

PUBLICATION

The New China and Your Company's Intellectual Property

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The Chinese economy has changed dramatically in the past two, five, and even 20 years, but its intellectual property (IP) laws have only very recently developed to somewhat better deal with the new reality. The new Chinese environment, and the growing availability of Chinese laws to protect IP, are of particular interest to Western companies only now contemplating selling or manufacturing in China, as well as to those already doing business there. In fact, even companies not in China should know: if you aren't taking care of your business in China, rest assured that someone else is.

Challenges for U.S. Companies in China: Private Enterprises, Increasing Wages

Two of the features of the new reality include the recent rise of private enterprises, and the end of "cheap China." State-owned entities (SOEs) have declined in the Chinese economy due to the rise of private enterprises, or *minqi*. Reportedly, SOEs' profitability is increasingly lower, and their share of total assets has decreased to less than half of the Chinese economy. Some well-known private Chinese enterprises, like Alibaba, have even become the world's largest players in their respective industries.

In addition, minimum wages have increased steadily since 2005, and China has gradually developed into a consumer market instead of a world factory. As a result of both the increase in production costs and more intense competition with locals, Western businesses now have to consider whether to expand organically or to join forces with locals.

The development of a consumer market has changed another consideration - that is, where in China to start doing business. Previously, Hong Kong, rather than mainland China or Taiwan, was recommended because it was perceived to be easier for foreigners as a result of being under British rule for so long. However, the vast number of new consumers in mainland China changes that calculus, and suggests launching there in order to take advantage of the much larger population and corresponding market.

The Increasing Impact of Gray Market Goods

The current impact of gray market (infringing) goods is even greater than before, as efficient global logistics networks help gray goods reach more customers faster. Taobao and Alibaba are similar to eBay and Amazon, but dwarf the revenues of their American inspirations. In fact, although the sales figure reported by luxury brand stores in mainland China in 2013 was US\$28 billion, China's actual consumption of luxury goods was estimated to be more than four times that amount (US\$116 billion). Parallel importers (infringers) play a crucial role in generating this market disparity.

Get Good Legal Advice

Accordingly, the Western company considering expansion into China needs guidance in handling government relations, or *guanxi* (connections requiring dependability, trustworthiness and respect). It needs advice regarding how to avoid corruption charges despite the requirements of *guanxi*. It also needs counsel regarding its Chinese workforce, with respect to who is running the company (is the manager taking orders from you, or the Communist Party?), and whether the employee's loyalty is to the Party or to the employer. The peculiarly

Chinese approach to negotiating contracts — which continues even after signing — must be anticipated, and even the different regional cultural approaches to negotiations must be taken into account. Drafting contracts in Chinese is recommended, as the contract must be understandable if it is to be respected by your Chinese partner.

Proactively Protect the IP

Given the realities of the Chinese market, good IP legal advice is critical, as Western companies should assume that their IP will be stolen, and prepare accordingly. Guidance regarding using and protecting IP in China (including trade secrets), and the best practices for negotiating with and litigating against infringers in China, is critical. Keep in mind that China is still a first-to-register (not first-to-use) country, so early, preventive measures for protecting IP are essential. Among the steps Western companies working in China should take are the following:

- Register trademarks in all possible classes and sub-classes, and in Chinese as well as English.
 - Register not only the translation of the image or idea of the mark, but also any transliterations of the mark's sound (including where the meaning is different, in order to prevent third-party use). In Chinese, which does not have an alphabet, but instead characters with meanings, there can be multiples of both translations and transliterations of your mark.
- Regarding registration in Chinese, Mandarin dialect used to be recommended. Now, however, Cantonese is recommended because it is more popularly used. Register in both the formal and informal versions of Cantonese in order to cover both commonly used variations.
- Registration is one thing; use is another.
 - For consumer products, use a Chinese version of your trademark, as the average Chinese consumer does not want to read English labels, and is unlikely to recognize an English word as a source of origin (trademark).
 - On the other hand, for high-tech or luxury goods, there is a perceived cachet to foreign language, so use the English trademark.
- File for patent protection on all inventions.
 - With respect to trade secrets, have a non-disclosure agreement with every person having access. Employment contracts can include a non-compete clause, but Chinese employees must be paid extra for this restraint on their ability to work.
 - Define the trade secrets carefully so that they are not inadvertently disclosed in the contract.
 - Defensively, also have your new employees agree that they will not use the trade secrets of their previous employers, so that your company is not targeted as a defendant for theft of another's trade secrets.

If pursuing infringers becomes necessary, both administrative and legal actions are available. Administrative action is usually preferable, as it is more efficient and effective. However, litigation may put more pressure on the infringer, and could be used as a means to increase bargaining power in negotiations.

If you have any questions or want to discuss how this decision could impact your business, contact your Baker Donelson attorney or one of the attorneys in the Firm's Intellectual Property Group.