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IP DEVELOPMENTS IN GREATER CHINA

Intellectual Property Update

2015 was a year of significant change in the intellectual property (IP) field, with China redoubling its efforts to tackle counterfeit goods, long-awaited and controversial legislative amendments being debated in Hong Kong and headline making judgments that have set clear precedents. Summarised below are some of the key highlights of 2015, as well as predictions for the year ahead.

CONTROVERSIAL CHANGES TO THE COPYRIGHT LAW IN HONG KONG

The most prominent and controversial development in Hong Kong was the Copyright (Amendment) Bill 2014 (Bill) which finally received legislative consideration after eight years of preparation.

The Bill aims to bring the Copyright Ordinance in line with international standards and to keep pace with rapid technological advancements. Key aspects of the Bill include introducing a technology-neutral exclusive right for copyright owners to communicate their work through any mode of electronic transmission, including works done for the purposes of commenting on current events as an exception to copyright infringement; establishing a statutory 'safe harbor' for online service providers to limit their liability for copyright infringements occurring on their service platforms and creating new exception under the categories of parody, satire, caricature and pastiche.

Supporters of the Bill claim that this is a long overdue response to the rapid technological and digital advancements that have already driven other jurisdictions to update their copyright regimes. However, the Bill continues to be stalled by strong protests from parties concerned with the protection of free speech. The on-going controversy principally relates to the lack of a statutory definition of the terms 'parody', 'satire', 'caricature' and 'pastiche' and the lack of a broad exception of 'fair use' in the Bill, causing uncertainty as to what extent copying for these purposes can be exempted from copyright infringement. Critics also say that insufficient protection is accorded to popular internet activities such as rewriting of lyrics, covering a song without parodic elements, music mash-ups and fan comics.

The Legislative Council is currently reviewing the Bill. Whether the legislature can agree on the right balance between protecting free speech and protecting copyright owners remains to be seen. At the time of writing, both sides of the debate appear to be in a stand-off with Greg So, the Hong Kong Commerce Minister, described the situation in the LegCo as 'like a nuclear bomb explosion'.

HOW TO DEFEND A REGISTERED TRADE MARK FROM NON-USE CANCELLATION IN HONG KONG

Under the Hong Kong Trade Marks Ordinance (Cap. 559), a registered trade mark may be revoked if it has not been genuinely used in relation to its registered goods or services for a continuous period of at least 3 years. The recent Burberry v Polo Santa case clarified the standard of use that a trademark is required to meet in order to resist revocation on the grounds of non-use.

Burberry and Polo Santa both registered a similar checkered pattern in Hong Kong. Burberry sought a court order to revoke Polo Santa's registered trademark on the grounds of non-use. Polo Santa had the burden to prove that its checkered mark had been genuinely used by it or other parties with its consent. Polo Santa produced two pieces of evidence to prove use of its trademark:

- Polo Santa had licensed two entities to use the its trademark, one of which operates its business in the Mainland, and
- A four page catalogue containing photographs of handbags bearing the Polo Santa mark.

The court dismissed both pieces of evidence. In relation to the licensing of the Polo Santa mark to other entities, the court considered that any use of the mark in the Mainland was irrelevant. In relation to the catalogue, Polo Santa could not prove that the goods in the catalogue were actually offered for sale to end customers because information that would enable customers to make purchases, such as the number of shops offering such products, their contact details and webpages, were missing. Polo Santa also failed to prove that the catalogue itself had been made available to potential customers because the catalogue was undated.

The court clarified that to prove use of a trademark, sales vouchers of the trademarked products, documents showing the actual manufacturing, marketing and sale of such products; or employee witness statements confirming the sale or offer to sale of such products, are required as evidence.

This case provides clear guidance of the type of evidence needed if a business is to successfully defend its registered trademark from a non-use cancellation attack. Brand owners should preserve manufacturing, marketing and sales records of its products, especially for trademarks the use of which cannot be easily found through a Google search.

CHINESE SUPREME COURT RULES THAT ORIGINAL EQUIPMENT MANUFACTURING (OEM) IS NOT TRADE MARK USE

Foreign businesses who own a trademark in a market outside China will often contract with an OEM in China to manufacture goods bearing its trade mark solely for exporting such goods to overseas markets. This has led to the long-running question of whether such OEM use infringes any Chinese trade mark rights for the goods where the Chinese trade marks are not held by the foreign business or the OEM. As trade mark rights are territorial, there is the risk that OEM use infringes the Chinese trade mark owner's rights. This issue has gained particular piquancy because very often the Chinese trade mark owner is a "pirate" registrant which has copied the trade mark from the foreign business. Typically, the pirate registrant will register the trademark at Chinese customs and then ransom the foreign trade mark owner to allow it to continue to use the trade mark in China.

In a recent decision, the Chinese Supreme Court decided that manufacture by an OEM for export outside China does not constitute 'use' of a trade mark and therefore cannot be considered as infringement of a mark registered in China, rather the "use" of a trademark in China can only be fulfilled through circulating the product in commerce in China. This decision was made in the context of the PRETUL trademark which was used on OEM padlocks exported to Mexico without any sale in China. The Supreme Court reasoned that although the plaintiff had engaged Chinese OEM factories to manufacture the padlocks, it neither distributed nor advertised the padlocks in China. Although not binding, this decision strongly indicates the trend of future decisions.

This case is undoubtedly welcome news for trade mark owners. Foreign businesses which are simply using China as a manufacturing base are well-advised to clearly state in their OEM agreement that the goods are solely for export and provide clear proof to the OEM that the contracting party has the requisite trademark rights in the destination country.

RECORD STATUTORY DAMAGES FOR TRADEMARK INFRINGEMENT IN CHINA

2015 was the year in which the Chinese Trademark Law, introduced in May 2014, was earnestly put into effect by the Chinese courts and administrative bodies. In November, the Swiss apparel company Moncler, which had sued a Chinese company, Nouyakate, for trademark infringement, was granted statutory damages of RMB 3 million (US$480,000) by the Beijing IP Court. Statutory damages were awarded because Moncler had insufficient evidence to prove its loss of profit as a result of the trademark infringement. Notwithstanding this, the court awarded the maximum statutory damages available on the grounds that:

- Moncler has been a well-known brand in China since at least 2008
- Nouyakate acted in bad faith because it sold goods on its website that bore marks that infringed Moncler's trademark rights.
- Nouyakate sold the infringing goods at high prices
- Nouyakate deliberately did not print its company name on its products, which is evidence of malicious infringement, and
- Nouyakate was a large scale infringer in the process of setting up a commercial network including franchising stores and distributors.

The case is significant because foreign plaintiffs have for many years complained about low damages awards made against Chinese companies for trade mark infringement, on the grounds that they provide an insufficient deterrent against trade mark infringement. The fact that a Chinese company was sanctioned in this way suggests that the climate for brand owners in China is slowly but surely changing for the better, notwithstanding the widely publicized challenges facing brand owners in China.

NEW BALANCE TRIPPED UP BY HEAVY DAMAGES AWARD IN CHINA

Despite the Moncler case, foreign businesses continue to face a torrid time in China. The difficulties faced by New Balance at the hands of a Guangzhou businessman, Mr. Zhou Lelun, are the latest example.

In this case, New Balance was successfully sued for trademark infringement for using the Chinese mark "新百伦" (Xin Bai Lun, being the Chinese character mark which New Balance used as an equivalent for New Balance) and was ordered to pay a record breaking 98 million yuan (nearly US$ 15,000,000) in damages. This amounted to half the total profits New Balance had generated during the period of infringement (November 2011 to November 2013).

How did New Balance come to be sued for (and to have to pay record breaking damages) the use of its "own" mark in China. Some background is required. Zhou Lelun obtained a registration for "百伦" (Bai Lun) in 1996, well before New Balance entered the Chinese market in 2006. When New Balance launched in China, it applied to register the mark "NEW BALANCE" but failed to apply for a Chinese equivalent. Over time, both Chinese consumers and New Balance began referring to New Balance using the Chinese mark "新百伦", which was the same as Zhou Lelun's earlier registration but with the addition of the Chinese character "新".

In 2008, Zhou Lelun applied to register "新百伦". New Balance filed opposition proceedings against this application. The Guangzhou Intermediate Court in rejecting New Balance's opposition, ruled that "新百伦" was not the literal translation nor the only translation available for New Balance, especially because New Balance had used different versions like "纽巴伦" and "新平衡" in relation to its products. It was also held that the well-established status of the trademark "New Balance" was irrelevant towards whether the use of the trademark "新百伦" had been infringed. New Balance did not further appeal the Guangzhou Intermediate Court's decision. As a result, Zhou Lelun successfully registered the mark "新百伦".

In 2013, Zhou Lelun promptly sued New Balance for infringing his registered mark "新百伦". A key factor in the record breaking damages award was that the Court considered that New Balance was using the trademark "新百伦" in bad faith because it continued to use the mark despite failing in its opposition.

The key lessons all brand owners should learn from this case are as follows. Firstly, the 'first to file' principle (ie the principle that whoever files for a trademark first in China secures it) continues to be a key plank of Chinese trademark law with only limited exceptions. Secondly, given the first to file principle, when entering the Chinese market, brand owners should devise a Chinese language mark for their brand and promptly register this mark. Thirdly, consistency is key: one of the big problems which New Balance faced in the opposition to " 新百伦" was that it had used three different Chinese marks, "新平衡", "纽巴伦" and "新百伦" for its products and had switched between them. New Balance therefore unable to show that its products are associated with a single Chinese name. Fourthly, brand owners should be aware that every failed opposition is a potential infringement case in the making. Furthermore, the failed opposition can be used as evidence of bad faith if the failed opponent continues to use the mark. Brand owners with similar problems should mitigate the risk of infringement or face the risk of significant damages.

CHINA'S CAMPAIGN AGAINST ONLINE COUNTERFEIT GOODS

As further evidence of China's intent to shed its reputation as a hotbed of IP infringement, China's State Administration of Industry and Commerce (SAIC) launched its 'Red Shield Net Sword' campaign, aimed at tackling counterfeit goods sold over e-commerce platforms. The campaign was launched after the SAIC publicly criticized Alibaba's failure to scrutinize counterfeits sold through its website.

This campaign enabled easier identification of infringers (since online store operators are required to show their business licence information online); more effective enforcement of IP rights through administrative complaints; an increase in inspection and regulation of online store operators and greater deterrence (administrative authorities will publish the identity of infringers and details of punishment decisions within 20 working days of the decision). According to the State IP Office's press release in December 2015, China handled nearly 4,000 patent infringement cases involving e-commerce in the first 11 months of 2015.

China's 4th draft amendment to the Patent Law A new draft on the PRC Patent Law, released on 1 April 2015, proposes to introduce significant changes. These include:

- Restricting situations under which employers can claim ownership over an employee's work: Under the amendments, employers will only have the right to claim ownership over an employee's work if such work was made for the execution of work assignments. Despite this limitation, an employer can still contractually agree with an employee to claim ownership over any work or inventions created by an employee during the course of that person's employment. However, if the employer has entered into such a contractual agreement with the employee who invented the work in question, the amendments require the employer to reward the employee after the right to file for patent has been granted to the employer and pay a remuneration to the employee upon exploitation of the work in question. What is considered as an appropriate type of reward and remuneration remains to be specified by government agencies. However, once clarified, businesses will need to establish a suitable reward and remuneration program to ensure compliance.
- Individual components can be patented: Currently, an individual component or part of a product cannot be patented. This inconveniences companies that specialize in making innovative elements that form components of a design, such as smart phones. This also condones the copying of certain portions of a design without legal consequences. The amendments will allow an industrial design made for either the overall or the partial appearance of a product to be patented. Businesses should review their design portfolio and register the ones that could benefit from being patented as an individual component to a design.
- Extension of term: the term of design patents are proposed to be extended from 10 years to 15 years.
- Lower burden for proving damage: the lack of automatic discovery in civil proceedings in China means that patent holders are unable to access the infringing party's financial information and therefore have difficulty in proving the actual losses suffered as a result of the infringement. The amendments will give courts the discretion to order the infringing party to disclose its financial accounts relevant to the infringement if the patent holder cannot prove its loss.
- Internet Service Providers will not be liable: Internet service providers will be exempted from liability for patent infringement if, upon notice that users are conducting infringing activities on their sites, they immediately terminate or screen access to the infringing products.

- Increased enforcement powers and streamlining of decision making process: The amendments propose to increase the enforcement powers of the State Intellectual Property Office and require the patent administrative authority to register and publish its decision declaring whether a patent right is affirmed or invalidated immediately upon making such a decision.

Introduction of the Provisions on Prohibition of Abuse of IP Rights to Eliminate or Restrict Competition (IPR) Regulation.

On 1 August 2015, the IPR regulation came into force as the first IP specific antitrust regulation in China. The IPR regulation are aimed at prohibiting businesses in a dominant market position from abusing such dominance and hindering competition. To achieve this, the IPR regulation introduces the following restrictions:

- Horizontal and vertical agreements between businesses that restrict competition are prohibited unless conditions regarding the combined market share of the contractual parties and the availability of substitutes are met
- IP owners are required to license their IP rights under reasonable conditions if the IP in question is 'essential' based on three factors: (i) lack of reasonable substitutes and the IP is indispensable for the licencee to compete in the relevant market; (ii) the refusal to license has a negative impact on competition or innovation in the relevant market; and (iii) the licence will not cause unreasonable harm to the licensor, and
- Businesses in a dominant position are not allowed to include certain contractual clauses such as exclusive grant backs to improved technology, no challenge clauses and non-compete clauses without valid justification. What constitutes a valid justification remains to be clarified.

The IPR regulation complement China's maturing IP regime and reflect similar legislation in other countries, all of which aim to place limits on the use and exploitation of IP where businesses are in a dominant position and the effect is to hinder competition.

WHAT TO EXPECT IN 2016

As in previous years, China will be a significant source of new IP developments in 2016. It would be sensible to bet on the Chinese authorities extending the 'Red Shield Net Sword' campaign throughout 2016 and beyond. The online marketplaces will continue to face scrutiny from brand owners over combatting fakes on their websites. Whilst problems of brand 'piracy' will continue, it is expected that 2016 will show an increasing number of successful cases in which brand owners defeat brand pirates in China, although much will depend on the facts of each case and what steps brand owners would have taken to protect their position. In Hong Kong, with the Legco still deadlocked over the Bill, there is a good chance that the Bill will eventually be passed but only once safeguards to protect free speech are written into the Bill.

AUTHORS

Edward Chatterton
Partner, Hong Kong
T +852 2103 0504
edward.chatterton@dlapiper.com

Lam, Horace
Partner
Beijing
T +86 10 8520 0600
horace.lam@dlapiper.com

Yan Zhao
Partner
Shanghai
T +86 21 3852 2166
yan.zhao@dlapiper.com