

Research and Development in China for European Businesses: Part 2

An important component of your business strategy in China should be the management of intellectual property (IP) portfolios. This is relevant to you even if your main business activities do not focus on research and development (R&D). For more on developing your R&D strategy in China by structuring your IP ownership and licensing, see the first instalment of this two-part article in the previous edition of INSMEnews.

Building valuable IP Portfolios

After European SMEs come to an agreement on ownership and licensing issues with Chinese partners, the real steps to developing a valuable IP portfolio require good discipline and good management. Due to budget constraints for most SMEs, it may not be entirely realistic to apply for and register all their inventions, and therefore scrutiny is required to figure out which are the 'must-file' patents. Always remember that it is extremely difficult to enforce your rights or prove ownership for inventions that are not patented.

Below is a check-list of essential actions to keep in mind:

- **Quality patent drafting:** The initial draft can be done in Chinese or a foreign language. You may even file an international application (PCT) from China if it is justifiable to do so from the cost and strategic perspectives. However, if the application needs to be translated, attention should be given to the quality of translation.
- **Foreign filing licence:** If the invention is made in China, either by Chinese or European engineers, the filing of the invention for patents requires a *foreign filing licence*, which is given by the State Intellectual Property Office (SIPO). Very often foreign filing licences are granted quickly unless the technology relates to sensitive areas such as national security.
- **Filing entity:** If a Chinese entity, which is set up by a foreign SME, alone or jointly with a Chinese business partner, retains all the IPR ownership, the Chinese entity must file patent applications under its own name. The patents can later be transferred or licensed to the foreign SME. If a foreign SME manages to be the sole owner of all the technologies under the R&D activities, the SME may apply for the patents under its own name.

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- **Transferring of patents after the filing:** The Chinese government has imposed restrictions on (or in certain instances has banned) the transfer of ownership of certain types of technologies to foreign companies or individuals. Such types of technologies mostly include unique innovations, or otherwise have significant long term effects on China's social, economic and technological interests. For example, prohibited technologies for export could include those related to the manufacture of traditional Chinese medicine, land surveying, breeding of livestock, encryption, and computer network security. If foreign SMEs believe that the technologies developed under their R&D activities in China are somehow sensitive, it is advisable to check the Catalogue of Export Restricted Technologies and the Catalogue of Export Prohibition Technologies.
 - **IP other than patents:** Besides patents, copyrights and trade secrets can also be of high importance. IP ownership or licensing agreements should include detailed information on both copyrights and trade secrets. Regarding copyright, registration of the copyrighted works with authorities such as the National Copyright Administration is not required, but can be helpful as proof of these rights.
 - **Recordal and registration for licences:** If IP licensing is adopted in R&D activities, registration and recordal requirements may be necessary under Chinese laws and regulations. Technology licences may need to be registered or recorded with local government authorities such as the Chinese Ministry of Commerce (MOFCOM) and the State Intellectual Property Office (SIPO) to comply with several legal requirements. If the licence has royalty payment clauses, the recordal and registrations are necessary under the foreign exchange control rules for the payments to be remitted through local Chinese banks to overseas bank account.
 - **Employee remuneration rules:** If a European SME hires employees to conduct R&D and to contribute to inventions, it is important to note Chinese employee remuneration rules. These rules are intended to ensure that inventors get fair returns and benefits from the patents they invent. The current rules allow the employer and employees to dictate how the employees are rewarded for their inventions. However, in the absence of an agreement between the employer and employee, default rules under the Chinese patent law will be implemented. For example, an inventor or 'creator-employee' may claim for 2% of the business profits annually derived from the invention or utility model patents he or she invented. It is also important to remember that if the remuneration agreed in the contract is too low (and therefore deemed 'unreasonable' under Chinese law) the term on the remuneration in the contract may be void and the employer will end up paying a higher amount in fees. In order to understand the definition of 'reasonable' reimbursement, reference may be made to the Chinese patent law, which requires, in the absence of other agreements, the employer to give a bonus of no less than RMB 3,000 to an employee who completes an invention patent, and RMB 1,000 to an employee who completes a utility model or a design patent.

What to do?

A European SME has come up with a very unique algorithm and prototype software in the video searching field. The SME has identified a promising business partner in China with whom to conduct joint R&D. The purpose of the joint R&D is to launch a software product suitable for Chinese search engines. The Chinese business partner has an R&D team and impressive marketing capability in China. The Chinese business partner is offering equity in its current company in exchange for the IP rights to the future R&D. How should the IPR issues be handled?

Advice

IP ownership: The market potential and strength of the Chinese business partner are likely to make it difficult for the European SME to retain the full IPR ownership. A co-ownership of IP in China and full ownership of IP outside of China may be considered.

Licensing: The European SME should think about the potential applications of its algorithm and software in sectors other than search engines. The SME may consider the option of giving an exclusive licence to the Chinese business partners for the search engine sector, but retain the right to use the technologies for other business applications, e.g. security surveillance or traffic control systems. If the SME desires to have a licence given back from the Chinese business partners for those future improvements, the SME is advised to take into account the possibility that the joint-venture is terminated or fails in a situation like bankruptcy of the Chinese business partner. Under the bankruptcy law in China, a licence given by the bankrupted entity may be revoked without compensation.

IP Portfolio: The European SME should enter into a contract with the business partner to dictate how the patents are going to be filed, how to manage the non-patented technologies, source codes, etc. This will be critical in order to minimise the risk of disputes in the future.

Take-Away Messages

- Investing time and resources into protecting your intellectual property assets should be considered worthwhile even if you do not focus on R&D activities. In most cases, intellectual property rights protect your business' innovations and therefore your competitive edge; not protecting them could prove fatal.
- To build quality IP, you need to manage several important aspects: patent drafting, foreign filing license, and employee remuneration etc., on an on-going basis.
- For more information on the intellectual property rights mentioned in this article, download Helpdesk guides from www.china-iprhelpdesk.eu

The China IPR SME Helpdesk is a European Commission funded project that provides free, practical, business advice relating to China IPR to European SMEs. To learn about any aspect of intellectual property rights in China, visit our online portal at www.china-iprhelpdesk.eu. For free expert advice on China IPR for your business, e-mail your questions to: question@china-iprhelpdesk.eu. You will receive a reply from one of the Helpdesk experts within seven working days. The China IPR SME Helpdesk is jointly implemented by DEVELOPMENT Solutions and the European Union Chamber of Commerce in China.