China joint ventures: an eight-point guide to success

Sino-foreign joint ventures are the most popular way to access the Chinese market, but business owners should beware the traps that lurk every step of the way

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China is a lucrative market for many foreign businesses looking to expand on a global scale. The country boasts a projected disposable income of $8,000 per household by 2020 – doubling the figure from 2010 in just a decade. This growth demonstrates the immense potential of Chinese consumers and the future opportunities for foreign brand owners.

There are many ways for foreign businesses to gain a foothold in China. Sino-foreign joint ventures are by far the most popular, due to the vastly different landscape of the Chinese market, which can be difficult to traverse for new investors. Foreign brand owners can also appoint local licensees or distributors to help explore unfamiliar markets. Alternatively, they may wish to appoint franchisees. However, since franchising activities in China are subject to considerable, strict regulatory requirements, this may not be the preferred route. No matter which form it takes, Sino-foreign cooperation is not void of risk – especially with regard to trademark protection, which can give rise to various disputes and difficulties if not handled properly.

Since the third amendment to the Trademark Law came into force in 2014, it has become easier for foreign applicants to register and enforce their trademark rights in China. Further, there is now strict adherence to a nine-month registration period, which would have taken around 15 to 18 months before the amendment. The law explicitly upholds the principle of good faith and clarifies and strengthens the protection of well-known marks – owing to the prevalence of so-called 'trademark squatters', who aim to sabotage the IP rights of well-known overseas brands.

Despite the government's efforts in improving trademark protection, trademark squatting remains rampant in China. Thus, foreign businesses must learn to safeguard their interests before entering the Chinese market. Many companies set out to expand their brands or well-known products into the Chinese market, believing that their trademarks will be protected as they are in other jurisdictions, only to discover (much to their dismay) that trademark squatters have already registered their brand names or, worse, that local partners have adopted their trademarks. Numerous brand owners have been known to engage in lengthy legal battles over trademark-related disputes and, in some cases, never retrieve ownership of their marks.

STEP 1

Ensure your trademark portfolio is in order before discussing cooperation

In 2013, the Supreme People's Court ruled in favour of Italian company Bianchi Vending Group, whose trademark was registered in China by Xu, the owner of its joint venture partner, Changzhou Vending Equipment Ltd. Bianchi and Changzhou established a joint venture in 2001. Although Bianchi had registered its trademark in Italy, it did not apply to do so in China until 2003. In 2004, Bianchi discovered that Xu had already registered the mark in China and immediately demanded the re-assignment of the registration. Xu flew to Italy to sign the assignment documents, purportedly transferring the registration to Bianchi; however, he failed to complete the assignment formalities and instead assigned the registration to his wife, Zhou. Bianchi eventually commenced legal proceedings and – after losing in the first two instances – appealed to the Supreme People's Court, which held that Bianchi was the rightful owner of the disputed mark. Further, the court held that the defendants' behaviour constituted malicious collision and that Xu's "rush to register" violated the principle of good faith. Although Bianchi recovered its trademark eventually, it took almost 10 years to do so.

The Supreme People's Court found in favour of Bianchi despite China's 'first-to-file' principle because of the defendants' obvious bad faith. However, in most cases, SIPO and the courts will adhere to this principle.

The Chinese trademark system adopts a first-to-file, rather than a first-to-use regime. This means that the applicant which applies for a trademark registration first will have priority over other applicants. Because of this system, it is essential that foreign companies obtain their trademark registration as soon as feasible – before discussing any cooperation arrangements with potential partners in China. In fact, companies should do so before making any plans to expand into the Chinese market.

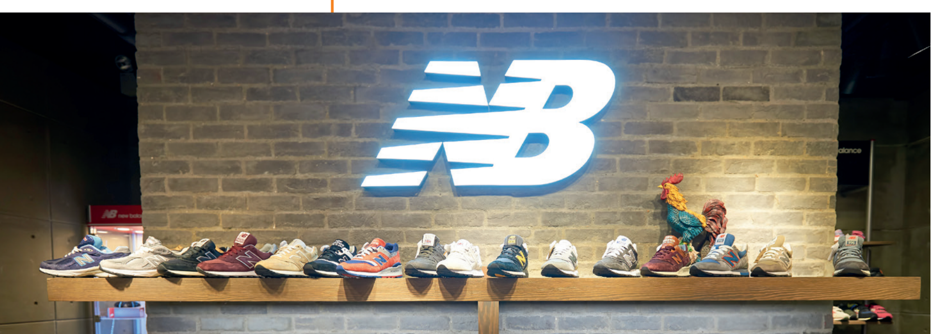
STEP 2

Adopt and register a Chinese name or trademark before entering the market

Chinese names

A case involving trademark infringement claims brought against New Balance is a key example of how a brand owner may lose its rights in a mark in a local language under the first-to-file system.

In 2015, the Guangzhou court ordered New Balance to pay $15.8 million in damages to Chinese resident Zhou, who had registered the Chinese translation of New Balance – '新百伦' (XIN BAI LUN) – as a trademark. The court ruled that New Balance had infringed Zhou's registration, as he acquired the Chinese trademark before New Balance under the first-to-file system. New Balance appealed the decision but the higher court upheld the ruling – despite lowering the damages to $750,000.



The New Balance case shows that brand owners should not overlook the importance of registering their Chinese name

PICTURE: SORBIS/ SHUTTERSTOCK.COM

The New Balance case shows how crucial it is to register a brand's Chinese name. After all, most Chinese consumers recognise famous brands by their local Chinese name. Further, brands such as Nike and Coca-Cola have successfully adopted Chinese names that are not merely translations or transliterations, but rather connote meanings that align with the brand's image (eg, "patience and conquer" in the case of Nike and "tasty and joyous" in the case of Coca-Cola). A strong combination of translation, transliteration and creative adaptation can help to boost a brand's popularity in the local market. However, the following examples outline some of the problems that brand owners may face with regard to Chinese names.

PICTURE: TONYV3112/ SHUTTERSTOCK.COM

Hermes would never have imagined the vast costs of recovering the name '愛馬仕', which was registered by a third party in China

Hermes, one of the most popular luxury leather goods brands in France, would never have imagined the costs, time and struggle that it would have to endure to recover the distinctive Chinese name '愛馬仕' (ÀI MǍ SHÌ), which was already registered in China by another party. Indeed, the dispute would have been avoidable if Hermes had diligently registered its Chinese mark well in advance.

Basketball superstar Michael Jordan also fell victim to trademark squatting problems when his Chinese name, '乔丹', and its Mandarin transliteration QIAODAN were used as trademarks by Chinese company Qiaodan Sports Co Ltd. Jordan spent years pursuing Qiaodan, which had owned a number of registered Chinese trademarks – including '乔丹' and QIAODAN – since 2000. In 2012, Jordan sued Qiaodan for infringement of his name rights, but the Trademark Review and Adjudication Board, the Beijing No 1 Intermediate People's Court and the Beijing High Court did not share the same view. Jordan had to bring the case all the way to the Supreme People's Court, but the registration of Qiaodan's '乔丹' mark was removed only after Jordan could establish that his Chinese name was well-recognised in China and clearly associated with him personally. The basketball star was unable to recover the English transliteration QIAODAN, as the court found no established link between the transliteration and Jordan himself.

Castel Freres SAS was equally unlucky when it lost the rights in its Chinese trademark under the first-to-file system. Castel had been using the trademark '卡斯特' (KǍ SĪ TÈ) on wine products since August 1998, but had failed to register the mark in China. In September 1998 a Chinese company applied to register the Chinese mark and ownership was later transferred to an individual. Castel tried to deal with the matter through negotiation and administrative proceedings, including non-use cancellation and invalidation actions, but without success. Castel continued to use the Chinese mark and, in 2009, the owner sued Castel and its distributors for trademark infringement. After losing in the first instance and subsequent appeals, Castel ultimately decided to change its Chinese mark.

By adopting a Chinese trademark well in advance, brand owners can choose one that is meaningful and appropriate for their products. This also helps to avoid having unflattering nicknames attributed to their products by local consumers.

Unflattering nicknames

Peppa Pig is a children's TV series featuring a female pig named Peppa. In Hong Kong, the main character is widely known and recognised as "Peppa". Similarly, in Taiwan, she is known as "佩佩豬" (*Pei Pei Zhu* – the transliteration for Peppa Pig). However, in China, Peppa Pig is known by a number of names, including "小猪佩奇" (*Xiao Zhu Pei Qi*, meaning "little pig Peppa"), "粉红猪小妹" (*Fen Hong Zhu Xiao Mei*, meaning "pink little girl pig") and "粉红猪" (*Fen Hong Zhu*, meaning "pink pig"). Indeed, the latest addition to the list is "吹风机猪" (*Chui Feng Ji Zhu*) – which means "hairdryer pig" due to the shape of the character's head. Most of these nicknames have been attributed by the public; therefore, they are not the official Chinese brand name.

Moreover, while some nicknames may be amusing, they can be demeaning to a brand's reputation. If a trademark squatter files a trademark application for an undesirable nickname closely related to a specific brand, it is possible that the brand owner will not be able to oppose the registration due to a lack of prior right and prior use in China.

Even where brand owners have properly registered their Chinese names as trademarks, they should still regularly monitor the market and be alert to any new translation or nickname adopted by the public. In such cases, they should try to eliminate the nickname from use or immediately file an application to register the mark for defensive purposes.

STEP 3

Review your trademark portfolio regularly and establish an effective monitoring system

Registering a trademark in only one or a few classes of goods or services may not ensure adequate protection, since the remaining classes are still susceptible to trademark squatters. Therefore, registering a mark in as many classes as are affordable and practical will best protect a brand owner's intellectual property. This also applies to sub-classes – the importance of which is often overlooked as sub-classification is unique in China.

The 2013 *G2000* case is a typical example of this. The case involved two similar trademark registrations in different sub-classes. In 1992, the G2000 Group registered the trademark G2000 in Class 25. However, in 1997, another applicant registered the trademark 2000 in Class 25, as well as a sub-class that the G2000 Group neglected to cover. As a result, in 2013, the Beijing Municipal High People's Court ordered that the G2000 Group pay Rmb12 million in damages for infringement of the 2000 mark. To avoid similar cases, companies should be aware of the importance of registering trademarks in all the classes and sub-classes that may be relevant to their business.

Indeed, another brand with an unquestionably well-known mark in Hong Kong and growing exposure in China recently reported that, due to expanding business and growing reputation, an increasing number of parties have been applying to register its trademarks in multiple different classes. With one such party having used the mark in a different field in China for over 10 years and having accrued close to 300 trademark registrations and applications in China alone, any dispute will be difficult for the well-known brand.

STEP 4

Find the right partner

Apart from ensuring that all trademarks have been properly registered in China, foreign brand owners should also endeavour to find the right partner – whether as their joint venture partner, licensee, distributor or franchisee. Local partners with local market knowledge and distribution networks can assist with a smoother entry into the Chinese market. Moreover, partnering with a Chinese business that has a well-established customer base, business intelligence and, crucially, an affinity with the local business landscape can be the difference between failure and success for overseas brands.

Nevertheless, foreign brand owners should be careful not to rush into a relationship. Instead, they should conduct extensive due diligence not only on the target partner, but also on the controlling individuals. Local offices of leading business consultancy companies should maintain a stronger and more China-focused database with pertinent and in-depth information on the credit status, reputation, market ratings, past projects and credentials of the local company and its controlling individuals. Further, brand owners can develop an understanding of a local partner by visiting its factories and offices – talking to the local staff, where possible. In addition, the partner's postings and connections on China's leading social media platforms, such as Weibo and Weixin, can offer an idea of its recent activity, as well as its performance and strength. Reviewing press releases or reports on the company will also be beneficial.

Foreign brand owners should take the time to meet with local partners and discuss their business strategy. Aside from conducting due diligence from a legal perspective, this will help to establish a long-term relationship if the parties have the same vision and objectives. A good translator, who understands the industry and the terminology used, will be key to avoiding any mistranslation or miscommunication during discussions.

STEP 5

Clarify what is being contributed and how

In a licensing, distribution or franchise arrangement, foreign brand owners need not part with their ownership of a trademark.

However, if the parties are entering into a joint venture, the question arises over whether the brand owner should confer its trademarks and any other intellectual property to the joint venture by way of an assignment or licence. The appropriate strategy will depend on the need of the joint venture, the capital injected by the local partner and the agreement of the parties. Once the trademark has been assigned, ownership and control will be transferred to the joint venture. Therefore, brand owners should think carefully before agreeing to assign their trademarks to such a venture.

$8,000 Projected disposable income per household in China by 2020

STEP 6

Establish clear contractual protection

No matter how amicable the negotiation has been, there must be a written agreement which clearly sets out the rights and obligations of both parties, as well as their respective ownership and interest in the business and associated rights, including IP rights. Business owners generally dislike long legal documents. However, the parties should not compromise their position by simply relying on trust, and should make no assumptions without clarifying the parties' rights and obligations, as these can fall apart the moment that the relationship turns sour. To avoid disputes, it is important to have a well-written agreement between the parties. In particular, the agreement should contain appropriate terms governing the use of the relevant trademarks. Indeed, the brand owner should retain control over the use and registration of their marks.

> "Brand owners should seek legal advice to ensure that no terms in the agreement are contrary to local law – no matter which governing law the parties agree to

The following terms must be included in any licence agreement for the relevant marks:

- whether the licence is exclusive or non-exclusive;
- whether the licence is exclusive or sole – if the intention is that the brand owner will retain the right to use the licensed trademarks, the licence granted is a sole licence;
- the licensed territory – unless the right granted is to operate a franchised store or restaurant in a particular city, the licensed territory is usually the whole of mainland China. Although Hong Kong and Macau are part of China, they are special administrative regions with separate legal systems; therefore, the licensed territory should specifically exclude Hong Kong and Macau if necessary;
- any restriction on use of the trademarks by the licensee – for example, the licensee or distributor should be restricted from using or registering another mark in relation to the licensed products. In a previous case, a brand owner's distributor adopted a Chinese mark for the licensed product without prior consultation with, and approval of, the brand owner, before registering the mark in its own name. If there had been appropriate terms in the distribution agreement restricting the distributor from distributing the products under any other trademarks in any language, the brand owner would have had recourse against the distributor; and
- ownership of any new trademarks adopted by the joint venture – this is negotiable between the parties. If the new trademark is a combination of the licensed mark and a new element, it is reasonable to provide that rights in such a mark should belong to the brand owner, rather than the joint venture, unless it has been specifically assigned to the joint venture.

Even if a brand owner agrees to assign its trademark to the joint venture, there should be terms governing use of the mark, which allow the brand owner a degree of control in order to preserve the brand's reputation. Further, it should be clearly stated under what circumstances the trademark will be re-assigned to the brand owner.

The parties are free to choose the governing law and jurisdiction to deal with any dispute that may arise. Arbitration awards are generally enforceable in China, provided that the decision is not contrary to public policy or Chinese law. Therefore, brand owners should seek legal advice to ensure that no terms in the agreement are contrary to local law – no matter which governing law the parties agree to.

STEP 7

Protect new brands

As well as securing protection for core brands, in the course of cooperation, foreign brand owners should also keep an eye on new names, logos and designs with the potential to grow in value, and should register these before it is too late. Logos and designs that are likely to encounter obstacles upon registration (eg, lack of distinctiveness or marks containing a country name or state reference) may be protected by way of copyright registration or recordal – which is less restrictive and subject to fewer rules.

STEP 8

Be aware of the growing power and effect of social media

China's growing number of educated consumers with a strong awareness of the latest trends commands special attention. Smart activity through social media platforms, such as WeChat, Weibo and Douyin, can generate positive exposure of a brand or a new product – thus increasing the likelihood of success.

Conclusion

China is a vast market with valuable opportunities for foreign businesses. However, it is crucial that brand owners ensure all trademarks and their local-language equivalents are properly registered before attempting entry into China. The ultimate rule is to be prepared, expect the unexpected and think outside the box. WTR

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