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14th) and Pescara (June 18th).

As far as the content of the present newsletter is concerned, we wish to introduce some updated and interested information about distributions and franchising in China. Indeed there is a certain risk that distribution agreements are qualified as franchising contract, especially in case there is a uniform business model, which might lead to sanctions for the parties involved.

Enjoy reading our CHINA GOSSIP and if any clarification is needed do not hesitate to contact us.

Dear Readers,

It is conference time in the IP world!

INTA confirmed to be the major event in the IP world. Thousands delegates gathered in Dallas, Texas from May 5 to 9. HFG joined the event with a delegation composed by three members. Beside INTA, many conferences will be held in June and among these we remind you IPBC (Boston, US 9-11 June), China IP Symposium (Xi An, China 15-17 June), ECTA (Bucaresti, Romania 19-21 June), LES pan european conference (Davos, Switzerland 23-25 June). HFG members are joining the latter three, drop us an email if wish to meet us. Moreover, please be aware that a delegation from HFG is travelling to Italy where a seminar + cocktail party is organized in Milan on June 13th "Breaking the Myths of Intellectual Property in China". HFG members are then participating as speakers in two conferences in Florence (June

NEWS

Cartier sues China's online shop for infringement

Cartier – set up in 1847 – has always been one of the world's top luxury brands.

Because of its well-known reputation, Cartier is often target of unfair competition worldwide.

PRC company Mengkela sells its own jewellery products through the famous online shopping platform Yihaodian, which is run by Shanghai Yishiduo E-Commerce Co., Ltd.

Mengkela promoted its products on such platform by making various referrals to Cartier, such as «*Cartier classic crown diamond ring*» etc... Cartier discovered this unfair practice in August 2011 and decided to file a suit against both Mengkela (the direct infringer) and Yishiduo (the platform provider) for trademark infringement.

Yishiduo claimed not to be responsible for Mengkela's actions, based on its nature of web service provider for platform Yihaodian.

On the other hand, Mengkela claimed that the description «*Cartier classic crown diamond ring*» can not be considered as trademark infringement. Shanghai Pudong District People's Court stated that both Mengkela and Yishiduo unfairly mentioned «Cartier» on the products' advertisement, thus exploiting Cartier's reputation to attract visibility and prestige.

This decision is particularly important as it states the provider's joint responsibility for IP infringement carried out on its platform.

Therefore, the court ordered the two defendants to pay damage of 130,978 RMB for infringement of Cartier's trademark.

(Source: www.cipnews.com.cn)

Pharmaceutical industry in China: hot issues and update from HFG staff

HFG's Helen Wang (patent attorney specialized in chemical and pharmaceutical industry) and Nicola Aperti (foreign counsel) participated to Pharma-Legal Affairs Asia 2013, held in Shanghai from 21-23 May.

The 3-day event was representatives of major pharmaceutical as well as of many Asian SME.

The seminar has underlined how Asia is becoming the crucial market for the pharmaceutical industry, and has discussed some of



the hottest issues faced by multinational companies as well as SME moving their business focus on Asia.

Stringent regulation in the key emerging markets (China, India, ASEAN) impacts the strategy of international companies. While the biggest players establish plants in these areas, most SME cannot and therefore opt for import of their drugs into Asia or cooperating with local partners.

Asia – except Japan and Korea – still remains mainly a generic-drug market, therefore IP litigation for patent breach/invalidation is on the rise, and is already affecting some of the biggest MNC.

While India already has seen compulsory licensing of patented drugs to generic companies, China so far has not and may pursue in this way, as it aims to become a world leading country in pharmaceutical innovation. However, China *de-facto* does not guarantee data exclusivity.

Corruption (mainly in India and China) also becomes more and more an issue, especially for the US- and EU-listed companies which, risk heavy fines in their home jurisdiction and even reputation damage.

Despite the risks related to the level of IP protection, technology transfer is more and more chosen as the “affordable” way that SME can enter Asian markets. However, regulation – especially in China - determines which kind of technology can be imported and which cannot. Antibiotics, vitamins, vaccines, blood products still require partnership with local Chinese company. When partnering with and transferring technology to Chinese State-owned company, such technology can be considered state-assets, which means that re-exporting or re-transferring it to foreign entities may require governmental special authorizations.

R&D is also moving more to Asia, both as indigenous R&D and as international companies outsourcing R&D to local Asian CROs.

Pharmaceutical industry can be encouraged (biotech R&D, manufacturing), restricted (antibiotics, narcotics, vitamins, calcium, vaccines, blood products) or prohibited (stem cells, TCM, some diagnostics and therapeutics), according to specific activity and products

In order to get around restrictions for stem-cells, foreign companies may try to outsource to local CRO. If the service agreement gives too much control to foreign investors, this can be re-qualified as foreign investment into a forbidden industry.

Swarovski wins a battle against a Shanghai company for trademark infringement.

The famous jewelry company from Austria specialized in crystal products, Swarovski, won a

first instance decision about trademark infringement and unfair competition in Shanghai against Shanghai Swalro Wedding Dress Company. Swarovski, which registered SWAROVSKI and 施华洛世奇 trademarks in China in 1980's, claimed that Swalro, a company established in 2004 for the manufacturing of dresses, used 施华洛, 施華洛, and SWALRO labels not only for its wedding dresses but also for its promotional material.

The Court held that this action has substantively damaged the exclusive use of Swarovski of the trademark 施华洛世奇 and it has condemned the use of the Swarovski name by Swalro in advertising material like «*Swalro wedding dress, together with Swarovski crystal, to lead a luxury fashion in wedding dress* »

In China, Swarovski gained a prestigious image and a very good reputation among the consumers and both its trademarks SWAROVSKI and 施华洛世奇 have been identified as well-known trademarks in 2009. According to the Shanghai No.2 Intermediate People's Court, Swalro must have been aware of Swarovski's visibility and took specific advantage of the influence of the famous company for its own business activities or commercial advertising.

Therefore, the court assumed that the existence of Swalro can have a negative effect on Swarovski's market, which constitutes not only an infringement to Swarovski trademarks but also unfair competition

The court ordered Shanghai Swalro to cease the trademarks infringement, make a compensation of 280,000 RMB in damages and eliminate all negative effects.

(Source: www.cipnews.com.cn)

Chinese store WOWO faces a national flag trademark issue with Thailand

WOWO, a Chinese-owned convenience store located in Chengdu, registered a three-color stripe (orange, blue and white) logo as trademark in 2010, though it was already in use since 2005.

Two years after its registration, Thailand IP office found that the logo was too similar to Thailand national flag and applied at the Trademark Office (TMO) for the cancellation of the trademark.

TMO agreed with Thailand IP Office's request and decided to cancel the WOWO trademark on the grounds of similarity to Thailand national flag based on colours and design used. The decision

of TMO has been later confirmed by the Trademark Review and Adjudication Board (TRAB).

However, the founder of WOWO, Tang Yaohua, decided to bring the case to Beijing No.1 Intermediate People's Court which recently heard the case. According to his claim, his logo is only a representation of the spirit of the brand and the colours orange, blue and white are considered very popular in 24-hour stores' business. Moreover, orange colour is not present in Thailand flag and the position of the colours in WOWO's logo is different from the Thailand flag.

Besides, the decision made by TMO and TRAB did not take into consideration the criterion of confusion. In fact for a trademark to be considered similar to another, it is necessary that the similar one creates confusion among the public according to WOWO's attorney.

But in this case, in WOWO founder's opinion, no confusion is caused because Chinese customers are not familiar with Thailand national flag. Moreover, the Court should consider the long term reputation and the market practice before cancelling a registered trademark.

The judgement for this interesting case is expected in the coming months.

(Source: www.chinaipr.gov.cn)



The existence of Swalro can have a negative effect on Swarovski's market.

SPECIAL SECTIONS

PRACTICAL TIPS: What Copyright means in China

China Copyright Law protects works of literature, art, natural sciences, social sciences, engineering and technology created in any forms of written, oral, musical, dramatic, choreographic and acrobatic works, works of fine arts and architecture, photographic works, cinematographic works, graphic works, computer software; and other works by law. (Art. 3rd of Copyright Law)

IP SCHOOL: Who owns the copyright?

The creator has the copyright of the work created. The ownership of the copyright in a commissioned work shall be agreed upon a contract entered between the commissioning and the commissioned parties. In the absence of such a contract or an explicit agreement, the copyright belongs to the commissioned party. (Art. 17th).

Copyright could be licensed or transferred by concluding a written contract. The licensee or transferee may not, without permission from the copyright owner, exercise any right that is not explicitly licensed or transferred. (Art. 27th).

DISTRIBUTION VS. FRANCHISING: RISKS OF REQUALIFICATION OF THE CONTRACT

Retail market in China is growing very fast. More and more international companies open stores in China, in first-tier cities as well as in second/third-tier. While most major brands nowadays open directly-owned stores, many SMEs in medium market segments still prefer to rely on local distributors' resources, network and experience of the local market.

Still, one of their main concerns is how their brand is managed by their PRC distributors.

A long list of brands whose reputation has been ruined by local distributors' management is long.



That is why, more and more, distribution agreements provide for a tight control of the distributor's activities by the principal.

For example, the latter often pre-approves or provides store concept, the visual merchandising, the advertising campaign, the sales staff uniform, etc.

While increasing the level of details can prevent brand-management problems, this opens the gate to a critical question: is the foreign brand simply providing its products, or is it actually providing a business model that needs to be uniformly and strictly implemented?

The answer has deep legal and practical consequences. In fact, if the foreign brand actually provides a business model, its activity may be re-qualified as franchising rather than mere wholesale distribution.

This may turn out to be a problem, as franchising in PRC is allowed only under specific conditions, failing which foreign players risk heavy sanctions.

Therefore, how can a foreign brand understand whether its distribution activities in China risk to be qualified as franchising?

Franchising – Regulation and sanctions

Franchising is defined by art. 3 of *Regulation on the Administration of Commercial Franchises* (the "Regulation"), which were promulgated by PRC State Council in 2007, as "... the arrangement whereby a company who owns business resources such as trademark, trade name, patent and know-how, through the execution of a contract, grants a franchisee to conduct business activities with its business resources under a uniform system according to the contract and the franchisee pays franchise fees to the franchisor".

In an interview released to the press on February 16, 2007, officials from the Legal Department of the State Council expressed their view that franchising as such consists of four elements:

- (1) The franchisor is a company who owns business resources such as trademark, trade name, patent, and know-how;
- (2) Franchisee's use of the business resources is under a uniform system stipulated in the franchising contract;
- (3) The relationship between the franchisor and franchisee is contractual; and
- (4) The franchisee pays franchise fees to the franchisor.

In order to avoid an abuse of the franchising business model, PRC Law provides entry-requirements for franchisors.

Basically, only entities who comply with the following conditions can operate as franchisors:

They shall have a business scope including "franchising" (art. 3, *Administrative Measures on the Investment in the Commercial Field by the Foreign Investors of the People's Republic of China* effective from 1 June, 2004);

It shall own at least two direct stores which have conducted business for more than 1 year (art. 7, Regulation). These shops can also be located abroad.

Within 15 days after having signed a franchise contract, a franchisor shall report it to the commercial administrative department for archival filing (Article 8, Regulation).

This registration can prove a time consuming, as a long list of documents is required (Article 5 of *Administrative Measures for Archiving Commercial Franchises*):

- basic information on the commercial franchise;
- information on all the stores of the franchisee within China;
- the franchisor's commercial prospectus;
- one copy of the business license of the enterprise as legal person, or one photocopy of other qualification certificate;
- copies of registration certificates of trademark right, patent right and other business resources;
- evidence of 2 directly-owned retail stores operating for more than 1 year;
- catalogue of franchising operational manual;
- franchisor's commitment letter signed and sealed by the legal representative.

It normally takes around 4 months to complete the registration. Franchisors that operate without having the "two shops requirement" can be confiscated of all illegal gains and fined between

100,000 RMB to 500,000 RMB.

Violation of archiving obligation may lead to a fine between 10,000 RMB to 50,000 RMB.

to prevent risks, foreign companies should assess the real nature of their distribution agreements

Judicial interpretation concerning commercial franchises

Despite the definition provided by the Regulation, when dealing with extremely complex agreements it may not be crystal-clear distinguishing their nature - franchising or than ordinary distribution.

Interpretation by courts becomes then a very important criterion.

In order to address this issue, in 2011 the High Court of Beijing Municipality issued the *Guiding Opinions on Several Issues Concerning the Application of Law in the Trial of Disputes over Commercial Franchise Contracts* (hereinafter referred to as “*Judicial Interpretation*”).

“Business resources” (as defined under article 2 of the Judicial Interpretations) include registered trademarks, logos, patents, names, trade secrets, overall business images with unique features, unregistered trademarks which have been firstly used and formed certain influence, and other business resources that may form certain advantages in market competition.

At the same time, also the Intellectual Property Tribunal of High court of Beijing Municipality issued a report regarding the trial of disputes over commercial franchise.

The report refers to three kinds of contracts: sales contract, license contract and franchise contract.

According to the report, sales contract or license contract only involve sales of products or license of intellectual property rights; supervision, management, training, technology support are excluded.

On the other hand, a franchise contract is defined as the combination of sales of products, intellectual property rights license and uniform business system.

In other words, if the contract does not involve any uniform business system, it should be regarded as license contract or sales contract. Franchise fees may not be a mandatory element in order to ascertain a franchising scenario, as those could be waived by the franchisor. Thus, if there are no specific provisions about the payment of franchise fee, it shall be deemed that the franchisor has waived such right and this does not affect the qualification of the contract as franchise.

Finally, we can mention the interpretation on franchising - provided by Judge Xie at Guangxi Higher People’s Court – whereby a franchising contract shall contain the following elements to differentiate from other types of contracts:

A) First, the franchisor licenses patent or know-how to the franchisee and provides necessary trainings to use the technology, instructions on how to manage the business and technical assistance. This is the most important difference from other contracts such as agency, distribution and sales.

Franchising can be structured as “*Product + Trademark*” or “*Product + Business model*”. In a typical sales contract, the trademark is attached to each and every product. They constitute an inseparable subject. However, in a “*Product + Trademark*” type franchising, products and the trademark are separately used.

The purpose of a sales contract is to sell the product while the purpose of a franchising contract is to manage the brand.

B) Second, a uniform business model is agreed and the franchisor provides follow-up services to the franchisee.

Unification and standardization is another major element of franchising.

A uniform business model reflects for example on: the decoration of the storefront;

combination of services and products and the standard;

classification of consumers and targeted consumers;

the standard to choose the location of the storefront; and

basic structure and management system.

Last, typical follow-up services include technical support, business training, distribution and delivery, advertising and publicity, after-sale service, etc.

Remember: it does not matter whether the contract is expressly named “*franchising contract*” or whether there is a franchising fee clause in the contract. The nature of the contract calls.

So far, the cases whereby distribution contracts have been re-qualified in franchising are still few. However, changes in China can happen very fast. If the authorities will decide to enforce the regulation and re-qualify the contracts, companies may need to update their business scope in order to include franchising. To prevent these risks, foreign companies should frankly assess the real nature of their distribution agreements, and organize accordingly their PRC structure.

written by Nicola Aporti, HFG Foreign Counsel

HFG NEWS



Breaking the myths of Intellectual Property on China

HFG is glad to invite you attend a seminar and cocktail party to be organized in Milan on 13th June 2013 at the Sheraton Diana Majestic Hotel. For the first time in Italy, this seminar will provide attendees with a concise road map of business related Intellectual Property issues in China. Moreover, our speakers will prove how the information asymmetry and legal and cultural differences created several myths. To attend the seminar, please send an e-mail to rsvp@hfgip.com by 7th June. For more information, please click [here](#).

HFG Staff will host a workshop in Florence

Nicola Aporti, Foreign Counsel at HFG, will be one of the speakers at the forthcoming workshop “*Practical Guide for the Italian companies to make business in China*”. The workshop will be held in Florence, Italy, on 14th June 2013, and it is organized by the European School of Economics. The workshop aims at analyzing the new trade opportunities and the protection of Intellectual Property rights in China with reference to the new Five-Year Plan. For more information about the workshop, please click [here](#).

HFG delegation will attend ECTA and LES in Europe

We'd like to inform you that HFG delegation will attend the two conferences to be held in Europe in the next weeks. Our partners, Bian Jun and Fabio Giacobello will attend ECTA Annual Conference on 19th-22nd June in Bucharest, Romania. Giacobello will then move to Davos, Switzerland, to attend the LES Pan-European Conference to be held on 23rd-25th June. If you want to meet us, please feel free to write an e-mail to hfg_china@hfgip.com

HFG Staff will attend the China Intellectual Property Symposium in Xi'an

Patent Attorney Ms. Julie Zhao and Intl. Relations Executive Ms. Ottavia Curcuraci will attend the 2013 Edition of the China Intellectual Property Symposium to be held in Xi'an on 15th-18th June.

HFG PUBLICATIONS

China IP Focus – Annual Overview – Major developments in 2012 by Eric Su & Zhang Xu
Cina: opportunita' anche per i fertilizzanti by Nicola Aporti

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