Legal Commentary

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Anatomy of Licensing Deals from China Regulatory Perspective[1]

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Driven by the passion and belief, and fraught with various risks and challenges, the research and development of innovative drugs and medical devices is a journey that's never easy. Along the journey, an individual may stride resolutely, yet with companionship, two can traverse faster and farther. Therefore, pharmaceutical companies have been frequently collaborating in the research and development of drugs and medical devices to leverage each other's resources, share risks, explore regional markets, achieve profit maximization, or promote mutually beneficial effects in strategic partnerships. Meanwhile, licensing transactions are commonly used for the implementation of collaborative projects in the field of drugs and medical devices (including medical aesthetics).

Our team has been 100% dedicated to legal work in the field of life sciences, and we are honored to have the privilege of assisting numerous multinational pharmaceutical and medical device companies, as well as leading innovative biotech companies in China, in conducting licensing transactions and research collaboration projects. With the explosive growth of license-out transactions in recent years, in 2022 and 2023, we have handled over 50 pharmaceutical and medical device licensing (including collaborative development) projects, including but not limited to collaborative projects involving various small molecule drugs, ADC drugs, RDC drugs, mRNA drugs, AI pharmaceutical technologies and products, cell therapy products such as CAR-T/CAR-NK/TIL, medical aesthetics products, and various innovative medical devices for treatment or diagnosis (IVD/LDT). Recently, we have frequently observed a lack of consideration for regulatory issues related to drugs and medical devices in a considerable number of previous license agreements of our clients. As a result, many terms are ultimately unimplementable and require renegotiation between the parties. The business arrangements throughout the entire life cycle of the licensed products serve as the cornerstone for licensing projects. To smoothly carry out collaborative licensing projects, it is crucial to prudently allocate rights, obligations, and interests among the parties involved in the license agreement, and the parties shall take the entire life cycle of drugs and medical devices into consideration and pay particular attention to key aspects when drafting terms.

As mentioned above, as one of the few teams in China fully dedicated to the field of life sciences, we

[1] For the Chinese version, please click *汉坤 • 观点 | 从药械产品全生命周期视角解读 License-in/out 许可交易项目合作条款要点*.

[2] Leyi Wang and Shuwen Sun have contributions to this article.

practice with a particular focus on regulatory issues throughout the entire life cycle of drugs and medical devices. We will share further insights on key terms of collaborative licensing projects, from the perspective of regulatory compliance and consideration of the entire life cycle of products, which mainly include research and development ("**R&D**"), registration, manufacturing, commercialization, and post-market regulations.

Research and development

I. Project management and committees (JxC)

For the purpose of product R&D, the parties often establish a Joint Development Committee ("**JDC**") (or a committee with a different name but similar responsibilities) to discuss and determine on related matters. Despite the fact that both parties share a joint aspiration to promote product development, there typically remains tension between the Licensor and Licensee in terms of the control over R&D activities: The Licensee desires more autonomy to conduct R&D activities within the licensed territory and field, while the Licensor seeks supervision and control over the Licensee's R&D activities. Taking one of our medical device collaborative projects as an example, the Licensor sought comprehensive supervision of worldwide R&D activities of the licensed products and aimed to hold approval authority for clinical trial protocols and the selection of Contract Research Organizations (CROs) through the JDC. However, the Licensee believed that the Chinese market had its own unique characteristics and required ample autonomy to ensure timely and smooth progress in product R&D. Ultimately, we successfully negotiated on behalf of the Licensee to secure the exclusive decision-making power for the Licensee regarding the aforementioned matters within the licensed field and territory.

In fact, the establishment of project management committees depends on the specific circumstances and the practical needs of each project. For instance, in the case of comprehensive collaborative licensing projects, the parties typically set up various management committees, each designated for distinct phases of product development, including the R&D, registration, manufacturing, and commercialization. They might additionally opt to establish additional management committees, such as the Joint Bioanalytical Team ("**JBT**") and the Joint Finance Committee ("**JFC**"), to facilitate the project's progression. In contrast, for projects with a simpler transactional structure, parties might solely establish a Joint Steering Committee ("**JSC**") to supervise project management as a whole without the establishment of additional management committees. The structuring of project management mechanisms has no universal and optimal solution; instead, it involves seeking and discovering the most appropriate options for the particular project.

II. Diligence obligation

The development of innovative drugs and medical devices requires the collaborative parties to expend significant resources and exert diligent efforts. License agreements often include terms specifying diligence obligations of the parties during the R&D stage. On the one hand, the Licensor hopes to supervise the Licensee's active R&D activities to achieve early registration and commercialization of the licensed product. On the other hand, given the inherent uncertainties in R&D activities, the Licensee also needs to reasonably limit the R&D responsibilities it undertakes. Therefore, there is

always considerable tension between the parties regarding how to stipulate, interpret, and enforce the diligence obligation terms. We've also seen cases where disputes arose over the fulfillment of diligence obligations during the R&D phase, eventually leading to arbitration.

Generally, in a licensing project, the Licensor typically establishes clear diligence obligations for the Licensee, to expedite the receipt of subsequent milestone payments and royalties. In addition, the Licensor may also specify particular diligence milestone events and require the Licensee to complete before specific deadlines. If the Licensee fails to complete such events, the Licensor may have the right to choose to terminate the agreement, seek for compensation, or take other remedial measures such as transitioning from an exclusive license to a non-exclusive license. For each specific project, the formulation of diligence obligation terms further depends on various factors such as the nature of the collaborative project, negotiation and demands from the parties, and advice from legal counsels. In general, diligence obligation terms stand out as distinctive and representative provisions in license agreements. Unlike traditional asset acquisition agreements, license agreements usually lack a typical closing stage; the signing of the agreement only marks the very beginning of the collaboration, while the post-execution cooperation is the focal point of the project. Hence, both companies and legal counsels need to consider the implementation of the license agreements with a forward-looking perspective over an extended period, to ensure that the agreements can be effectively implemented, reducing subsequent communication costs for both parties.

III. Data sharing

The sharing of research findings/data is crucial, especially in aspects such as product registration, further product development in other territories, and continued improvement in product technology. For instance, in multinational collaborative projects, parties may progress with the research and development of licensed products in various regions, and the sharing of research findings and data within different regions plays a crucial role in expediting product development in other jurisdictions. Therefore, the design of data sharing arrangement is crucial.

In China, a notable regulatory trend in recent years is the increased focus of regulatory authorities on data export and human genetic resources (HGR) information. (For our insights on the regulations of HGR in China, please refer to: *Highlights on HGR Regulation Implementation Rules*; *Key Takeaways of the New HGR Guidelines*; *Key Takeaways on the New HGR FAQs issued by the MOST of China*). Taking the regulation of HGR information as an example, if the collaborative party falls within the scope of "foreign entities" under the HGR regulation, HGR regulations may significantly impact such party's access to HGR data (e.g. human genetic data). Therefore, it is crucial for the relevant parties to actively participate in proactive, thoughtful, and negotiable discussions and designs concerning the arrangements for sharing research data within the regulatory framework of data supervision in China. We will also consistently monitor updates and changes in regulatory requirements and provide professional advice to facilitate licensing projects.

Registration

I. MAH selection

The selection of the Market Authorization Holders (MAH) (or the registrants or record filing parties) of the products is crucial for both the products and the collaborating parties.

In licensing transactions, the Licensee typically takes the lead in product registration within the licensed territory and serves as the MAH, while in cross-licensing and collaborative projects, the selection of MAH may become more intricate. In practice, the selection of MAH involves considerations of the specific qualifications required for MAH in different jurisdictions, the rights and obligations associated with the MAH, and factors such as the resources and capabilities to take regulatory responsibilities possessed by specific collaborators in different territories. Moreover, the possibility of early termination of the collaborative project should also be taken into consideration and the transition of the status of MAH under post-termination circumstances should also be clarified accordingly. Due to the distinctions between China's regulations on the MAH frameworks for drugs and those for medical devices, such transition and obligations of the parties may be provided differently. In conclusion, companies and legal counsels shall carefully and strategically consider the selection of MAH.

Since the release of the famous *Opinions on Deepening the Reform of the Evaluation and Approval System to Encourage Innovation of Drugs and Medical Devices* by the State Council of China in 2017, China has actively promoted the comprehensive implementation of the MAH system through amending the *Drug Administration Law* and the *Regulations on the Supervision and Administration of Medical Devices*, along with issuing supplementary regulatory provisions. Such laws and regulations have imposed regulatory requirements for the entire life cycle management responsibilities on MAHs of drugs as well as registrants and record filing parties of medical devices. Drug MAHs and registrants/record filing parties of medical devices are obligated to assume full responsibility throughout the entire life cycle of the products, encompassing product registration, manufacturing, distribution, and usage. They are also required to fulfill duties such as post-market research, monitoring adverse reactions, and conducting product recalls. Additionally, if the licensed product is to be registered as an imported product, the Licensee, typically as the domestic representative, will undertake the MAH responsibilities on behalf of the overseas MAH and bear the corresponding joint liabilities. Therefore, the selection of the MAH may also be influenced by appropriate business arrangements in light of regulatory requirements. It is also essential to consider various regulatory aspects such as the regulatory requirements for IND sponsors and NDA applicants, the non-transferability of medical device registrations, the regulatory requirements pertaining to "dual invoicing" policy, and the arrangements for product distribution.

Furthermore, the regulatory framework and requirements for drugs and medical devices in China are constantly being refined and updated. As an example, in our recent participation in the preliminary legislative research for the *Medical Device Administration Law*, numerous of studies and discussions have taken place concerning obligations and responsibilities of registrant and record filing parties of medical devices, along with their domestic representatives (if applicable). Industry practitioners need to keep track of regulatory requirements and make timely adjustments to strategies and arrangements

within licensing transactions as needed.

II. Cooperations in registration process

The party not responsible for regulatory registration activities may also wish to supervise such activities to a certain extent. Therefore, in license agreements, it is necessary to pay attention to the requirements for the preparation and submission of regulatory filings, such as whether they need to be reviewed by the JDC, whether they must accept the comments from the JDC, and whether to agree on which party has the final decision-making power in certain matters. These arrangements may have a significant impact on the timeline for the market registration of licensed products.

Often, the parties other than the MAH also need to assume certain cooperation and assistance obligations, such as providing safety and efficacy data generated by the development activities outside the licensed territory or field. In addition, regulatory authorities such as NMPA and FDA typically require GMP inspections of the manufacturing site of the products when reviewing market applications. Therefore, the parties also need to clearly define their respective obligations in the license agreements in respect of regulatory inspections, and fully consider the practicality and operability of such arrangements. For example, in a medical aesthetic product license-in transaction, the products would be supplied by the Licensor's CMOs from overseas. During the negotiation, we, representing the Licensee, managed to request the Licensor to ensure that their CMOs will cooperate with China's regulatory authorities for extended GMP inspections.

Manufacturing

The arrangement of the manufacturing phase for licensed products in license agreements may be divided into two stages: the clinical study stage and the commercialization stage. The former is for the supply of products for development use, while the latter is for the supply of products for commercialization use.

In determining the party responsible for manufacturing, one of the key considerations is whether the licensed products will be registered as domestic products or imported products in the future. In other words, whether the MAH of the products is a domestic entity or an overseas entity. At present, except for the pilot projects for cross-border contract manufacturing of drugs and medical devices in the Greater Bay Area (For our insights on the pilot regulations of cross-border contract manufacturing, please refer to: *汉坤 • 观点 | 终于等到你 — 解读粤港澳大湾区药品医疗器械跨境委托生产新政*), products held by domestic MAHs shall be manufactured by domestic companies, while products held by overseas MAHs must be manufactured overseas. Therefore, the arrangement of MAHs will also affect the arrangement of manufacturing and supply of the licensed products. In addition, it is also necessary to consider whether outsourcing service providers such as CMOs need to be appointed. If so, the parties should also pay attention to the terms and conditions for subcontracting and sublicenses, including who to own the decision-making power for the selection of subcontractors and sublicensees, and who to bear responsibility for losses caused by subcontractors and sublicensees.

If the technology holder (Licensor) is not responsible for product manufacturing and supply, then it is common for the parties to specify the arrangement for manufacturing technology transfer in the license agreements. In such terms, the parties usually need to consider the scope, timing, methods and cost of

the technology transfer, and the protection of relevant intellectual properties and confidential information. Taking the timing of technology transfer as an example, the parties usually need to pay attention to issues such as whether the manufacturing site for the pivotal clinical trial stage and the commercialization stage needs to be consistent, whether it involves the transfer of an imported product to a domestic product, and whether it is compliant and feasible from a regulatory perspective.

Finally, in cases where the Licensor is responsible for the manufacturing and supply of the products to the Licensee, it is necessary to specify in advance in the licensing agreement the requirements for signing subsequent supply agreements and quality agreements. For example, the parties may determine the time period for negotiating and executing the supply agreement and quality agreement. In addition, it is also common for the parties to agree on some major terms of the supply agreement and quality agreement in the license agreement to improve future negotiation efficiency.

Commercialization

I. Governance committee

Similar to the JDC arrangements mentioned above, during the commercialization stage of the licensed products, the parties may also choose to establish a joint commercialization committee (JCC) (or other committees with different names but similar responsibilities) as the governing body to discuss commercialization plans and other matters related to commercialization. Similarly, there is tension between the parties regarding such terms as the scope of JCC's responsibilities, the allocation of final decision-making power. For example, as the responsible party conducting commercialization activities within the territory, the Licensees typically hope to have more autonomy and decision-making power over commercialization matters. As a result, they would like fewer matters to fall within the scope of JCC responsibilities or have more final decision-making power in JCC. On the contrary, the Licensors often hope to retain a certain degree of supervision and decision-making power over the commercialization activities within the territory.

II. Commercialization plan and budget

Common areas of focus in the commercialization process include the formulation of commercialization plans and budgets, the agreement on diligence obligations, and the arrangement of product promotion. As for the formulation of commercialization plan and budgets, the parties need to pay attention to the frequency of updating and revising the commercialization plan, as well as the approval process. In licensing projects, the Licensees are typically responsible for the commercialization activities in the territory and bears the corresponding costs. While in co-development projects, the allocation of responsibilities and costs is often related to various factors such as each party's responsible territories, the capabilities of each party's sales force, and the way in which the revenue is shared. In particular, for the party who is not responsible the commercialization activities, how to reasonably control the scope of shared cost while not affecting the effective promotion of the product's commercialization, largely depends on the allocation of the formulation, approval and modification rights of the commercialization plans and budgets in the license agreement. In addition, it is noteworthy that there are many tax incentives at national and local levels in China that can be provided to

Licensors/Licensees. Therefore, how to set up tax-related clauses in the license agreement to make good use of relevant policies may also bring real benefits to the companies.

III. Diligence obligation

The success of commercialization is closely related to how much royalties and milestone payment the Licensors can receive, so it is common that the license agreements may require the party leading the commercialization activities to fulfill certain diligence obligations. Depending on the bargaining power of the parties, different levels of strictness such as definitions of the terms "best effort", "reasonable effort" or "commercially reasonable effort" may be agreed upon. The parties may further agree on objective standards, such as requiring the Licensees to pay a minimum annual commercial payment. In such way, if the actual amount of royalties owed by the Licensee is less than the applicable minimum annual commercial payment, the amount of royalties to be paid will automatically be deemed to be such minimum annual commercial payment.

Post-Market surveillance

As special products with significant impacts on the safety and health of patients, drugs and medical devices are subject to vigilance requirements such as adverse reactions reports and product recalls. In particular, for pharmaceutical products that are marketed both domestically and overseas, regulatory authorities in China have certain requirements for monitoring, collecting and reporting overseas adverse reaction information. There are also requirements to report and evaluate product recalls that occur outside of China. In practice, many biotechs may not have paid enough attention to pharmacovigilance (PV) matters because their products are still in the early development stages. Nevertheless, since we have previously been deeply involved in multiple NMPA regulatory actions on adverse events against pharmaceutical products or companies, we are well aware of the importance for the companies to comply with relevant regulatory requirements. Therefore, for the parties involved in cross-border licensing transactions, it is also important to focus on how to arrange the obligations and responsibilities related to product vigilance.

Usually, the cooperating parties will agree in the license agreement to sign a separate PV agreement before a certain point in time (e.g. before conducting the first clinical trial in the territory). In such PV agreements, the cooperating parties may allocate and clarify their respective responsibilities regarding matters including adverse event reporting, quality complaints, and safety data exchange.

Conclusion

On the journey of innovative pharmaceutical research and development, licensing transactions have built a bridge for communication and cooperation among companies, encouraging all parties to work together to achieve win-win outcomes. Improving the terms under licensing agreements from the perspective of the whole life-cycle of pharmaceutical products can better promote the implementation of the projects, fully leverage the advantages and resources of all parties, avoid legal risks that may be encountered in the development activities, and optimize the companies' business arrangements. We also look forward to providing professional advice for more licensing projects, reducing uncertainty and transaction barriers through reasonable arrangements, and ensuring smooth cooperation under the premise of protecting the

clients' interests. We hope our humble efforts may assist industry practitioners in embarking on a broader path of future cooperation and bringing more breakthroughs and innovative pharmaceutical products for the benefit of patients around the world.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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