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## 1. Introduction: Contracts in China

Tailoring contracts to suit your intellectual property rights (IPR) is an important way to ensure that your company's specific intellectual property (IP) assets are adequately protected.

Contracts involving the protection of IP can be divided into four main categories:

- Technology development, transfer, consultancy and service contracts.
- Trade mark and copyright licence contracts.
- Manufacturing, distribution and sales contracts.
- Employment contracts.

Using the right provisions and contracts for your specific IPR is key to protecting them.

It is also essential to include provisions to protect confidential information and trade secrets in contracts with third parties. In China, 'trade secret' is defined as "any non-public technical or business information with commercial value that is guarded by confidentiality measures". 'Confidential information', on the other hand, generally refers to "any non-public information pertaining to a company's business", and is therefore broader in scope than 'trade secret'. However, no protection is afforded to 'confidential information' under Chinese law, unless it falls within the scope of trade secrets, or is otherwise specified in a contract. Since trade secrets and confidential information are critical to a company's

business and operations, they must be carefully protected, as outlined in this guide. For more information on trade secrets, please refer to the 'Related Links' section at the end of this guide.

## 2. Important Contract Provisions to INCLUDE

Since different types of contracts are used to cover different IPR in China, the content and focus in each type of contract varies according to the specific IPR to be protected. Usually, however, all such contracts contain basic provisions that should not be missed. To illustrate this, the key provisions in a licence agreement or employment contract should address the following:

- **Definition of licensed rights**  
These clauses define the scope and uses of the licence, and identify the IP subject matter and the type of rights being licensed.
- **Monitoring of the licensee's activities: Prevent unauthorised use of the licensed rights**  
Licence agreements usually contain clauses stating that licensors can monitor and inspect the licensee company's activities so as to prevent unauthorised use of the licensed rights. These clauses usually identify the parties who will have permission to use the licensed rights, as well as the security procedures that are in place to prevent unauthorised use or misuse of the IP assets.
- **Challenges of validity: Ensure the**

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### validity of your agreement

It is important to include clauses on the severability\* of validity of the licence agreement. This will ensure that even if one or more of the licensed rights in the licence agreement expires, the validity of the entire agreement and the licence granted within that agreement may not be challenged.



- **Protection of new IPR generated: Address ownership issues**

In general, China's Copyright Law recognises contractual terms for the purposes of determining ownership of new IPR generated or derived from licensed rights. For this reason, it is very important to address ownership issues in licence agreements. In the absence of a clear contract on ownership rights, the law generally recognises the creator of a work as the owner, even if the underlying licensed rights belong to another party. For example, the translator of an original licensed literary work would be the owner of the copyright of the translated work, even though the copyright of the underlying licensed work belongs to the original owner.

On the other hand, under China's Patent Law, the party who makes improvements to a technology based on the licensed patent or technology automatically owns the IPR on such improvements. The licensee can enter into a separate agreement to assign or license its rights to the improvements back to the licensor. However, if the technology covered in the improvements falls into the 'prohibited for exportation' category as outlined in the official guide, China's Ministry of Commerce will not approve such a transaction, and the improvements will not be granted back to the licensor.

- **Assignments or transfers: Prevent your IPR from being transferred to third parties without your permission**

To protect your IPR from being passed to unauthorised third parties, clauses on the control of assignments and transfers of the contract must be included. For example, clauses can be included to restrict and prohibit the contract from being assigned and transferred without your express written authorisation, and you may add a further clause to bind all successive transferees and assignees\* to your agreement.

- **Warranties: Guarantee your technology is fit for transfer**

Warranties\* are a kind of guarantee that should be provided by the licensor on the licensed technology. For example, the warranty may state that you have the right to grant the licence, and that by doing so you are not infringing anyone else's IPR in China. The warranty may also state that the technology or products being licensed are free from defects or errors in material and workmanship. In some instances, such as technology transfer contracts, you may need to guarantee in your contract that your technology is complete, free from error, effective and capable of achieving the prescribed goals, or alternatively, specify that the warranty cannot be amended or omitted by the parties.

- **IPR produced by employees: Avoid future disputes**

It is important to make sure that the inventions of your employees will belong to you as the licensor, and that you, the licensor, will be entitled to grant a licence for such inventions. For methods of protecting your IPR on works produced by your employees, please refer to the 'Employment Contracts' section.

- **Confidentiality: Protect your confidential information**

Usually licence agreements include clauses that address the confidential information to be acquired or exposed in the course of the agreement. These clauses usually define the confidential information and outline the exact nature and length of the protection. Alternatively, a separate and more detailed non-disclosure agreement (NDA) may also be entered into by the parties. More information on NDAs and an example of an NDA are provided in the 'Non-Disclosure Agreements (NDAs)' section.

- **Dispute resolution: Plan ahead, just in case**

Like any other contract, the licence agreement should specify the law that governs the disputes of the agreement (in this case, foreign law or Chinese law), along with the chosen methods of dispute resolution. It is important to note, however, that while disputes on the performance and interpretation of the contract in general can be governed by foreign law, the sections in the contract relating to the protection and dealings with IPR in China specifically, should as a general rule be governed by Chinese law. Other mandatory Chinese laws (e.g. technological import and export regulations) may also apply. If your contract adopts arbitration\* or other non-judicial methods of dispute resolution, it is also important to include a clause that permits you to file in courts where you can seek injunctive relief\* or claim damages against IP infringement.

- **Termination: Specify what happens when the agreement comes to an end**

It is necessary to specify when and on what conditions the agreement will terminate, e.g., upon the liquidation or dissolution of one party. You should always include terms on the consequences of termination; for example, the

licensee shall cease to have access to, or must return, all the licensed rights, or the licensee shall destroy or return all inventory bearing the licensed trade mark to the licensor.

### 3. Important Contract Provisions to AVOID

A contract may be void in whole or in part if it contains any provisions in contravention of Chinese law or administrative regulation. Set forth below are examples of IP provisions you need to avoid in China, particularly in technology and employment contracts, because they may well be in contravention of the Chinese laws.

#### Technology Contracts

Provisions **to avoid** in technology contracts include those that:

- Prohibit a licensee\* from making improvements to the licensed technology and using the improvements.
- Restrain a licensee from obtaining from other parties technology similar to, or competing with, the licensed technology.
- Under PRC law, a licensor\* cannot make any 'unreasonable' restraints on a licensee's procurement channels, such as the sources from which the licensee purchases raw materials, equipment, etc.
- Prevent a licensee from making full use of the licensed technology in a reasonable manner as required by the market. For example, the licensor cannot unreasonably restrain the quantity, price, sales channels, etc., for products or services provided by the licensee when using the licensed technology.
- Require a licensee to accept additional conditions that are unnecessary for the use or working of the licensed technology, e.g., engaging unnecessary consultants.
- Prohibit a licensee from challenging the validity of the IPR of the licensed technology or from attaching additional conditions to such a challenge.
- Waive the provision of warranty, which states that the licensed technology is complete, free from error, effective and capable of achieving the prescribed goals.
- Include unfair terms for the exchange of improvements made to the licensed technology, such as requiring a licensee to provide or transfer an improvement that he or she has made to the licensed technology, back to the licensor for free or without any non-monetary compensation (i.e. technical assistance).

#### Employment Contracts

Provisions **to avoid** in employment contracts include those that:

- State that the employer owns the patent rights and/or copyright of any non-employment-related work or creation made by employees on their personal time and using their own personal resources.
- Exclude any remuneration to an employee for his or her patented creation.

- Impose unreasonable non-compete and non-solicitation obligations upon employees; for example, making non-compete obligations last for more than two years.
- Waive monthly compensation to employees fulfilling their non-compete obligations.

#### General Contracts

Provisions **to avoid** in a general contractual context include those that:

- Exempt a party from liability for causing the other party bodily harm or property losses (resulting from wilful misconduct or gross negligence).
- Require Chinese IPR to be governed or protected by the laws of other jurisdictions (i.e., non-Chinese law).

### SME Case Study 1

#### Background

Company A, a wholly foreign owned enterprise, entered into a manufacturing contract with Company B, a Chinese company, in which Company B would utilise Company A's patent to manufacture computer motherboards. The manufacturing contract expressly prohibited Company B from making improvements on Company A's patent and required Company B to purchase raw materials only from suppliers appointed by Company A. After the deal was signed and work began, Company B improved Company A's patent and purchased raw materials from other suppliers without first notifying Company A.

#### Action Taken

After discovering the patent improvement and purchases, Company A requested the court to enforce the manufacturing contract and prohibit Company B from making further patent improvements and purchasing raw materials from other suppliers.

#### Outcome

The court held that the provisions specified above were unenforceable, as they contravened relevant Chinese law. In this situation, Company B was allowed not only to make improvements to Company A's patent and use such improvements under Chinese law, but also to purchase raw materials from suppliers as it saw fit. It was further held that in the absence of any clear contract, Company B, as the creator of the improvements, was the owner of the improvement rights.

#### IP Lessons

Do not include any provision in contravention of Chinese law in your IP contract, particularly those listed above. If there is any contradiction, that clause in your contract will become void (in some cases the entire contract can be held void), and the default rules under Chinese law will be implemented instead.

### 4. Non-Disclosure Agreements (NDAs)

It is advisable that you sign an NDA with any third party to whom you plan to reveal confidential information such as sensitive product information, designs and sketches, business strategy, client information, etc. before doing so. NDAs are quick and inexpensive, and a basic template will require little modification for use with different products and clients. NDAs are widely used in China and well-accepted by Chinese courts, so a Chinese third party that is unwilling to sign an NDA is likely not a trustworthy potential business partner and should be treated with caution.

Sometimes an NDA on its own is insufficient to protect your IPR, especially for companies in the manufacturing industry or sourcing their products from China. This is because not every single product will be covered by patents or other forms of registered IPR. Under these circumstances, a 'non-disclosure/non-use/non-circumvention agreement' (an 'NNN' agreement) may be used:

1. The non-disclosure provisions will cover the unauthorised disclosure of confidential information.
2. The non-use provisions will state that the Chinese manufacturer cannot produce your product or any similar products for anyone other than you. These provisions will prevent the Chinese manufacturer from making or selling similar 'copycat' products without your authorisation.
3. The non-circumvention provisions will prevent the Chinese manufacturer from by-passing the protection or circumvention\* means or technologies that you put into your product (for example, anti-counterfeit micro-chips).

At the end of this guide is a sample NDA appropriate to a licensing context between a licensor and a licensee. If the NDA is made between a licensor and an employee, the terms should be altered to reflect this specific situation. Under Chinese law, the Chinese company must affix its official company stamp to the written contract instead of a representative's signature.

### 5. Confidentiality, Remuneration and Other IP Provisions in Contracts

Companies should think carefully about protection against IP risks when hiring employees in China. It is good practice to include express provisions in employment contracts regarding confidentiality, IPR ownership, non-compete and non-solicitation in order to avoid future disputes and material damages to your business' operations.

Some key IP-related areas that should be considered when drafting employment contracts to protect your business' IPR are identified below.

#### **Confidentiality Information/Trade Secrets**

The best way to keep trade secrets and confidential information from being divulged by employees is to impose confidentiality obligations upon the employees in employment contracts; for example, employees may be required to keep confidential information and trade secrets confidential, unless the employer has given prior written consent for the information to be disclosed. Employers should also limit employees' use of confidential information and trade secrets to work-related purposes (as provided in the employment contract). Such confidentiality obligations should continue to bind employees even after the termination or expiry of their employment contracts.

In addition, if a new employee discloses confidential information or trade secrets of his or her former employer in performing his or her current work, the new employer may be found to be infringing the IPR of its employee's former company. Hence, you should make clear to your employees orally and in writing that they should not disclose or apply confidential information and/or trade secrets obtained from previous employers during their employment terms with your company.

#### **Patents/Copyrights**

Under China's Patent Law, any rights to patents arising from creations made by an employee in the course of his or her employment or using primarily the resources of an employer (known as 'employee creation'), automatically belong to the employer unless otherwise stated in the contract. This is the same for ownership of rights to improvements made by an employee to an existing patent in the course of his or her employment or using the resources of the employer.



The employment contract should also limit the use of employer's patents to the sole benefit of the employer, rather than extending such use to benefit employees or others, in order to ensure that all patent improvements belong to the employer. Moreover, the employment contract should require employees to disclose all inventions they have created to their employer, whether or not they are work-related inventions.

The employer should enter into agreements with its employees explicitly stating the employer's ownership of patents and patent improvements, in order to avoid any misunderstanding or dispute, despite protection from China's Patent Law. In addition, the employer should be made the applicant of any patents arising from employee creation, as patent rights are granted only to patent applicants.

Meanwhile, under China's Copyright Law, the copyright of a copyrightable work created by an employee when fulfilling an assignment from an employer (known as 'service work') belongs to the employee, as he or she is the author, unless the service work is created primarily with the materials and technical resources of the employer and the employer is responsible for the work, in which case the employer is the copyright owner. Nevertheless, the employee is still required to be named as the author of such service work.

Since ownership of copyright does not automatically belong to the employer, it is extremely important for the employer to enter into agreements with its employees stating that all service work for which the employer is responsible, or which are created using the employer's resources, belong to the employer.

### **Creator-Employee Remuneration**

Under China's Patent Law, when an employee has created something that subsequently results in the granting of a patent to his or her employer (known as 'creator-employees'), the employer is required to award remuneration to the creator-employee for the patented creation. Unless otherwise stated in the contract, the remuneration to be awarded to the creator-employee must be in accordance with the minimum requirements provided in the Implementing Regulations of China's Patent Law. For this reason, employers should insert in employment contracts a provision that quantifies the amount of remuneration to be awarded to creator-employees for their patented creations. However, such remuneration must be 'reasonable'; otherwise, the provision may be void (in some cases the entire contract can be held void).

In addition, if an employer wishes to transfer the rights of a patent made by a creator-employee, the creator-employee enjoys a pre-emptive right to acquire the creation. This means that the employer cannot transfer the creation to another party if the creator-employee offers to purchase the creation under the same conditions. However, employers can require employees to waive the pre-emptive rights to any creations made

## **SME Case Study 2**

### **Background**

In March 1999, Company A was preparing for the establishment of Company B, a wholly foreign owned company in China. Company A entrusted Company C to hire programmers and organise the development of software projects for Company B. The parties agreed that all rights and obligations created during the establishment of Company B would belong to Company A and that such rights and obligations would be transferred from Company A to Company B upon its establishment.

Company C employed the defendants, X and S for Company B. Their employment contracts expressly provided that the defendants would keep Company B's trade secrets confidential. Furthermore, all products and technology which the defendants had a role in researching and developing were to be owned by Company B. The defendants were not allowed to use the relevant technology or disclose it to any third party without Company B's prior approval.

The defendants were involved with important software development projects. In August 2000, Company B was established and the defendants became its employees.

X was dissatisfied with Company B and considered joining a new company, Company D, and persuaded S to join him. To secure their jobs with Company D, the defendants disclosed to Company D the latest version of the source code for encrypting email systems, which had been developed by Company B.

### **Action Taken**

Company B reported the defendants to the police after discovering the unauthorised disclosure of its trade secrets.

### **Outcome**

The court found that the defendants were bound by their employment contract to keep the source code confidential, as it was an important part of the software. By disclosing the source code to Company D for personal gain, the defendants breached their confidentiality obligations under the employment contract and thus were held liable for the unauthorised disclosure of trade secrets.

### **IP Lessons**

To prevent material damage to the operations of your business, the duties of employees regarding confidentiality, ownership of IPR, non-compete and non-solicitation, etc., should be expressly provided in the employment agreement.

by them during their employment. For more information about creator-employee remuneration and conducting R&D in China, see the 'Related Links' section.

### **Non-Compete/Non-Solicitation**

More often than not, employers incorporate non-compete and non-solicitation provisions in the employment contract to prevent leaving employees from stealing, or using without authorisation, the employer's customers, employees, suppliers, etc., and competing with their businesses. These provisions must be 'reasonable', otherwise, they may be void.

According to China's Labour Law, non-compete obligations must not exceed two years and must apply only to senior management personnel, senior technical personnel and others with non-disclosure obligations. Moreover, employers are required to pay compensation to former employees fulfilling their non-compete obligations; however, the amount of compensation is not specified by China's Labour Law. In general, the compensation can be anywhere from 20% to 60% of the employee's annual salary over the last 12 months, as provided in the meeting minutes of the Supreme People's Court and Labour Dispute Arbitration Committee of Beijing Regarding Labour Disputes.

### **Guide Glossary\***

- Severability – means if any portion of a contract is held unenforceable, such portion does not affect the validity of the rest of the contract.
- Transferees and assignees – a person to whom an interest or right is transferred or assigned, which gives him or her the interest or right the owner had prior to the transfer or assignment.
- Warranties – assurances, promises, or guaranties made by one party to another party that a particular statement of fact is true and may be relied upon.
- Arbitration – a method to resolve disputes outside the courts whereby a dispute, with the consent of all the parties, is submitted to one or more unbiased third persons for a decision.
- Injunctive relief – an order granted by the court requiring an individual or a company to do or not to do certain acts.
- Licensee – a person to whom a license is granted.
- Licensor – a person who gives or grants a license to another.
- Circumvention – refers to a company which, after acquiring another company's technology, IP rights, confidential information, etc. through negotiation, cooperation or collaboration, bypasses that company and sells directly to the market.

### **Important Tips**

- Use a China IP specialist to help draft your contracts to ensure the protection of your business' IPR.
- Have your contracts translated into Chinese by a trusted source to avoid any misinterpretations due to poor translation, or have the official versions of your contracts drafted in Chinese and English with both languages having equal effects (meaning both languages are official and shall be respected when interpreting the contract terms).
- You may choose foreign or Chinese law as the law governing the disputes of the performance of the contract, but Chinese IPR under the contract will always be governed and protected in accordance with Chinese IPR laws.

### **Take-Away Messages**

- Tailor your IP contracts to suit the IPR you are protecting, and make sure you include sufficient specific detail in the contracts' key provisions.
- Certain IPR protection provisions are unlawful under Chinese law, and may render a contract void if you include them in your agreement, so be cautious when drafting these provisions.
- Sign an NDA or ensure that there is adequate protection in your contract addressing confidentiality issues.
- For manufacturing or sourcing in China, consider signing an NNN agreement to prevent your Chinese business partner from disclosing your confidential information or competing with you later.
- Ensure that employment contracts include provisions relating to ownership rights, remuneration, non-compete, non-solicitation, and confidentiality (if no separate NDA is in place).
- Include confidentiality provisions in all employee contracts. Even if that employee is currently unlikely to have access to confidential information, he or she may do in future roles within the company.

### **Related Resources on the China IPR SME Helpdesk Website ([www.china-iprhelpdesk.eu](http://www.china-iprhelpdesk.eu))**

#### **1. Trade secrets:**

- Helpdesk guide '[Patent and Trade Mark Protection in China](#)'
- Helpdesk ELM '[Trade Secrets](#)'

#### **2. Research and Development:**

- Helpdesk guide '[Guide to R&D in China for European SMEs](#)'

#### **Other related resources:**

1. [China State Intellectual Property Office \(SIPO\)](#)

**Sample One-Way Non-Disclosure Agreement (NDA)**

This Agreement is made on the \_\_\_\_ day of \_\_\_\_\_ between A and B.

Whereas A and B enter into this non-disclosure agreement ('Agreement') relating to the confidential information to be disclosed by A to B in connection with the Technology Licence Agreement entered into between A and B on \_\_\_\_\_ in which A is the licensor and B is the licensee (the 'TLA').

**IT IS AGREED AS FOLLOWS:**

1. For the purposes of this Agreement, 'Confidential Information' shall mean any and all information, whether oral, written, graphic or in machine-readable form, including, without limitation, software products, techniques, blueprints, product plans, product designs, product and service developments, manufacture plans, comparative analyses of competitive products, technical plans and proposals, research and development plans, progress and reports, business information, business policies, marketing strategies, pricing policies and lists, customer and user lists, procedures, improvements, concepts and ideas, designs, drawings, artwork, equipment, processes, budgets and projections, and information, trade secrets and/or any other information, materials, data or documents, in whole or in part, now existing or later acquired or supplied by the disclosing Party, whether or not such information, materials, data or documents qualify as 'trade secrets' under applicable laws or regulations or are classified by the disclosing Party as confidential information and are marked as such or, by the nature of the circumstances surrounding the disclosure, ought in good faith to be treated as proprietary and/or confidential information owned or created by, or proprietary to, the disclosing Party or third parties to whom the disclosing Party owes a duty to maintain confidentiality. The terms and conditions of this Agreement, and other information and content made available during the Term of this Agreement and the TLA, are all deemed Confidential Information. The term 'Confidential Information' shall not include any information properly, legally and independently developed by or for the receiving Party without access to the Confidential Information of the disclosing Party.

**Part 1:** This definition of 'Confidential Information' is very important, as it will determine the scope of what will be protected. If this is not sufficiently wide, it may miss works that are important for your business.

2. B undertakes in relation to the Confidential Information:

(i) To maintain the same in confidence and to use it only for \_\_\_\_ and for no other purpose and in particular, but without prejudice to the generality of the foregoing, (a) not to make any other commercial use thereof, and (b) not to use the same for the benefit of itself or of any third party other than pursuant to a further agreement with A;

(ii) Not to copy, reproduce or reduce to writing any part thereof except as may be reasonably necessary for \_\_\_\_\_ and that any copies, reproductions or reductions to writing so made shall be the property of A;

(iii) Not to disclose the Confidential Information to any third parties without express written consent of A except for those employees who have a need to know the Confidential Information in order to understand, assess, advise, consult, or decide on, disclose or fulfil \_\_\_\_\_; and

(iv) To inform each of its employees who may have access to the Confidential Information of the confidential nature of that Information and to take reasonable endeavours to ensure that each employee complies with the terms of this Agreement as if he or she were a party to it.

**Part 2:** The details in this section identify exactly what the receiving party is allowed (and not allowed) to do with the Confidential Information.

3. B shall:

(i) Within one month of completion of \_\_\_\_\_ or receipt of a written request from A, return to A all documents and materials containing the Confidential Information obtained by B pursuant to this Agreement, or provide sufficient and satisfying proof that B has destroyed all or any part of the same according to the instructions of A and certify in writing to A that it has complied with the requirements; and

(ii) Notwithstanding completion of \_\_\_\_\_, continue to be bound by the undertakings set out above for a period of \_\_\_\_ years from the completion of \_\_\_\_\_.

**Part 3:** The timing for the return of the documents and for the validity of the agreement to continue past the completion of the agreed project is extremely important to ensure the ongoing protection of your business's IPR.

IN WITNESS whereof, the parties hereof have duly executed this Agreement on the \_\_\_\_ day of \_\_\_\_\_.

[Signatures] [Company Chop]

The China IPR SME Helpdesk provides free, confidential, business-focused advice relating to China IPR to European Small and Medium Enterprises (SMEs).

**Helpdesk Enquiry Service:** Submit further questions to the Helpdesk via phone, email ([question@china-iprhelpdesk.eu](mailto:question@china-iprhelpdesk.eu)) or in person and receive free and confidential first-line advice within seven working days from a China IP expert.

**Training:** The Helpdesk arranges training on China IPR protection and enforcement across Europe and China, tailored to the needs of SMEs.

**Materials:** Helpdesk business-focused guides and training materials on China IPR issues are all downloadable from the online portal.

**Online Services:** Our multi-lingual online portal ([www.china-iprhelpdesk.eu](http://www.china-iprhelpdesk.eu)) provides easy access to Helpdesk guides, case studies, E-learning modules, event information and webinars.



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