Nature of OEM Production in China

By Ms. Haoyu Feng and Ms. Jia Li, Chofn Intellectual Property, China

Different countries hold different views on whether OEM (original equipment manufacturer) or pure production without actual sales constitutes infringement of trademarks. As China has grown into a factory to the world, numerous international entities entrust Chinese manufacturers with production for other markets. The nature of OEM production in China gets increasingly important. Through study of China's recent cases and the newly revised Trademark Law, we hope to clarify this issue to some extent.

Provided that the trademarks attached to the OEM products are not owned by the international entities or the manufacturers, but are owned by other registrants or parties concerned, during the course of production or after production and/or during the course of storage and/or shipment, if the trademarks are used without authorization, can such use be deemed as infringement and incur fines or other penalties?

1. Three verdicts issued by the Chinese Courts

Through the following three contradictory cases, we can see that different Chinese Courts hold different views.

Case 1: Chinese trademark CROCODILE, No. 246898

Court: The Guangdong Higher People's Court
Verdict No.: (2011) Yue Gao Fa Min 3 Final No. 467
Date: December 16, 2011
Second Instance

Background: The Plaintiff is the owner of the trademark "CROCODILE" No. 246898 registered in mainland China, while Yamato, a Japanese company, is the owner of the alleged infringing mark registered in Japan. Yamato entrusted the Defendant, through another Japanese company, with production of the alleged infringing products.

Court's Opinion: the Defendant's production of OEM does not constitute trademark infringement against the Plaintiff's trademark rights on the grounds summarized below:

✧ **Confusingly similar or not**

When judging if trademark right is infringed, the following two factors should be considered:

1) Whether the two parties' trademarks are confusingly similar in respect of overall appearances, pronunciation and meanings, etc.; and

2) If there is a likelihood of confusion among the Chinese consumers.

In the above case, the alleged infringing products are to be sold only in Japan, but never in mainland China, and accordingly, the alleged infringer's trademark can never function as a trademark to distinguish the origin of goods in mainland China. As such, there is no likelihood of confusion among the Chinese consumers. Moreover, the Plaintiff's market share in mainland China has never been occupied improperly and its trademark rights has not been infringed.

✧ **The Defendant's subjective intention**:

In this case, when signing the OEM contract, the Defendant had reviewed Yamato's trademark registration certificate in Japan. Therefore, the Defendant conducted the manufacture according to the OEM contract after performing the obligation of paying necessary attention or due diligence, and had no subjective intention to infringe the Plaintiff's trademark.

Case 2: Chinese trademark HPC, No. 7247298

Court: The Pudong New District People's Court of Shanghai
Verdict No.: (2014) Pu Civil 3 (Zhi) Chu No. 373
Date: July 2, 2014
First Instance

Background: The Plaintiff is the owner of the trademark "HPC" No. 7247298 registered in mainland China, while Hillber Parts Co., Ltd. ("Hillber"), a UK company, is the owner of the alleged infringing mark registered in UK. Hillber entrusted the Defendant with production of the alleged infringing products.

Court's Opinion: the Defendant's production of OEM does not constitute trademark infringement against the Plaintiff's trademark rights on the grounds summarized below:

1) As the mark attached to the alleged infringing products is identical with the Plaintiff's registered mark, and the alleged infringing products are similar to the approved goods of the Plaintiff's mark too, the premise of infringement should be if the Defendant's act of attaching the "HPC" mark constitutes valid use of a trademark according to the Trademark Law.

2) When defining valid use of a trademark, the most important factor should be the function as a trademark to distinguish the origin of goods.

3) In this case, though the act of attaching the trademark to the alleged infringing products is conducted by the Defendant, the actual user of the mark is the foreign entrustor. The alleged infringing products, when being detained by the Customs, has not gone into the market, and never had a chance to be known by Chinese customers. Moreover, all of the alleged infringing products are being sold out of Chinese border, and thus the trademark attached thereto never functions as a trademark to distinguish the origin of goods in mainland China.

Note: Though the above ruling is made on July 2, 2014, after the new Trademark Law came into effect, the ruling was based on the old Trademark Law as the alleged infringement happened before the new Trademark Law came into effect.

Case 3: Chinese trademark ORION, No. 1108636

Court: Tianjin Second Intermediate People's Court
Verdict No.: (2010) Second Intermediate Civil 3 (Zhi) Zhong No. 3
Date: December 16, 2011
Second Instance

Background: The Plaintiff is the owner of trademark "好丽友" (Orion in Chinese characters) No. 1108636 registered in mainland China, while the alleged infringer attached the trademark "佳丽友" (Jia-Li-You in Chinese characters, the last two characters of which are identical with those of the prior trademark Orion in Chinese characters) to the products, and used package designs confusingly similar to those of the Plaintiff.

Court's Opinion: the Defendant's OEM production has constituted trademark infringement against the Plaintiff's trademark rights, as well as unfair competition on the grounds summarized below:

> The Defendant, a food producer in the same industry with the Plaintiff should have known the Plaintiff's well-known trademark "好丽友" (Orion in Chinese characters), and the famous product package thereof, particularly considering the Plaintiff's big market share. Thus the defendant had not performed the obligation of paying necessary attention or due diligence, and its subjective default can be verified.

In addition to the above three cases, there are many other controversial verdicts: some of OEM productions are ruled as trademark infringement, others not.

2. Summary of different Court's grounds

Different Courts' grounds can be summarized as follows.

Grounds for Trademark infringement:

1) The alleged infringers products attached trademarks identical with or similar to other's registered trademark to identical or similar products;
2) The entrustors have not performed the obligation of paying necessary attention or due diligence;
3) Trademark protection should be territorial or regional. When and if a trademark is registered in China, without the registrant's authorization, any third party is not allowed to use identical or similar trademark on identical or similar products by all means.

Grounds against trademark infringement:

1) The OEM products are sold in foreign countries, but never in China. Therefore, there is no likelihood of confusion among Chinese consumers.

3. What leads to the above controversial conclusions?

Intellectual property matters are not only legal issues, but also the country's macroscopic economic policy. When determining whether certain OEM production constitutes infringement, the Courts also consider the economic factors. In China, OEM can not only contribute to earning foreign hard currency

and increasing employment, but also help local enterprises to learn advanced technology and upgrade the industries. Therefore, generally speaking, Chinese authorities would not like to restrict and/or crack down OEM production too much for the time being. Accordingly, when verifying trademark infringement, the Chinese authorities and Courts put such contribution into consideration. At the same time, the reputation of the alleged infringed trademark, subjective default of OEM producers and entrustors are also often considered.

4. Further thoughts

In our opinion, though in many Courts' rulings, OEM production is deemed as not constituting infringement, there is still big possibility that the controversial point of view will become more acceptable by Courts in the future, taking the following theory as a basis.

According to the theory behind the Chinese civil law, damage is available against actual harm. However, if no actual harm happens but the potential harm is likely to happen, the potential victim remains entitled to require the potential infringer to remove the potential harm or prevent the potential harm from happening. In a typical example, where a flower basin is placed in the balcony over a road, the passers-by are entitled to require the balcony owner or tenant to remove the flower basin. Likewise, the OEM factory's products, when shipped from the factor to the harbor or airport and then to a different country, are also likely to be downloaded somewhere on the way to the harbor or airport. When and if the possibility of such potential download cannot be ruled out, the trademark or other IPR owners should be entitled to keep the factory liable to potential harm. In other words, OEM product should be considered IPR infringement, with trademark included.

5. Uncertainty continues under the new Trademark Law

China has just revised its Trademark Law for the third time, which came into effect on May 1, 2014. The new Trademark Law failed to clarify the nature of OEM production. From the revision, we can find some contradictory or confusing message.

According to Article 48, "use of a trademark" means the act of using a trademark on goods, on the packaging or a container of such goods, on documents for the transaction of such goods, in advertising and publicity, exhibitions and other **commercial activities, in order to identify the origin of goods**. In other words, only use in commercial activities shall constitute use, the premise of infringement under Article 57. In addition, the purpose of such use is to identify the origin of goods. If these conditions cannot be met, the relevant acts shall be considered neither commercial use under Article 48 nor infringement under Article 57. That is to say, we can conclude that OEM production constitutes no infringement.

However, according to Article 60.1, the Administrations for Industry & Commerce (AICs), when taking actions against infringement, are empowered to impose fines against the infringers. Turnover is the basis for fine. If there is no turnover, the infringers can still be fined by RMB250,000 in maximum. This provision has actually confirmed that pure production without sales can be considered as infringement and consequently fined. From this we can conclude that after May 1, 2014, once OEM producers' unauthorized use of others' trademarks is verified as trademark infringement, the authorities and parties concerned will be empowered to take actions against the OEM producers and entrustors.

Although the new Trademark Law has failed to clarify the nature of OEM production and caused confusion, in the foreseeable future, OEM production is likely to face the following risks:

a) Local AICs may impose a fine of RMB250,000 in maximum and destroy or confiscate the goods;

b) Customs may detain and/or destroy the exportation from China to other countries/regions; and
c) Courts may grant damage.

6. Safe practice tips:

1) Register trademarks earlier.

Compared with the possible high amount of fine or damage, the costs of registering a trademark is much lower.

2) Search in advance.

If trademark registration is unavailable temporarily or in a long time, prior trademark search can at least help OEM producers and entrustors predict possible risks and make necessary preparation.

3) Do not attach the trademark to the goods inside mainland China

If possible, the parties concerned should consider attaching the trademark to the products until the products leave the mainland Chinese territory, not including Taiwan, Hong Kong, or Macao.

In this way, costs of OEM producers and entrustors might increase to some extent. Nevertheless, compared with the possible troubles when and if trademark infringement is verified, it is still worthwhile.

For more information, please contact:

Ms. Haoyu Feng
Attorney-at-law & Trademark Attorney
Chofn Intellectual Property
trademark@chofn.cn, office@chofn.cn
www.chofn.com

Ms. Jia Li
Trademark Attorney
Chofn Intellectual Property
trademark@chofn.cn, office@chofn.cn
www.chofn.com