

## China: the trade mark basics

**When first entering any overseas market, whether to sell goods or services or as a place of manufacture, one of the most important things to remember is that trade mark rights are geographical in nature. Hence, rights which you might have in one territory (such as the UK) do not necessarily provide corresponding protection in an overseas market. In view of this, we have put together some advice and top tips for those entering the Chinese market for the first time.**

### The 'heads up'

#### 1. Drafting contracts

When drafting contracts in China, it is important to bear in mind that your ultimate goal is to have a precise and enforceable contract. Many companies have been left empty handed because their contracts lacked these characteristics. **Specificity of the terms is key.** For example, if a certain transistor can usually dissipate nine watts before it overheats, it is better to say that explicitly rather than rely on 'in accordance with industry standards'. **Chinese courts are much more reluctant to read implied terms into a contract** than some western jurisdictions. Additionally, to maximise your chances of enforcing the terms of a contract in China, the contract must be in Chinese, apply Chinese law, and the forum selection clause must choose a Chinese jurisdiction. Otherwise, you risk having a contract which is unenforceable before a Chinese court. The only time a party should use a different forum and law is if the other contracting party has significant assets overseas which cannot easily be transferred.

#### 2. Business formation

**Many businesses encounter serious legal issues because they did not choose the appropriate structure for their entity** or did not fully comply with the associated registration requirements. Companies can choose between a wholly foreign owned enterprise (WFOE), a joint venture (JV), a representative office (RO), or a variable interest entity (VIE). Your selection will depend on the nature of your business, and each carries certain risks. A WFOE must be incorporated in accordance not only with national laws, but also local regulations which, among other restrictions, have varying requirements on employment and leases. A JV may give you access to a

partner's business network, but increases your risk of intellectual property (IP) theft. A RO is severely circumscribed in its activities, and is only suitable for the most limited ventures. A VIE in many circumstances may actually be illegal under Chinese law, because they are frequently used to circumvent Chinese legal restrictions on foreign enterprises. Seek advice if you are uncertain how best to proceed with your business

#### 3. Using agents and manufacturers

Businesses sourcing products from China may engage directly with a manufacturer or a third party agent. It is critical to **know with whom you are dealing.** In many cases, when procuring a product from a Chinese based entity, it is unclear whether you are contracting with a third party agent or a manufacturer. In the case of breach, it would be **much easier to enforce a contract against a manufacturer** than a third party agent because the latter rarely keeps substantial assets on hand.

Whilst some agents may be particularly beneficial, identifying those of real value requires substantial investigation into historical performance and existing relationships on the market. It is vital to do the required **due diligence on any party you contract with** to ensure that it is a registered business entity which is appropriately licensed under Chinese law.

#### 4. Regulatory compliance and enforcement

Every business must adhere to Chinese regulations, which vary from industry to industry. For example, if selling health or cosmetic products in China, there is a host of regulatory requirements that must be complied with. The dangers of noncompliance could lead to **incarceration**

of the responsible officers. This is more common in China than abroad because it is easier to pierce the corporate veil in matters involving public safety. Additionally, each industry must be aware of the consequences of the anti-corruption statutes in their home jurisdiction and in China. While enforcement may be selective, it is never wise to give the authorities a reason to prosecute your business, particularly when prosecutions against foreign enterprises for regulatory violations are likely to increase due to the recent economic slowdown in China.

### 5. Ramifications of the business and legal culture

China's culture is quite different and presents difficult issues for any foreign entity. For example, in the legal arena equity tends to play a much larger role in a judge's decision than in Europe or common law jurisdictions. Accordingly, where circumstances change and dramatically impact the Chinese entity negatively, its foreign counterpart may want to look at modification before litigation, which in many cases leads to an expensive and negative outcome. The negotiation process is also quite different in China. For example, in western nations it is common to bring attorneys to the forefront early on in negotiations, whereas in China, this may be seen as a move taken in bad faith. A business must be thoroughly aware of Chinese business and legal culture to maximise its earning potential.

## Some important branding considerations for overseas companies planning to expand into China

### 1. Trade marks: registration

China is a first to register country, rather than a first 'use' country like the United Kingdom. Therefore, a business must register its mark in China if it intends to do business there, and should do so before the business actually enters the Chinese market, in order to avoid any risk of losing the trade mark in China. If the mark is not registered, there is no mark. After a mark is registered with China's Trademark Office, it should also be registered with Chinese

Customs. Without this separate registration, enforcement against counterfeit products entering or leaving China will be difficult.

### 2. Trade mark enforcement: brand dilution and enforcement procedures

If you do not enforce your trade mark rights and other companies sell goods under your mark, you risk not only a loss in market share, but also brand dilution or damage through the presence of potentially inferior products on the market. In the case of infringement, Chinese law first calls for 'negotiation', a common requirement in Chinese statutes. Should that fail, you may bring an action in the courts or an administrative action in the Administrative Department of Industry and Commerce. A People's Court will have the authority to enforce the decision. Enforcement is usually limited to damages and the destruction of the infringing goods. Once a decision is rendered, you will also be able to enforce your mark through customs, assuming it has been registered there. However, there is no substitute for constantly monitoring your mark and this should be central to any brand protection strategy.

### 3. Licensing your mark

Licensing agreements are fraught with danger and opportunity. Like any contract in China, your agreement must be very specific in order to protect the brand and business. A common negative outcome is that a licensee will choose to manufacture its own goods bearing your mark and sell them on to your customers. During preliminary negotiations, a business should draft a combination of non-disclosure, non-circumvention, and non-compete clauses. After negotiations are complete, these clauses must be explicitly incorporated into the final agreement. It is also important to carefully manage trade secrets (such as customer lists) to limit the business' exposure to damage in case of breach and infringement. Finally, because damages in these cases are hard to calculate, a foreign party should include a liquidated damages clause and specific performance clause within the agreement, allowing for the destruction of the infringing goods.

### 4. Adapting the mark to the Chinese market

If you are selling to the Chinese market, it is important to weigh the pros and cons of adapting your mark to the Chinese market. Whether or not you wish to change the mark's appearance or translate it to adapt it to the Chinese market depends on why Chinese customers are choosing your product over domestic products. In some cases, maintaining the 'foreignness' of the brand is a distinct advantage. Other companies have translated their mark with great success, with Coca Cola being a prime example. The Chinese translation is not only a transliteration of the original English, but also carries an excellent meaning in Chinese. A foreign business which translates its mark should consider whether the characters used are positive and whether there are any associated meanings of a transliteration, whilst also remembering to register the original foreign mark alongside it.

### 5. Trade mark squatters

Sometimes a business simply cannot beat a squatter to the mark. In this event, there are two recourses; a foreign party may challenge the registration based upon a 'well-known mark' ground or a 'bad faith in registration' ground. Unfortunately however, obtaining a favourable decision in either instance is both difficult and expensive. The alternative is to negotiate an assignment from the squatter. If this option is pursued, it is advisable to use experienced trade mark agents who can formulate the best negotiation strategy depending on the nature of the case.