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Before beginning his legal career, Mr. Hill graduated from the United States Military Academy and served five years on active duty in the U.S. Army Corps of Engineers, spending most of this time in Nuremburg, Germany. During his military service, he also earned a Master's Degree in Business Administration.

In 1986, Mr. Hill moved to Tokyo, Japan to open the firm's Tokyo branch office. Mr. Hill spent three years in Japan as the resident partner of the firm, and was licensed in Japan as a Gaikoku-ho Jimu Bengoshi (Foreign Lawyer). As a result of his experiences in Japan, Mr. Hill has developed an extensive knowledge of Japanese intellectual property law and Japanese culture. He has frequently written and spoken on topics related to Japanese intellectual property protection. He has also delivered numerous seminars and speeches in many countries on U.S. patent and trademark litigation and prosecution procedures and strategy.

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Japanese: Tips for the Uninitiated," *East Asian Executive Reports*," Dec. 1993; Coauthor, "Preparing for Japan's New Trade Secrets Law," *East Asian Executive Reports*, Dec. 1990.

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LICENSING IN ASIA

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Licensing in Asia

Introduction

Preparation is the key to successfully negotiating technology transfer agreements in Asia. Before starting negotiations, a Western negotiator should gain a basic understanding of the country's technology licensing laws. The negotiator should also become familiar with the negotiation style of the Asian country.

The following discussion consists of two parts. Part one identifies the key legislation and relevant authorities governing technology license agreements in three major economic powers of Asia: China, Japan, and South Korea. Part two provides some general tips in business negotiations in Asia and describes some unique negotiation styles of these countries.

Part I: Current Technology Transfer Laws of China, Japan, and South Korea

A. Technology Transfer Laws of China

China's legal framework underwent drastic changes in recent years, resulting in a much friendlier legal environment for foreign companies to enter into technology transfer contracts with Chinese companies. Before its entry into the WTO, China's burdensome prior approval and registration requirements, coupled with its inconsistent IP enforcement, discouraged cross-border technology transfers. After its entry into the WTO, however, China modified its laws and regulations to ease restrictions on foreign technology transfers. As a result, many cross-border technology transfers no longer require prior governmental approval. In addition, China clarified the registration requirements for technology transfer agreements.

Today, Chinese technology transfer agreements are mainly governed by the Unified Contract Law and the Regulations on Administration of Technology Import and Export. In many ways, these new laws and regulations led to a technology licensing regime that should be familiar to those who have engaged in licensing in the U.S. and Europe.

In 1999, China enacted the Unified Contract Law to replace the former Economic Contract Law, Foreign Economic Contract Law, and Technology Contract Law.[2] Under the Unified Contract Law, specific clauses of a license agreement can largely be constructed by the parties through negotiation and will be deemed valid unless they violate the laws and administrative regulations of China.[3]

The Unified Contract Law also adopted many new features. For instance, the fault liability provision of the new contract law allows a party to a technology transfer agreement to collect compensation for damages caused by the other party.[4] The new contract law also contains a validity-pending contract rule, which allows a principal to ratify a license, if a technology transfer agreement was made by a person lacking proper legal authority.[5] Similar to the contract laws of the U.S., a technology transfer agreement can be modified, or even rescinded, if it was made under substantial misunderstanding or under deception or coercion. The new contract law also extended the statute of limitation for a party to bring a contract dispute to two years.

On December 10, 2001, the Chinese government issued the Regulations on Administration of Technology Import and Export (the New Regulations), which became effective on January 1, 2002.[6] The New Regulations replaced most of the existing ones on technology import and export. This new regulation applies to all cross-border transfers of technology, including the assignment and licensing of patents, technological know-how, and technical services.[7] Before 2003, the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and the State Economic and Trade Commission (SETC) regulated technology transfers and carried out the New Regulations. In 2003, China established the

[2] The old Technology Contract Law only applied to contracts reached between domestic parties, not to a technology transfer contract with a foreign party.
[3] Despite the liberalization, certain restrictions on the contents of technology import contracts remain. For instance, technology transfer contracts must not contain anti-competition provisions.
[4] Section 107 of Unified Contract Law
[5] Section 352 of Unified Contract Law
[6] Li L. Chiang, *China's New Technology Import and Export Regulatory Regime*, PATENT WORLD, Feb., 2002, at 25.
[7] *Id.*

Ministry of Commerce (MOFCOM) to replace the MOFTEC and the SETC, and it is now the sole regulating authority of technology import and export.

Under the old technology transfer regime, Chinese authorities required that *all* technology transfer contracts be approved by the government, subjecting even the most routine technology transfer agreement to government scrutiny. The New Regulations significantly relaxed its restrictions on import and export of technologies; and depending on the type of technology involved, only certain transactions are subject to governmental approval.

The New Regulations classify technology into three categories: (1) technology *prohibited* from import and export, (2) technology *restricted* from import and export; and (3) technology *permitted* for import and export.[8] MOFCOM defines the circumstances under which the import or export of technology is prohibited or restricted.[9] MOFCOM also periodically updates the list of technologies restricted or prohibited from technology transfer.[10] Therefore, the parties to a technology transfer agreement should always refer to the latest version of the catalogue issued by MOFCOM.

MOFCOM currently prohibits twenty-five categories of technology and restricts sixteen categories of technology from importing into China[11]. On the other hand, MOFCOM prohibits exporting thirty-three categories of technology and restricts one-hundred-seventy categories of technology[12]. Since most technology transfer agreements are intended to transfer or license technology *to* China, the regulation of import-restricted technology is generally more relevant to a foreign company than that of export-restricted technology.

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[8] *Id.*

[9] This includes situations where (1) national security or the public interest is jeopardized; (2) the prohibition is necessary to protect the lives or health of human beings; (3) the ecological environment would be greatly damaged; or (4) the prohibition is required under international treaties or agreements concluded or acceded to by the PRC. *See New Regulations for Technology Import and Export*.

[10] For a partial list of prohibited and restricted import technologies, *see The Risks of Technology Deregulation In China*.

[11] Examples of technologies prohibited from importing into or exporting out of China are: manufacturing of nickel-cadmium cells; types of lead and copper making; typesetting and plating processes for sheet glass.

[12] Restricted technologies include genetically modified organisms, certain oil refining technologies, polyester production and types of pigment manufacture.

Only the importing or exporting of a restricted technology needs MOFCOM approval. When importing a restricted technology to China, the licensee or the transferee must file an *Application for Importing PRC Restricted Technology* with MOFCOM. MOFCOM must then determine, within thirty business days, whether to approve or reject the application.[13] When examining an application to import restricted technology, MOFCOM considers a number of criteria, such as whether the importation conforms to China's foreign trade policy, whether such importation would jeopardize national security or endanger the public health and environment, and whether such importation would promote China's technological advances.[14] Upon approval, MOFCOM will issue a *Proposal for Technology Import License of the PRC* ("the Proposal"), and only then may the parties sign the technology import agreement.[15] The parties must submit the signed agreement and other application materials, along with the proposal to MOFCOM for final approval. If MOFCOM approves, it will issue a *Technology Import License for the PRC*. The technology transfer agreement takes effect on the date of issuance of the license.[16]

Similar to importing restricted technologies, exporting restricted technologies also requires MOFCOM approval. In determining whether to approve the export of a Restricted Technology, MOFTEC considers whether the export is in line with China's foreign trade policy and promotes exports; complies with the PRC's science and technology development policy; and benefits the promotion of science and technology.[17]

If a technology is not listed as "restricted" or "prohibited," then it is deemed "permitted." However, all cross-border technology transactions, even for the permitted technologies, must be registered with MOFCOM. The registration process is quick and easy, and it can be done online. Unlike the approval process for restricted technologies, the registration process is not a substantive review. However, a technology transfer agreement must not contain unreasonable

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[13] CATHERINE SUN, CHINA INTELLECTUAL PROPERTY 124 (LexisNexus, 2004)
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] *Id* at 125.

restrictive, anticompetitive terms.[18] In addition, all technology transfer agreements involving a Chinese patent must also be registered with the State Intellectual Property Office (SIPO) within three months after the effective date of the contract.

Prior to its entry into the WTO, China limited all technology transfer contracts to a maximum term of ten years. As a result, foreign investors were not permitted to contract for indefinite control over their technology. The New Regulations abolished this restriction and leave the choice of term to the parties of an agreement, so long as the term does not exceed the life of the underlying IP right. In addition, the parties are free to negotiate the royalty payment structure and amount, so long as the agreement does not require royalty payments after the expiration or invalidation of an IP right.

Under the New Regulations, the parties are free to negotiate the warranty clauses in a technology transfer agreement. However, the licensor or transferor of the technology must provide a warranty that it is the lawful owner of the technology, and that the technology is "complete, error free, valid, and capable of accomplishing contracted technical objectives."[19] The New Regulations require the licensor or the transferor to indemnify the licensee if the technology used in accordance with the technology agreement infringes a third party's IP right.[20]

A technology license in China is subject to income tax. Income received by a foreign licensor or transferor is subject to a 10% flat tax.[21] Chinese law requires the licensee to act as the withholding agent and pay the withheld tax within five days from the date of the transaction.[22] On the other hand, a foreign technology licensor or transferor is exempted from

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[18] Some examples of the prohibited anti-competitive terms are: requirements for the transferee to purchase unnecessary technology or equipments, requirements for the transferee to pay for royalty on an expired/invalidated patent, restrictions on the transferee acquiring competitive or similar technology from a third party, and unreasonable restriction of the export channels for products produced by the transferee employing the imported technology. *See id.*

[19] *Id* at 127.

[20] The third paragraph of Article 24 of the Regulation of Administration of Technology Import and Export provides "[i]f the use of the technology provided by the licensor by the licensee of a technology import contract in accordance with the contract infringes upon the lawful rights and interests of another person, the responsibility shall be borne by the licensor. "

[21] Section 19 of the Foreign Investment Enterprises and Foreign Enterprises Income Tax Act.

[22] *Id.*

paying any business tax on income or payments received from transfers of technology, technology developments, and technical consulting services.[23]

2. Technology Transfer Laws of Japan

In Japan, there are two types of technology licenses: legal licenses and contractual licenses. Contractual licenses are the results of private negotiations by parties and are treated as ordinary contracts. Just like any contract, therefore, the rights and obligations of the parties to a contractual licensing agreement depend mainly on the terms of the agreement.

Japanese courts generally do not impose implied duties upon the parties to a licensing agreement. For instance, unless the licensor fails to disclose material facts about the licensed technology, there is no implied guarantee that the technology actually works.[24] Likewise, even where an exclusive license has been granted, the licensee is not obligated to use the licensed technology, i.e., to produce or sell the products, unless the agreement explicitly states so.[25] As a result, parties to a licensing agreement should make all obligations and rights explicit, so long as these clauses do not violate other Japanese laws, such as the Anti-Monopoly Act.

Unlike contractual licenses, legal licenses are not contracts negotiated by parties, but rather stipulated by the Japanese Patent Law. In Japan, there are three types of legal licenses. First, if an employee patents an invention that falls within the scope of the business of the employer, the employer automatically receives a nonexclusive license for the patent without any obligation to compensate the employee.[26] Second, if a person independently discovers the same invention as that of the patent owner, and has already manufactured, used, or made preparations for making the invention at the time the patent owner files an application, that person may receive a nonexclusive license to the patent.[27] However, this nonexclusive license from prior user's right is not transferable unless the entity holding the privilege as a whole is sold or

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[23] Notice of the Ministry of Finance and the State Taxation Bureau Concerning the Implementation of Tax Questions with respect to the Decision of the Central Committee of the Chinese Communist Party and the State Council. (October 1, 1999).

[24] CHRISTOPHER HEATH, LEGAL RULES OF TECHNOLOGY TRANSFER IN ASIA 112 (Max Planck Institute, 2003)

[25] *Id*.

[26] Section 35 of the Patent Act.

[27] Section 79 of the Patent Act.

transferred; even then, the manufacture and use of the infringing product must remain confined to the original scope of activity. Third, a party may request a compulsory license if a patented intention has not been "sufficiently and continuously" worked for three years in Japan.[28]

Under the Japanese Patent Law, an exclusive license must be registered with the Japanese Patent Office (the JPO).[29] The registration (and the revocation) of a license requires the consent of both parties. Once an exclusive license has been registered, the licensee may independently bring an action against a third party for infringement and sue for injunctive relief and damages.[30]

While only the licensee to a registered, exclusive license can enforce the patent right against third parties, the licensor can always enforce the patent right against third parties. Regardless of the type of license granted, the licensor is entitled to sue for injunctive relief. However, in the case of an exclusive license, since only the licensee may use the patent, the licensor may not sue for lost profits. On the other hand, if the license is nonexclusive, and since nonexclusive licensees may not sue for infringement, the licensor can sue for lost profits suffered by the licensor *and* the nonexclusive licensees.

According to the Japanese Income Tax Act, payments for the use of intellectual property rights are considered taxable income.[31] The Japanese tax authorities require the licensee, instead of the licensor, to pay taxes on the licensor's behalf. Under the Japanese Income Tax Act, only payments for the use of a Japanese intellectual property right are taxable. Therefore, licensing payments for using a U.S. patent in Japan are non-taxable. In addition, the obligation to pay taxes refers only to the use of the intellectual property right, not to other payments in the contract, such as supply of equipment and material, etc. Thus, it is important to clearly distinguish the respective payments in a licensing agreement so that only the portion relating to licensing the intellectual property right is taxed. According to the Japanese law, licensing

[28] Section 83 of the Patent Act.
[29] Section 98 of the Patent Act
[30] Section 100 and 102 of the Patent Act.
[31] Section 161 (7) of Tax Act

royalties are taxed on the basis of a flat rate of 20%.[32] This rate can be reduced to 10% if the licensor resides in a country with which Japan has concluded a double taxation treaty.[33]

In Japan, a technology license or transfer agreement must not violate the Japanese Anti-Monopoly laws. The Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade (the Antimonopoly Act) prohibits international agreements containing provisions that unreasonably restrain trade or constitute unfair trade practice.

The Japanese Fair Trade Commission (JPFTC) has promulgated a set of additional regulations specifically addressing the treatment of patent and know-how licensing agreements under the Antimonopoly Act. These regulations are the Guidelines for the Regulation of Unfair Trade Practices (the JPFTC Guidelines).

The JPFTC Guidelines outline the types of restrictions in a licensing agreement that are deemed unlawful and unenforceable. Some of the impermissible restrictive clauses are: requiring a licensee to pay royalties after expiration of the patent right, requiring a licensee to license a patent unnecessary for the technology involved, requiring the licensee to assign rights over improvement inventions without compensation, and imposing restrictions on the licensee's research capacity. In addition, in the most recent revision of the JPFTC Guidelines, the JPFTC prohibits forming patent pools and refusing to grant licenses to exclude new businesses from entering a particular market.

The JPFTC Guidelines established a prior-consultation system for parties seeking to license patents or technical know-how. As its name suggests, the prior-consultation system allows the contracting parties to voluntarily request the review of a license agreement before contract negotiations are concluded.[34] If the JPFTC determines that the terms of the contract do not violate the Antimonopoly Act, it issues both parties a clearance notification. This special clearance system assures the parties that the FTC will not find the contract anticompetitive once

[32] Section 179 (1) of Tax Act

[33] According to a new double taxation treaty between Japan and the U.S., the rate could be reduced to 0% after July 1, 2004.

[34] Similar to its counterpart in the West, the Japanese FTC would only launch an investigation into a potential violation if a grievance is filed by an excluded party.

an agreement is reached. It avoids having such a finding made by the FTC after the deal is completed and announced to the public. However, the FTC reserves the right to withdraw the clearance notification if the circumstances surrounding the agreement change or the parties add new clauses to the contract that violate the Antimonopoly Act.

The Foreign Exchange and Foreign Trade Act governs all foreign transactions in Japan. It provides a minimum level of regulation while facilitating foreign transactions. It requires parties to a foreign technology license agreement to give prior notice to the Ministry of Finance for certain sensitive technologies. These technologies include aircraft, weapons, gunpowder, atomic energy, and space development.

After review, the Ministry can reject a license agreement or request a change, if the ministry finds that the agreement: (1) threatens national security, (2) disturbs public order, or (3) adversely affects domestic business.[35] The Ministry requires the parties to submit a report three months before the transaction if (1) the amount of payment is more than 100 million yen ($830,000); (2) the transaction involves cross-licensing; or (3) the foreign licensor of the sensitive technology provides it to its subsidiaries. Otherwise, the Ministry only requires the parties to submit a report within fifteen days after the transaction.

3. Technology Transfer Laws of South Korea

Historically, South Korea has imported foreign technologies through a tightly regulated technology-licensing system. There are two main reasons for this careful governmental regulation of technology transfer. First, the regulation ensures orderly and controlled technological development. Second, the regulations protect young industries from paying inequitable amounts of money to their more mature and economically powerful counterparts from the United States, Japan, and European Countries.[36]

As the South Korean industries have matured, however, they have increased their bargaining power against the powerful industries of foreign licensors. Therefore, in recent years,

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[35] Section 30 of the Foreign Exchange and Foreign Trade Act

[36] *See* John C. Paul et al., *Licensing to South Korea Into Future, in* THE LAW AND BUSINESS OF LICENSING 514 (Jay Simon ed., 1999)

the Korean government has become less protective of its industries and has amended its existing laws to encourage foreign investment.

South Korea underwent a major overhaul in its foreign investment laws in 1998. All laws previously related to foreign investment, including technology transfer laws such as the Foreign Capital Inducement Act, were updated and incorporated into a single legal framework. The new law, called the Foreign Investment Promotion Act (FIPA), regulates all foreign investment in South Korea.[37] The FIPA encourages foreign investment by reducing governmental regulation, simplifying procedures, and increasing financial incentives. The main goal of FIPA was to create an investment environment that is internationally competitive and attractive to foreign investors.[38]

The Ministry of Finance and Economy and the Ministry of Commerce, Industry, and Energy jointly oversee and apply the FIPA. The FIPA requires that an agreement transferring technologies be reported to the ministries if either the contract period or the payment period is one year or longer, and if:

- the license agreement involves the introduction of *advanced* technology which is absolutely necessary for the strengthening of international competitiveness of domestic industries, and the licensor wishes to take advantage of tax exemptions under the Restriction of Preferential Taxation Act in connection with the license agreement;
- the licensed technology relates to the aerospace industry listed in the Aerospace Industry Development Promotion Act; or
- the licensed technology relates to the defense industry listed in the Act on the Special Measures for the Defense Industry.[39]

The Minister of Finance and Economy selects the "advanced technologies" covered by the FIPA and the Restriction of Preferential Taxation Act. Currently the "advanced technologies" include the following eight categories:[40]

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[37] *See* Hee Chul Kang & Min Han, *Korea, in* INTERNATIONAL LICENSING (Dennis Campbell ed., BNA International Inc. 1999)

[38] Kyu-sung, Lee, Former Minister of Finance and Economy

[39] *See* Paul, *supra* note 52.

[40] Regulation on Tax Reduction or Exemption for Foreign Direct Investment and the Royalty for the Technology Inducement Contract

- Electronic, information and electrical technologies (including computers, semiconductors, video and audio instruments, etc.)
- Advanced industrial machineries and new manufacturing technologies (including textile machines, printing machines, agricultural machines, robotics, etc.)
- Advanced materials (including conductive materials, insulation materials, casting and rolling technologies, recycling technologies, etc).
- New materials, precision chemicals, and bio-industries (including medicines, catalysts, industrial chemicals, biomedicine technologies, etc.)
- Optical and medical equipment (including laser equipments, optical materials and technologies, etc.)
- Aviation and transportation (including aircrafts, automobiles, weapons, etc.)
- Environment, energy and resources (including pollutant treatment systems, power plants, nuclear power technologies, etc.)
- Construction and infrastructure (including new construction materials, construction machines, etc).

Under the FIPA and the Restriction of Preferential Taxation Act, the South Korean government provides tax exemptions to the licensor of license agreements.[41] If a licensor obtains "advance technology" status, it receives a tax exemption on royalty income for five years from the date of the first royalty payment made under the license agreement. Because a licensor need only give notice to the Ministry when seeking a tax exemption, an application for tax exemption should be made together with a notice of technology inducement.

In South Korea, a nonexclusive license agreement is legally binding upon signing. On the other hand, the licensor of an *exclusive* license must register the license with the Korean Intellectual Property Office (KIPO).[42] If the licensor fails to register the exclusive license, the licensee may request a court order to compel the licensor to register the license. An unregistered exclusive license would be considered a nonexclusive license. Although only the exclusive licensee is entitled to exercise the intellectual property right, the exclusive licensee may not assign the exclusive license without obtaining the consent of the patent owner.[43]

The Monopoly Regulation and Fair Trade Act (the "Fair Trade Act") prohibits Korean businesses from entering into international agreements containing provisions that constitute anti-

[41] *Id.*
[42] Section 101 (2) of Patent Act.
[43] Section 100 (3) of Patent Act.

competitive practices.[44] The Fair Trade Act does not require parties to report the agreement to the Fair Trade Commission (FTC). However, a party to a license agreement may request the FTC to review the agreement for an advanced ruling on whether it violates the Fair Trade Act.[45] This request should be filed within sixty days after the execution of the agreement. The FTC will notify the requesting party about the result of the review within twenty days. If the FTC determines that an agreement violates the Fair Trade Act, the FTC can order the parties to modify or cancel the agreement. In more severe cases, the FTC may impose a fine not exceeding 500 million Won to punish the violators.[46] As a practical matter, however, the FTC rarely fines parties to license agreements even if the agreements contain provisions violating the Monopoly Regulation and Fair Trade Act.[47]

[44] Monopoly Regulation and Fair Trade Act, Article 31, ¶1.
[45] *Id.* Article 33
[46] *Id.* Article 34-2
[47] *See supra* note 19.

Part II Negotiating Technology Transfer Agreements in Asia

Asia is a growing market for technology licensing. For instance, China is a country with more than a billion three hundred million friendly, educable and industrious people. China's economy had been growing at a double-digit rate for more than ten years. While understanding technology transfer laws of a foreign country is critical to successfully completing a technology license, Westerners must also understand the Asian culture, values and the nuances of the different negotiation styles.

A. General Advice for negotiating in Asia

Preparation

May be the most important factor in successfully negotiating a technology transfer agreement in Asia is preparation. A potential licensor must develop a clear negotiation strategy before even contacting potential licensees. When negotiating a licensing deal with Asian companies, a potential licensor should assemble a team, rather than a single negotiator, for the negotiation. The negotiating team should have a high-level management representative who can make decisions quickly without obtaining approval from the company management. The team should also include an experienced technical specialist. The technical person should have a thorough understanding of the technology because, often, the technical representatives of the potential licensee are very familiar with the technology. If the potential licensees know more about the technology than the licensor's negotiation team, then it would weaken the licensor's bargaining position. In addition, the negotiation team should include an individual who speaks the language of the potential licensee.

Patience

Patience is also important for successful negotiations with Asian companies. In general, the Asian corporate decision-making process adopts a leisurely pace, with each issue studied in detail and then reviewed through the bureaucratic chain of command. For instance, negotiations in China often take time because different departments within one organization tend to be

involved in the negotiation process. Whereas the Japanese take longer to reach a consensus because, unlike Western business people or attorneys, the individuals sitting at the negotiation table often do not have the authority to reach a final agreement. The Japanese have well-defined levels of authority and every decision must go though the proper chain of command. Unlike their American counterparts, Asian negotiators take frequent breaks to brief their superiors, compare notes, and prepare for the next round of negotiations.

When negotiating with Asians, foreigners should also know that Asians typically value personal relationships, (the Chinese call it "*Guan Xi*"), more than formal business partnerships. Furthermore, Asians generally do not like to rush into any serious discussion with someone they do not know. Therefore, it takes time to negotiate with Asians because it takes time to establish a certain level of mutual trust before starting any negotiation.

The resulting delays in negotiations can frustrate Westerners, who are used to more direct decision-making and faster corporate action. Westerners should not demand prompt action, but should instead view this process as an opportunity to strength friendship with the Asian company and work for the long-term interest of their companies. Once an Asian company decides that a foreign company is trustworthy, however, it tends to move rapidly forward with the negotiation process.

Know How to Communicate

In much of Asia, personal communication is often indirect or unspoken. For Westerners who are used to saying exactly what they think, this style of communication can be frustrating. The kind of direct approach, however, is considered impolite by many Asians because it makes avoiding confrontation difficult.

Generally, Asian negotiators speak around an issue, leaving the negotiators on the other side of the table to deduce the central point of the communication. As a result, negotiations with Asians usually take longer because of this indirect manner of communicating. But for those who can adjust to this style of communications, the reward may be a more solid, longer-lasting

partnership or business arrangement. An Asian party may have more respect for those who make the effort and may consider them better partners in the long term.

B. Unique Negotiating Style of the Chinese (Three Stages of Chinese Business Negotiation Process)

1. Pre-Negotiation Stage

A Chinese party generally starts a negotiation process by assessing the trustworthiness of their foreign counterpart and to learn about the technology. Likewise, a foreign licensor should use this opportunity to obtain as much information as possible about its counterpart. This is also a good time to gain familiarity with the hierarchy of the Chinese company and identify who are the real decision makers.

A Western company should not forget that China is a communist country. Therefore, the Chinese negotiation process generally starts with contacting the Chinese government authorities. This lobbying effort may be the most crucial part of the pre-negotiation stage. A foreign company must convince the Chinese government that it has a cutting-technology that suits China's needs and that it has long-term commitment to the Chinese market.

2. Formal Negotiation

When the Chinese negotiator begins discussing specific issues about the contract, this usually signals that the Chinese party has decided to move to the second stage. It is in this formal negotiation stage that the parties usually resolve specific disputes over the language of the contract clauses.

A difficult part of the formal negotiation stage is setting the price of the deal. The Chinese generally demand low technology transfer fees. There are many Western companies eager to do business in China today. As a result of this "China Fever", Chinese negotiators sometimes believe that it had already done the foreign company a big favor by giving a foreign company the huge Chinese market. In addition, the Chinese usually conduct price negotiations simultaneously with the licensor's competitors. Therefore, the licensor also needs to understand the strengths and weaknesses of its competition.

3. Post-Negotiation

In general, once a contract is signed, the Chinese will honor the contract. However, since the Chinese view their business partner as a "friend," they often push for further concessions after concluding an agreement.[48] To the Chinese, the negotiations are an on-going process extending beyond the signing of a contract. For example, Chinese negotiators typically ask for more technical assistance than what was specified in the agreement. To avoid running up the cost of travel and accommodations, a foreign licensor should clearly specify the amount of any technical assistance in terms of time and cost in the agreement.[49]

C. Negotiating in Japan

Unlike Americans and most Europeans, Japanese often find it strange to deal with people they do not know and to whom they have not been formally introduced. Westerners that are accustomed to a more direct approach may not recognize the importance of an appropriate introduction. Anyone approaching a Japanese party for the first time should give careful consideration to the mechanics of the approach and to arrange a proper introduction.

In Japan, the negotiation process usually starts with an introduction from an "introducer" or a go-between. Before the first meeting, this "introducer" is a prime source of information for both parties. In general, if the "introducer" or go-between is someone the Japanese party considers to be of good character, the "introduced" party may be more favorably received. One who makes a direct approach with no introduction, or whose "introducer" is not well respected by the Japanese party, may find that negotiations seem to stall, or even that the Japanese party shows no interest in discussing the matter.

Similar to negotiating with the Chinese, the first step in achieving a successful negotiation with a Japanese party is to develop a personal relationship of mutual trust and respect. Typically, there are three levels of executives involved in a business negotiation. They are top-level executives, middle managers, and operational staff. In Japan, rarely is an attorney

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[48] *Id.*

[49] Stanley B. Lubman, *Technology Transfer to the People's Republic of China: Law, Practice, and Policy, in* DOING BUSINESS IN CHINA 3-33 (Freshfields ed., 2002)

present during the initial part of a business negotiation. Since the Japanese place emphasis on building a personal relationship with their negotiation partners, a successful negotiation generally requires every member of the negotiating team meet and feel comfortable with every member of the other side's negotiating team.

D. Negotiating in South Korea

Much like other Asians, Koreans typically treat business relationships as personal relationships. Therefore, Koreans generally do not reach a business agreements until they feel comfortable with their counterparts.[50] Negotiations usually begin with a series of informal meetings designed to enable the parties to get to know one another on a personal level. Moreover, Koreans view the contract as the starting point for the development of the relationship[51] and, just like the Chinese, expect ongoing concessions after agreements are reached.

Like the Chinese and the Japanese, Koreans generally dislike direct confrontations. Therefore, if a consensus cannot be reached, Koreans prefer to prolong the process rather than break off negotiations. The most commonly used tactic for the Koreans to stonewall their opponents is to say "*keul she*," which translates to "We'll think about it."[52] It is up to the foreign negotiators to identify these subtle hints of trouble and address them before negotiations break down.

Beneath the mask of politeness, Koreans are skillful, resilient and sometimes hard-nosed business negotiators. Foreign negotiators must remember that one of the favorite negotiation tactics employed by Koreans, is to place the foreign negotiator under tremendous pressure, so that last-minute concessions are made to avoid going home empty handed. Typically, Koreans assume seemingly irreconcilable positions until the last moments of a deadline. Therefore, foreign negotiators generally should not disclose their departure date.[53]

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[50] Boye De Mente, *Negotiating Korean Style* (2001), *at* http://www.apmforum.com/columns/boye46.htm
[51] *Id.*
[52] *Id.*
[53] *Id.*

It is important to know that Korean licensees will likely object to certain terms and conditions in a licensing agreement.[54] In general, Korean licensees prefer a running royalty over a lump-sum payment.[55] In addition, Korean licensees are also not likely to accept a royalty rate that is greater than 5%, unless additional technologies are tied to the agreement. They typically oppose license provisions imposing secrecy terms greater than ten years. Korean licensees would also likely object to holding an arbitration outside of Asia. Furthermore, due to the strict Fair Trade Commission guidelines, Korean licensees tend to scrutinize any obligation to pay royalties after the patent expires. Unless the license agreement relates to valid know-how, the imposition of post-term royalty provisions would most likely be considered an unfair practice under the Fair Trade Act.[56]

Conclusion

There is no easy formula for conducting successful licensing negotiations in the Asia. A successful negotiation depends on many factors that vary from case to case. However, comprehending the laws and regulations concerned, understanding the negotiating styles, establishing a trusting relationship, and adopting a patient and effective communication style, can frequently contribute to achieving a successful result.

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54 John C. Paul et al., *Korea Campaigns to Interest World in IP*, Les Nouvelles, Jun. 1998, at 64.
55 *Id.* at 66.
56 *Id.*

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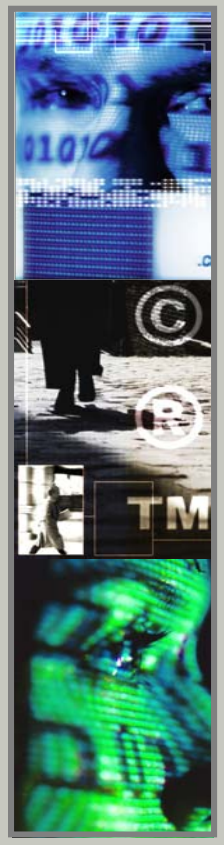
Licensing in Asia

Franklin Pierce Law Center
Advanced Licensing Institute 2005

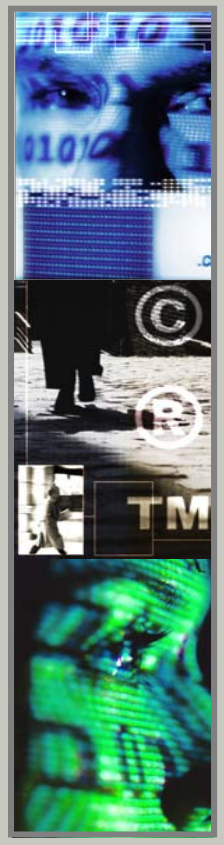
David W. Hill

Chinese Laws and Regulations That Affect Technology Transfer



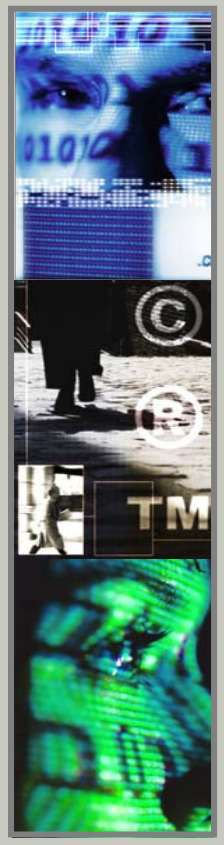
- As a result of China's entry to the WTO, it modified the existing laws and regulations to ease restrictions on foreign technology transfers
- Uniformed Contract Law (1999)
  - Replaced the old Economic Contract Law, Foreign Economic Contract Law and Technology Contract Law
- The Regulations on Administration of Technology Import and Export (2002)

Major Changes in the Uniform Contract Law That Affect Technology Licensing



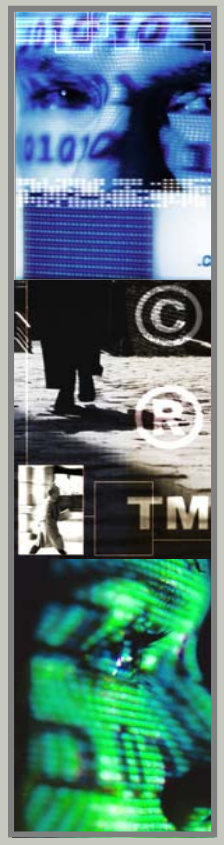
- Fault Liability Provision – allows a party to collect compensation for damages caused by the other party
- Validity-Pending Contract Rule – allows a license be ratified by the principal, if a contract was entered by a person lacking proper authority
- A license can be modified or rescinded if it was
  - Made under substantial misunderstanding
  - Unfair to one party
  - Made by deceit or coercion
- Anticipatory Breach of Contract provision
- Statue of Limitation – extended to two years

MOFCOM and the Regulations Governing Foreign-Related Technology Licenses



- MOFCOM (Ministry of Commerce) was established in 2003 to replace the MOFTEC and the SETC
  - Regulating authority of technology import and export
  - Approves and registers technology licenses
- *The Regulations on Administration of Technology Import and Export* (2002)
  - applies to all cross-border transfers of technology, including the assignment and licensing of patents, technological know-how and technical services
  - Divides technologies to be imported/exported into three categories: permitted, restricted and prohibited
  - MOFCOM periodically updates the list of technologies in each category

Government Approvals and Registrations



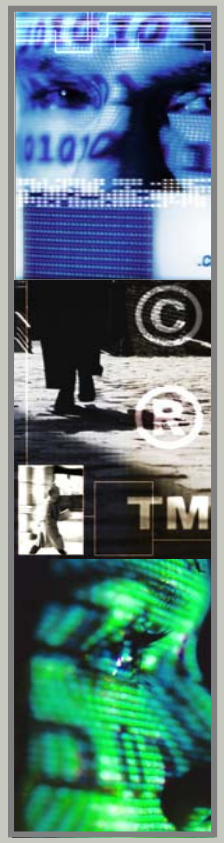
Approval:

- Importing/exporting of a restricted technology needs MOFCOM approval
  - MOFCOM considers the contract's affect on Chinese foreign trade policy and public interest
- After MOFCOM's preliminary approval, parties submit signed agreement for final approval

Registration:

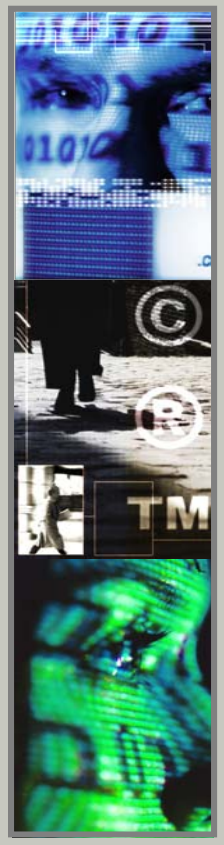
- All technology import and export agreements must be registered with MOFCOM
- MOFCOM reviews the contract terms prior to granting registration
  - A contract containing unreasonable restrictions and anti-competitive terms is not allowed
- Patent licensing agreements involving Chinese patents must also be recorded with the State Intellectual Property Office (SIPO) within three months after their effective date

Licensing Issues Under the Regulations



- The new regulations allow the parties to determine the duration of the license, except
  - Patent licenses cannot exceed the patent term
- Royalties
  - Parties are free to decide the royalty structure and amount
  - Illegal to make royalty payments after the expiration or invalidation of a patent, copyright or trademark
- No grant-back
  - Ownership of improvements in technology belongs to the improving party (this provision may change soon to allow free negotiation by the parties)

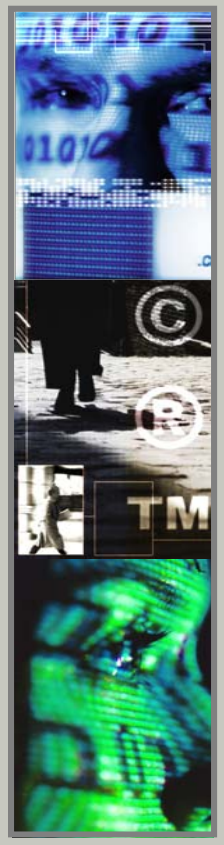
Licensing Issues Under the Regulations



- Warranty and indemnification
  - Parties may freely negotiate warranty clauses
  - Mandatory indemnification clause – requires the assignor or licensor to warrant that it is the "*lawful holder*", or "*authorized*" assignor or licensor of the technology and that the technology is "*complete, error-free, valid, and capable of accomplishing contracted technical objectives*."

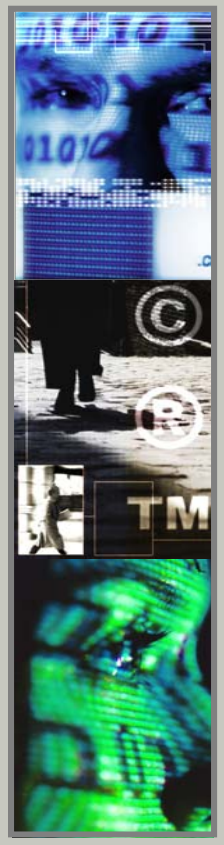
- Taxation
  - Income received by a foreign licensor or transferor is subject to a 10% flat income tax
  - Foreign licensors are exempt from business tax for income received from technology transfer, technology developments, and technical consulting services

Technology Transfer Laws of Japan



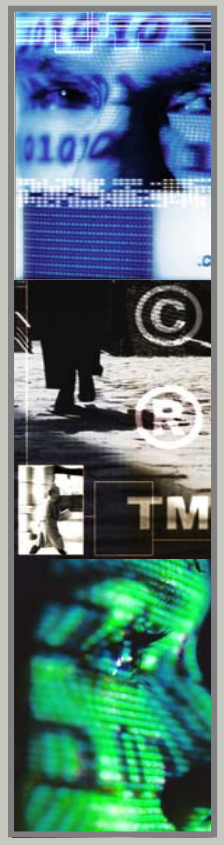
- Two types of technology licenses
  - Legal licenses – stipulated by the Japanese Patent Law
    - Nonexclusive license to an employer
    - Prior user's right
    - Compulsory license
  - Contractual licenses – ordinary contracts that result from private negotiations
    - Courts generally do not impose implied duties
    - Parties should make all obligations and rights explicit

Registration Requirement



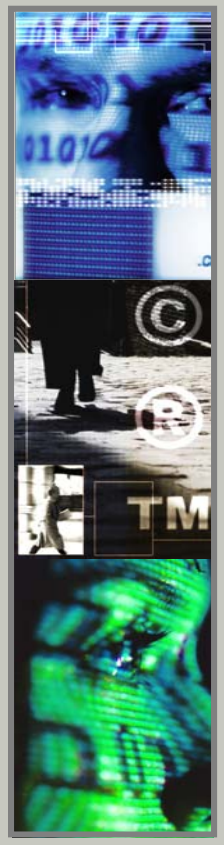
- An exclusive license must be registered with the JPO
  - Only the licensee to a registered exclusive license can enforce the patent right against third parties
- Licensor may always sue for injunctive relief; but may not sue for lost profits if the exclusive license was registered
- If the license is nonexclusive, the licensor may sue for lost profits suffered by the licensor and the licensee(s)

Tax Consequences



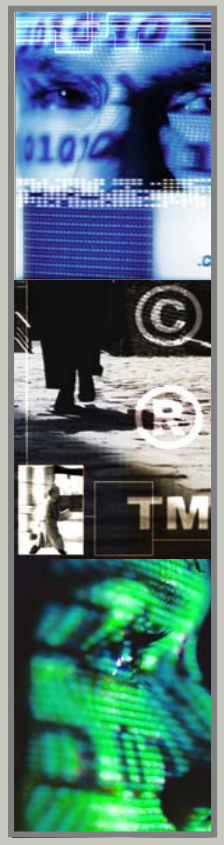
- Payments for the use of intellectual property rights are taxable income (at a flat rate of 20%)
  - May be reduced to 10% if the licensor resides in a country with which Japan has a double taxation treaty
- But only payments for the use of a Japanese intellectual property right are taxable
  - Licensing payments for using a foreign patent in Japan are non-taxable
  - Only need to pay taxes on payments for the use of the IP right, not other payments in the contract

The Japanese Anti-Monopoly Act



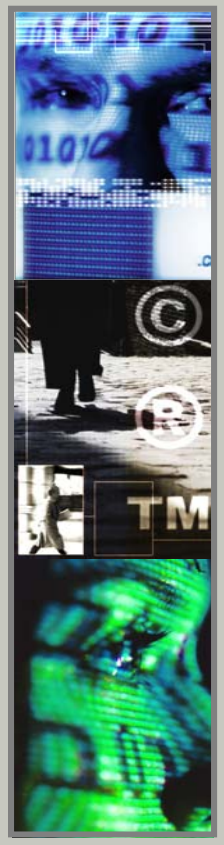
- A technology transfer agreement must not contain provisions that unreasonably restrain trade or constitute unfair trade practice
- The Guidelines for the Regulation of Unfair Trade Practices specifically address the treatment of patent and know-how licensing agreements under the Antimonopoly Act
  - Outlines the types of restrictions that violate the Act
  - Examples of illegal terms:
    - Requiring a licensee to pay royalties after patent expiration
    - Requiring a licensee to license a patent unnecessary for the technology involved
    - Requiring a licensee to assign rights to improvement inventions without compensation
    - Imposing restrictions on the licensee's research capacity

The Foreign Exchange and Foreign Trade Act



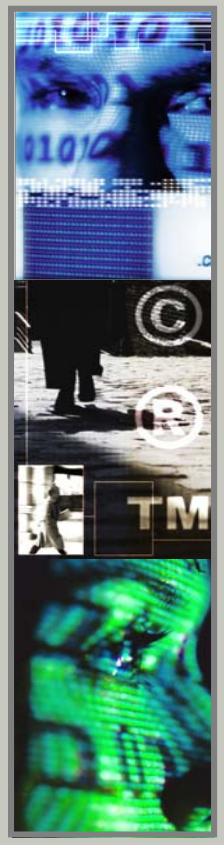
- Governs all foreign transactions in Japan
- Requires parties to a foreign technology license agreement to give prior notice to the Ministry of Finance for certain sensitive technologies
- Requires the parties to these agreements to submit a report three months before the transaction if
  - The amount of payment > 100 million yen
  - The transaction involves cross-licensing, or
  - The recipient of sensitive technology provides it to its subsidiaries

Technology Transfer Laws of South Korea



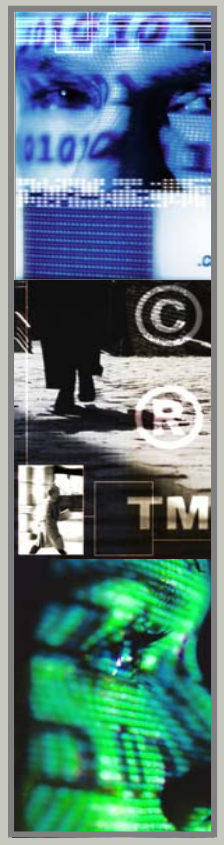
- Foreign Investment Promotion Act (FIPA) regulates all foreign investment in South Korea
- The Ministry of Finance and Economy and the Ministry of Commerce, Industry, and Energy jointly oversee the FIPA
- FIPA requires agreements transferring technologies be reported to the ministries if either the contract period or the payment period is one year or longer, and if
  - The license agreement involves the introduction of advanced technology identified by the Minister of Finance and Economy, and the licensor wishes to take advantage of certain tax exemptions in connection with the license agreement
  - The licensed technology is an aerospace technology listed in the Aerospace Industry Development Promotion Act
  - The licensed technology is a defense technology listed in the Act on the Special Measures for the Defense Industry

Registration Requirements



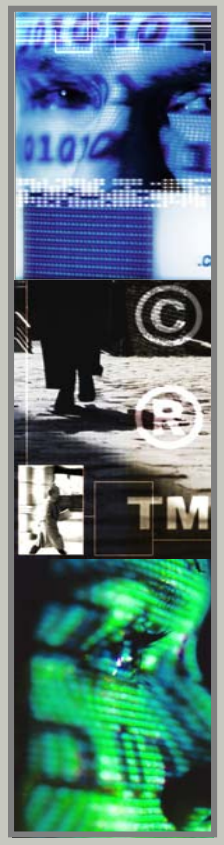
- A nonexclusive license agreement is legally binding upon signing
- An exclusive license must be registered with the Korean Intellectual Property Office (KIPO)
  - An unregistered exclusive license would be considered a nonexclusive license
  - Only the licensee to an exclusive license can enforce the intellectual property right

The Monopoly Regulation and Fair Trade Act



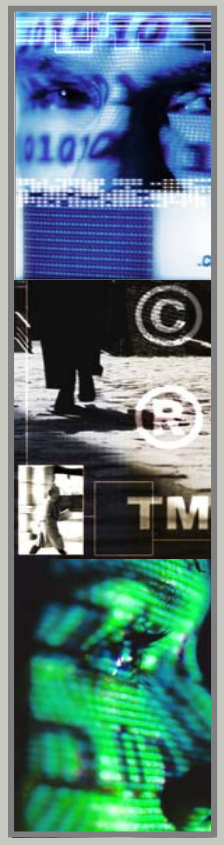
- Prohibits Korean businesses from entering into international agreements containing provisions that constitute anti-competitive practices
- A party to a license agreement may request the Fair Trade Commission (FTC) to review the agreement
- Request must be filed within sixty days after the execution of the agreement
- If the FTC finds violation, it may order the parties to modify or cancel the agreement

General Tips for Negotiations in Asia



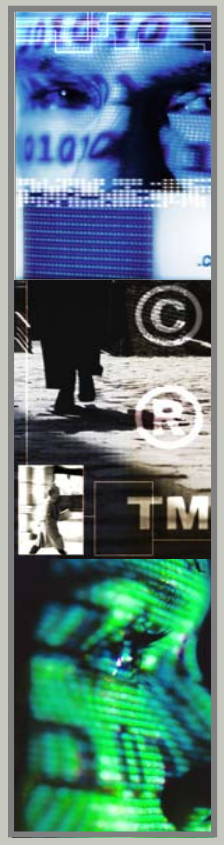
- Be Well Organized and Prepared
  - Develop a clear strategy before negotiation
  - Assemble a team, including a high-level decision maker and an experienced technical person
- Be patient
  - Understand the bureaucratic chain of command
  - Takes time because Asians generally prefer personal relationships (“Guan Xi”)
- Know How to Communicate
  - Sometimes Asians prefer indirect communication

Chinese Negotiation Style



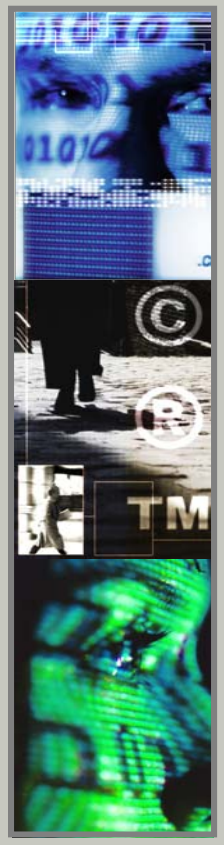
- Three stages of negotiation process
  - Pre-negotiation stage
    - Assess the trustworthiness of their foreign counterpart and to learn about the technology
    - Government lobbying
  - Formal negotiation
    - Anticipate low-price offers and intense competition
  - Post-negotiation
    - Negotiations are ongoing - extending beyond the signing of a contract

Japanese Negotiation Style

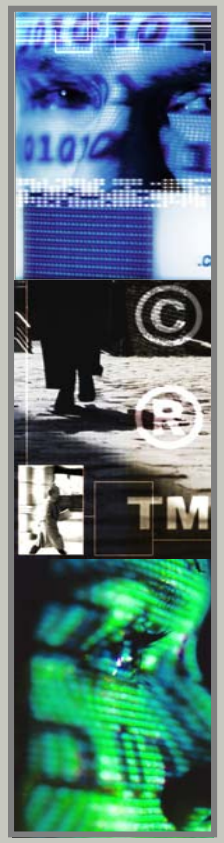


- Generally should start with an introduction from an “introducer” or a go-between
- Develop a personal relationship of mutual trust and respect
- Multiple levels of executives involved in a business negotiation

South Korean Negotiation Style



- Begin negotiation with a series of informal meetings to get to know the other party on a personal level
- Expect ongoing concessions even after agreements are reached
- Prefer to prolong the process rather than breaking off negotiations (“keul she” – “We will think about it”)
- Use last-minute concessions as a negotiation tactic



Thank You !