agreements include provisions on ownership of IP rights, technology and confidential information, together with restrictions on their use. It is also good practice to retain hard-copy records of such agreements – preferably witnessed by a notary public, as this will make them readily admissible as evidence.

### **Restrictions and other requirements**

In order to gain a competitive position in the Chinese market, it is essential to do things correctly from the beginning, not only when trading in goods, but also when licensing technologies or other IP rights. The Regulations on Technology Import and Export categorise prohibited, restricted and free-trade technologies, and apply to all cross-border transfers of patented and non-patented technologies. Lists of prohibited and restricted technologies are published whenever they are updated. For free-trade technologies, transfers must be recorded with the local government authorities, in addition to the recordal of any licence or assignment of patents or patent applications with the Chinese Intellectual Property Office. However, each local authority may have slightly different requirements and use different documentation or procedures, making this a potentially time-consuming process. The licensing of registered trademarks must be notified to the Trademark Office.

Such recordal must be completed within three months of execution of a licensing agreement (for either technologies or trademarks). Failure to comply with this timeframe may give rise to complications. For example, a licensee may lose its rights in respect of third parties in trademark cases (although the licensing agreement may nonetheless be considered effective between the parties, according to the Supreme Court's

interpretation). Furthermore, royalties may not be paid to foreign recipients unless the licensing agreement is duly recorded, owing to the rules and controls on remittances in foreign currency – banks require proof of the legitimate basis for the transfer before funds are remitted abroad.

In order to ensure that the process runs smoothly, technology or trademark licences should be recorded using official standard form documents with specified provisions. The duration of a trademark licensing agreement should not exceed the current registration term of the trademark; therefore, a new recordal may be necessary when a registered trademark is renewed. However, the updating or deletion of official records, including officially recorded licensing agreements, may require the signature of both parties. Although a unilateral termination notice may be effective between the parties, it will not be accepted for the purposes of updating the official records.

China's Trademark Law regulates the use of registered trademarks and the labelling of licensed registered trademarks. A registered trademark should be used as registered; a label must show that the mark is licensed and indicate the actual source of goods, showing them to be from the licensee. However, if necessary, agreements should clearly prevent distributors or authorised vendors from using foreign marks or adopting their phonetic equivalents as Chinese-character trademarks. Such provisions help to avoid further complications, such as the unauthorised registration of the owner's marks in China or the wrongful use of a Chinese phonetic equivalent as a trade name by distributors or authorised vendors. The recommended approach is to adopt an equivalent Chinese-language mark and use it consistently to build up the required reputation in it.

### **Beware of language issues**

In the context of trademarks, the words 'licence' and 'assignment' are normally unproblematic. However, the term 'technology transfer' may be less clear, as Chinese uses the same word for 'transfer' and 'assignment'. It is customary for a technology licensing agreement to be referred to as a 'technology transfer agreement'; as 'transfer' is a broader

term, used to cover both assignment and licensing. 'Assignment' means the transfer of title or ownership with few conditions or restrictions, whereas 'licensing' is usually defined as authorised use of a technology or trademark (or any other IP right) for a fixed period, with or without a fee, on specified conditions. When a licensing agreement expires or is terminated, the licensee must cease the use of the licensed IP rights and either return or destroy such things as the agreement may require.

Cases have arisen in which a Chinese licensee has understood the Chinese term for 'technology transfer' to mean 'complete acquisition of the technology' (ie, assignment), despite the fact that the agreement indicated the duration of use of the licensed technology and even stipulated the return or destruction of certain things on expiry of the agreement. In such cases, the problem can usually be traced to the reference in the relevant clauses or provisions to 'licensing' rather than 'assignment'. The misunderstandings were due partly to the two possible meanings of the Chinese term and partly to the fact that when the agreements were executed, 10 or 15 years ago, technology licensing was a relatively new concept in China. The potential for confusion is greatly increased if representatives of the parties sign only an English version of the agreement, while the Chinese party retains only an unsigned Chinese translation – a strong argument for bilingual agreements to be executed by authorised officials in accordance with Chinese law.

### **Legal protection for licensed IP rights**

As we have seen, IP rights are like commodities, carried across borders through the licensing process. It is vital to ensure that such rights are legally recognised and protected at their destination. Typically, technology is legally protected by a patent, while know-how is eligible for trade secret protection under Chinese legislation against unfair competition, provided that such information remains confidential and the appropriate measures are taken to ensure that it is designated as a trade secret. However, unregistered trademarks may not be fully protected, as China is not a common law country and the Trademark Law does not offer full

protection for unregistered trademarks; rather, protection is available for certain well-known marks, to the extent that they are well known within the relevant industries or among the relevant consumers in the areas in question. Proof of use and well-known status are required if legal protection is to be sought.

Over 1.5 million patent applications were filed in China in 2011, as well as 1 million trademark applications. Therefore, IP rights owners that wish to expand into the Chinese market or follow up any indication of market demand would be well advised to register their IP rights in China as soon as possible.

### **Jurisdiction and choice of governing law**

Previously, it was usually easy to designate the law of another territory as the governing law of an agreement and to identify foreign courts as having jurisdiction in the event of a dispute. Nowadays, such choices are not always acceptable and many agreements stipulate Chinese law and the jurisdiction of the Chinese courts. In addition to the laws governing patents, trademarks, copyright, unfair competition and antitrust offences, a range of other legislation (eg, the laws of contract and foreign trade) may apply, as well as a comprehensive body of regulations. If foreign parties are unwilling to have cases handled – in Chinese – by the Chinese courts, they should consider the possibility of arbitration before international arbitral bodies.

China has a comprehensive and nationwide four-level court system, with well-trained judges. Administrative authorities and arbitration committees may also come into play in the enforcement of IP rights. However, it may not be feasible for Chinese courts to apply foreign laws. Foreign IP rights owners should be aware that a Chinese court may have jurisdiction over any dispute if it occurs in China.

### **Regional differences and cultural norms**

The most crucial factor is finding the right licensee. In this context, the regional differences within such a vast country may be relevant. The south coast, the east coast and the coastal northeast tend to be more economically developed than central China, the west and the northwest. Partly as a result, the populations along the coast are often regarded

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as having higher standards of education and professional skills. However, many inland regions and cities boast good educational institutions, a rich cultural identity and valuable resources, such as water, minerals, farmland and forest. From an outside perspective, the key issue is to appreciate the similarities and differences of the destination, whether a country or a specific region, and to try to understand the cultural, economic, political and legal systems and the customary environment in which they operate.

The authorities often require the use and submission of forms and standard form documents. It is also customary for Chinese contractual parties to use standard form or sample agreements or contracts, which are normally available on paper or online; however, these are often intended for reference only, as they may set out certain required clauses for various contracts that may be named in accordance with the Contract Law or other applicable laws or regulations. However, this does not mean that other kinds of clause – or more typically Western contractual provisions – are not allowed. The inclusion of detailed, bilingual definitions and clauses in agreements is recommended as a way of avoiding potential confusion or misunderstandings.

It is vital to collect as much relevant information as possible before setting out on the licensing voyage. Once the destination is set and the basic information is gathered, the possible routes become clear. Moreover, the voyagers may discover much of value to exchange at their destination, as ever more brands and forms of technology are developed in or through China. The licensing voyage should always be beneficial to both sides. **iam**

**Liu Shen & Associates**

10th Floor, Hanhai (1+1) Plaza, 10 Caihefang Road,  
Haidian District, Beijing 100080, China

**Tel** +86 10 6268 1616

**Fax** +86 10 6268 1818

**Web** [www.liu-shen.com](http://www.liu-shen.com)



**Jay Sha**

**US and Chinese patent attorney**

[jaysha@liu-shen.com](mailto:jaysha@liu-shen.com)

Mr Jay (Jie) Sha is a Chinese patent and trademark attorney and a US patent attorney, admitted in Illinois and registered before the US Patent and Trademark Office. He obtained his JD and LLM from John Marshall Law School and is a bachelor of science in electrical engineering from Zhejiang University. He started his IP career in 1982 and worked at major Chinese and US patent firms before establishing Jeekai & Partners in 1998, following 10 years in the United States. He and his team joined Liu Shen & Associates in 2008.

Mr Sha's extensive experience includes patent and trademark prosecutions, litigation, administrative enforcement, licensing and transactions. He is a frequent speaker on patents, trademarks and other IP matters. His memberships include the American Bar Association, the American Intellectual Property Law Association, the International Federation of Intellectual Property Attorneys, the Licensing Executives Society, the International Trademark Association and the China Intellectual Property Society.