



MMLC Group  *China Update*

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Legal News

Intellectual Property

Three-Dimensional Trademarks in China

Nestle filed an international registration application designating China in 1995, for the well known Maggi sauce bottle:



Initially this application was rejected by the Chinese Trademark Office, however the Chinese Trademark and Adjudication Review Board, on appeal, accepted that the shape of the bottle had become distinctive

through use and allowed it to be registered. A Chinese entity was found to be using the following bottle for its soy sauce products:



The Chinese entity sought an order from the Jiangmen Intermediate Court to the effect that this bottle shape did not infringe Nestle's three dimensional trademark registration for its Maggi sauce bottle. The court issued the order on the basis that such use, was "unlikely to cause confusion among the relevant

consumers and did not constitute trademark infringement.” Nestle appealed this decision to the Guangdong High Court, but was unsuccessful. Finally, the Chinese entity applied to the Trademark Review and Adjudication Board for cancellation of Nestle’s trademark registration but was initially unsuccessful.

This case illustrates that it is certainly possible to register distinctive shapes as trademarks in China, but that enforcement of these registrations is usually fraught with difficulty. Indeed, the draft new trademark law will make it even more difficult to enforce these sorts of trademark registrations in China due to it expressly stating that infringement does not occur if someone uses a shape in a functional manner rather than in a trademark sense referring to the origin of a product. IP owners are strongly recommended to look at registering design patents for the shape of their products in China, in addition to trademark registrations, given the difficulties associated with the enforcement of three dimensional trademarks in China.

Privacy Concerns Regarding Personal Information

Concerns have been raised by Chinese consumers regarding the urgent need for China to develop strong privacy and data protection laws. In a recent case in Shanghai, the defendant was found to have stolen over RMB300,000 from six personal accounts – the defendant had simply purchased personal information regarding thousands of car owners from a Chinese data processing website and then sent the information to people he knew that had access to banking record databases for data matching purposes – the defendant paid US\$31 for each set of bank account and credit card records that were identified in the matching process. This case has led to the exposure of a developing market for personal data, with real estate agents and insurers, regularly buying data from telecommunications companies and banks. China first began talking about introducing a dedicated

privacy law several years ago, however little progress has been made – at present, some privacy law principles exist in China’s Constitution, the Criminal Procedure Law and aspects of the telecommunications regulations. Legislative reform is crucial in this area.

Corporate and Restructuring

VIEs

The China Securities Regulatory Commission (CSRC) has begun lobbying the State Council to take action against structures known as Variable Interest Entities (VIEs), which allow indirect control of entities in areas where investment is highly regulated, such as the telecoms and media sectors. VIEs have been extremely common over the last 20 years, where foreign investment has been prohibited in a sector – essentially, a VIE simply gives an investor contractual control over an entity, even if that investor does not have a controlling interest (or any interest) in that entity. The private equity industry relies heavily on VIEs. We can see why the CSRC is uncomfortable with allowing IPOs involving VIE structures, as Chinese law does not expressly recognize VIEs - however, the relevant laws do not expressly prohibit them either. Any legislative reform in this area would require the amendment of a large number of regulations across various sectors, outlawing “indirect control” provisions in contracts regarding the operation of entities in various sectors – this could not take place overnight.

Anti-Trust/Competition

New Guidelines

On 29 August 2011, the Ministry of Commerce issued the “Provisional Regulation on the Assessment on the Competitive Effects of Concentration of Undertakings” – these are aimed at standardizing the factors that the Anti-Monopoly Bureau is to consider, when analyzing

the competitive and anti-competitive effects of a concentration. Further details are available from our office.

Tax

Tax Residency – China-Controlled Foreign Enterprises

Announcement 45 of 2011 was issued by the State Administration of Taxation (SAT) in late July, and commenced operation on 1 September 2011. This Announcement clarifies tax residency issues for Chinese corporate income tax and should be read against Circular 82 issued by SAT in 2009 (Guo Shui Fa [2009] No. 82). Announcement 45 defines a China-controlled foreign enterprise as one that is “incorporated in a country or region (including Hong Kong, Macau and Taiwan) other than in Mainland China, whose main controlling investor is a Chinese enterprise or group in the mainland.” If a foreign entity is caught by Announcement 45, then it will be subject to Chinese Corporate Income Tax as a resident enterprise and be required to collect withholding tax when making payments abroad, such as dividend and interest payments to non-resident enterprises. Early communication with the SAT is recommended, where investors feel that Article 45 may apply to any of their entities, thus making them liable for Chinese corporate income tax, in order to avoid aggressive audits.

IT and the Internet

China Closes Online PR Sites

In late August, China’s new State Internet Information Office coordinated the shutdown of over 6,600 websites across China. It is understood that many of these sites offering “public relations services” for their customers, by which customers could pay to have rumours pushed to the public regarding the products or services of the customer or its competitors.

Further, the sites offered to be able to delete any unwanted negative press for the payment of a fee. The authorities had been monitoring the activities of these sites since April, and had concluded that their activities were at least misleading and deceptive, and in many cases, fraudulent. It is understood that some customers and third parties are looking at filing lawsuits against various sites involved in these activities, given losses that have been sustained as a direct result of their activities.

Employment

Maternity Pay

Shanghai and Qingdao have recently set up new rules on maternity pay, being based on the Social Insurance Law. The Social Insurance Law states that maternity pay is to be calculated on the basis of the average wages of all employees of an enterprise, over the last calendar year. The new rules state that any maternity leave payments should be paid out of the social insurance fund (up to a capped level) and an employer must then make up the shortfall, so that the employee received the average wage of all company employees. Of interest though, is that in Shanghai and Qingdao, older regulations exist, stating that employees are entitled to receive their full salary during maternity leave – it seems that the new rules should be followed despite the old regulations still being operational (as they deal with other aspects of maternity leave not dealt with by the new rules). It is anticipated that other cities and provinces will roll out new maternity leave rules based on those in Shanghai and Qingdao over the next few months.

Overtime Payments

The Shanghai Jing’An District Court was asked to deal with an employee’s claim for unpaid overtime in July. The employee worked for a cosmetics company as a “supply chain manager”, with a monthly

salary of RMB25,000 – the employment agreement, which had been approved by the local labour bureau, stated that the employee was subject to a “flexible working hours system” as a “senior manager” and not entitled to overtime pay. The employee claimed that he was not a senior manager and therefore he should have been entitled to overtime payments – the court found that, based on the evidence provided, the employee was a senior manager and that the provisions in the agreement were valid regarding a flexible working hours system. The court declared that the employee was not entitled to overtime payments. Clearly, the court felt that the main issue in this case, was whether the employee was really a “senior manager” or not – if in fact, the employee was able to prove that his work scope was more akin to a junior employee or mid level manager, then it is likely that the court would have read down the employment agreement and allowed the employee to claim for overtime. This case serves as a reminder for the need to regularly audit employment agreements and match them with the actual work duties being carried out by individual employees at the mid to senior management levels.

Judiciary

Chinese Courts to Get Wider Powers over Seizures

China’s Standing Committee of the National People’s Congress (alin to China’s federal cabinet) has been reviewing plans to amend the PRC Criminal Procedure Law, so that Chinese courts are given powers to seize illegally obtained assets of corrupt officials. The new procedures will allow Chinese prosecutors to apply to a court order for seizure of illegally obtained assets of persons suspected of corruption or serious crimes, who have had warrants issued for their arrest that have been outstanding for 12 months or more.

Business

Auto

Caterpillar Building US\$100m Facility in Nantong

Caterpillar has announced plans to build a proving ground and large wheel loader manufacturing facility in Nantong, Jiangsu, Province. It claims over 8,000 employees in China – sixteen factories, three R&D centres, six branch offices and three parts centres.

Chery Sees Record Exports

China’s largest auto maker has reported that it exported around 20,000 cars in August, an annual increase of 83.6%. From January to August, it exported around 110,000 cars. Local sales accounted for 682,000 cars in 2010.

China Auto Sales Up

According to the Ministry of Industry and Information Technology (MIIT), China’s auto sales rose 8.29% month-on-month for August – up 4.15% from 2010. Automakers have been aggressively trying to reduce their inventories after the Chinese government ended incentive programs and imposed new limits on car purchases earlier this year.

WTO Ruling on Chinese Tires

Earlier this month, the World Trade Organisation ruled that the US can raise import taxes on Chinese made tires by as much as 35%. China had argued that the tariff imposed in 2009 by the US, on top of a regular 4% import duty, was protectionist and contravened international trade laws. China’s claims were rejected by the WTO, concluding that the US trade officials had “acted consistently” with international trade laws. China recently lost another WTO trade dispute regarding precious metals – in July, the WTO

concluded that China's export restrictions on nine raw materials used in the manufacture of high-technology products are inconsistent with its WTO obligations - the raw materials covered by the export restrictions were bauxite, coke, fluorspar, magnesium, manganese, silicon carbide, silicon metal, yellow phosphorous and zinc. The affected materials are used in medicines, CDs, electronics, cars and automotive components, ceramics, refrigerators, batteries and other products. The export restriction regime includes quotas, export duties and a minimum export price systems.

Ecommerce

Online Game Profits Slide

Shanda Interactive Entertainment Ltd, the major Chinese online game company, has claimed that the Chinese online game space is maturing whilst costs continue to grow – this combination is said to have led to a dramatic slump in profit for the company. Shanda's second-quarter operating expenses rose 44% to 858.6 million yuan from 596.7 million yuan a year earlier, as a result of higher spending in areas including product development, salaries, and sales and marketing.

China Renews Google's License

The Ministry of Industry and Information Technology (MIIT) has announced that it had renewed Google's China Internet Content Provider license for another 12 months. Some ecommerce commentators had expected Google to run into trouble in renewing its license, following Google's decision to stop monitoring/filtering its Chinese language search results, against Chinese Internet policy. These days, Google is accessible in China, however the domain name for its search engine is located at www.google.com.hk. Apparently, this has been found to be acceptable by the MIIT – at least for now.

Government

Unity and Security Seen as Key Issues by Beijing

In September, China's State Council issued a policy paper identifying four key areas as China's "core interests" for the foreseeable future – sovereignty, national security, territorial integrity and national unity. The paper also emphasised China's commitment to its internal affairs and efforts to resolve territorial disputes with neighbours peacefully – "As an ancient country ... China has never sought hegemony ... We also hope that the international community will have confidence in the Chinese people's sincerity and determination to achieve peaceful development, and support rather than obstruct China's pursuit of peaceful development."

Taiwan Relations

Cross-strait trade relations have steadily improved since the signing of the Economic Cooperation Framework Agreement. Taking the next step in Taiwan's continuing efforts to attract more mainland investors, the Ministry of Economic Affairs recently announced that several new industry categories will be opened to Chinese investment. The announcement included 25 categories in the manufacturing industry, eight categories in the services industry and nine in the public works industry. Chinese companies will be allowed to invest in these categories by forming joint ventures with Taiwanese companies or by investing directly in existing Taiwanese companies. In the case of joint ventures, the share of Chinese ownership will be capped at 50%. The rules related to direct investments will vary according to the nature of the industry and the target company. Taiwanese authorities will generally treat Chinese investments in regular industries as they do other foreign investments and will not attach any restrictions. On the other hand, the share of Chinese ownership will be capped at 20% for slightly sensitive industries and 10% for sensitive industries.

Economic and Finance

China's Inflation Concerns Easing

The CPI rose only 6.2% year-on-year for August, down from a three year high of 6.5% in July, according to China's National Bureau of Statistics. The September figure could be below 6%, indicating that the measures implemented by the Chinese government to cool the economy over the last 6 to 12 months, are working.

MOFCOM to Aid Overseas Investment

During the recent China International Fair for Investment and Trade, the Minister of Commerce, Mr Chen Deming, assured Chinese delegates that the government was working on new measures and regulations to make it easier for Chinese companies to invest abroad. China is now the fifth largest overseas investor, despite difficult foreign exchange restrictions and government approval requirements for overseas investment. By the end of 2010, the Asia-Pacific region and Latin America were the top two destinations for China's overseas investment, but the EU and Australasia has witnessed the most rapid growth in recent years.

SOEs See Slowdown in Profits

China's State-owned enterprises reported a slow down in profits in August, although commentators at the Ministry of Finance are predicting an average 20% increase in profits for 2011 across the board. The Ministry revealed that those SOEs in the non-ferrous metals, coal, trade, petroleum and postal telecommunications sectors are doing the best in 2011.

Yuan Could be Convertible by 2015

Xinhua's Economic Information Daily, has stated that under the draft 12th five year plan for the finance

industry as issued by the People's Bank of China (China's central bank), China aims to make the yuan "basically convertible" by the end of 2015. It is thought that the settling of food and housing prices, have greatly contributed to the slow down in inflation. China's central bank has raised interest rates five times since October 2010, and lifted reserve requirements for banks, nine times.

Retail

Consumer Actions on the Rise

Walmart is facing fines of around US\$94,000 for selling standard pork as "organic pork", in one its stores in Chongqing (South Western China). Beijing News has reported that Walmart has issued apologies to its customers, and offered to compensate any customers that overpaid for their purchases. Meanwhile, Nike is under investigation for contravention of the PRC Pricing Law, for selling shoes at higher prices in China as compared to the US, but with lower quality and different features. It is understood that the Beijing Administration of Industry and Commerce is investigating Nike – last week, Nike issued a statement admitting to false advertising and offering to compensate consumers. These cases illustrate how China's consumers are becoming more savvy in relation to their rights and requiring better service levels from retailers.

This update is aimed at keeping our clients informed of developments in Greater China. Whilst every care has been taken to ensure the accuracy of this update, it should not be relied upon before individual advice is obtained. The MMLC Group is an international legal and corporate advisory group.