1. Your IP in the Chinese Automotive Industry

The automotive industry in China has seen rapid expansion over the last decade; the automotive parts market alone was worth RMB 1.5 trillion (€179 billion) in 2010 and the increasing volume of vehicle sales in the country predicts that the trend is set to continue. There are clear opportunities for European businesses to profit from this booming market but precautionary steps must be taken to meet the challenges that China poses.

When it comes to Intellectual Property (IP) protection, international small to medium-sized businesses that invest in the local automotive industry should be aware of the IP risks that they run when operating in China, and the main tools at their disposal to protect against those risks.

Currently, the most important factors that allow international automotive businesses to operate in Chinese Tier 1 and Tier 2 markets, are their established contacts with global car manufacturers (the Original Equipment Manufacturers, or OEMs who produce parts or components for sale to other manufacturers to market under their own brand name - for more information you can watch the China IPR SME Helpdesk webinar on OEM in China), their technological capabilities, and their reputation for quality. This gives them an edge over many Chinese competitors that are relatively new and lack the regimented processes that are required to guarantee a high level of quality. Therefore IP - in particular with regards to new technologies and the ability to protect this technology from Chinese competitors - will be a key factor in the battle for market share.

2. Why is Protecting your Trade Mark Important?

Branding is key to the success of many international companies in the Chinese automotive industry. The strong reputation that these companies have built up in other markets allows them...
to compete effectively for orders from (international) China-based customers. Trademarks play a relatively small part when it comes to the purchase of OEMs because most car manufacturers will only purchase from known suppliers, so counterfeiters are unlikely to get a foot in the door. Lower down the supply chain trademark infringements are a more distinct possibility, and European SMEs operating at this level should ensure their trademarks are registered in China.

Another area that is prone to trademark infringement is the market for spare parts. Parts distributors, whether wholesalers or retailers, may consider selling counterfeit products at real-product prices, increasing their own margin substantially. From a consumer’s point of view, the best way to curb the risk of being saddled with inferior counterfeits is to purchase only from qualified dealers. Automotive suppliers whose parts are being copied should be ready to file a complaint with the Administration for Industry and Commerce (AIC), to start an administrative IP enforcement action; or in the case of major infringements, a civil lawsuit which could lead to an injunction (a court order requiring the offender to immediately cease selling and producing the counterfeit items) and perhaps some compensation.

Companies in the automotive industry must remember to register their trademarks in China - if only to avoid third parties registering them first. As China applies the ‘first-to-file’ system, an international business that fails to register its brand name as a trademark in China, may be prevented from using this brand name in the future, which could have a serious impact on its business. Additionally, owners need to register the Chinese versions of their brand names as trademarks in China, because very often the Chinese equivalent becomes better known and more valuable than the original brand name. For more information on trademarks in China and how to register them, see the China IPR SME Helpdesk guide to trademark protection in China.

3. Patents and Inventions

China’s system to protect patents is relatively comprehensive and very similar to that of many other international jurisdictions. To be protected under the Chinese patent law, a technology must be registered in China, either directly or through depositing an international patent in China. Upon being granted, the patent holder will have the right to exclude others from making, using, selling, offering to sell, or importing patented products or technologies in China during the patent’s term of validity.

The three main conditions to be granted a patent are that the technology must be ‘novel’, ‘inventive’, and have practical applicability. In the Chinese automotive industry, the requirement of novelty is by far the most challenging. Companies that develop a new technology, in China or elsewhere, must ensure that the patent is applied for in China before the product’s use or publication (anywhere in the world). However, helpfully, China offers a twelve-month priority period upon application in another country or jurisdiction. This means that when a technology is invented and a patent is applied for in the home jurisdiction, then the company has twelve months to apply for the patent in China as well.

In addition, China has special rules that apply where a technology is invented in China. If the Chinese subsidiary of an automotive parts supplier has
invented the technology, then the patent must be applied for in China first. For further information about registering and using patents in China, please refer to the China IPR SME Helpdesk Guide to Patents in China.

4. Additional Faster Access to Protection - Utility Model

Besides applying for an invention patent, companies also have the choice of applying for utility model patents to protect their technologies. Although the utility model patents cover much of the same kinds of technologies as the invention patent, the main differences are as follows:

- Application: Utility model applications do not enter into a stage of substantial examination, which means that the State Intellectual Property Office (SIPO) does not need to review the patent's novelty.

- Timing: The application process for a utility model usually takes approximately one year (three or more years is common for invention patent applications) but the protection only lasts for ten years (as of granting).

- Protection: Unlike invention patents, utility model patents do not require 'substantial examination', which makes them less effective when enforced and exposed to higher risk of invalidation. An invalidation procedure may suspend any enforcement actions.

Utility model patents are no alternative to invention patents, but they still offer a certain level of protection if the invention patent is no longer available to the owner. Moreover, an effective strategy to protect technical solutions is to apply for both a utility model and invention patent simultaneously (i.e. on the same day); and then to abandon the utility model upon being granted the invention patent. This practice allows
patent holders to take advantage of the early approval of the utility mode to obtain a first level of protection, until completion of the more extensive invention application which provides the patent holder with maximum protection and for a longer period (of twenty years instead of ten).

5. How to Maintain Trade Secrets

The trade-off for the protection of inventions and utility models as patents is that they are fully disclosed to the public, through publication by the State Intellectual Property Office. Therefore while registering a technology as a patent offers legal protection in China, it also increases the risk that competitors are capable of copying the technology. A different approach to protect technologies is not to file for patent protection, but rather to try to protect the use of these technologies by avoiding disclosure to third parties. There are three effective methods to achieve this, outlined below.

1. Physical Protection

Limiting physical access is an important component of this strategy - for example by restricting the number of people that have (full) access, or by creating a black-box in China or abroad to which only few persons have the code. Those parties (whether persons or companies) that are given restricted access, can be bound by obligations of confidentiality with high penalties in case of breach, moreover their activities can be monitored through ITC solutions to ensure that breaches are detected.

2. Protection under the PRC Unfair Competition Law

A second layer of protection for sensitive information is created by stipulations under the PRC Law on Unfair Competition. Relevant articles determine that the infringement of “trade secrets” is punishable with an administrative fine (of between CNY 10,000 and CNY 200,000) and may also incur civil or even criminal liabilities. Acts that constitute an infringement (as per Article 10) include:

• Obtaining trade secrets by stealing, luring, intimidation or other unfair means.
• Disclosing, using or allowing another party to use the trade secrets obtained in such way.
• Disclosing, using or allowing a third party to use the trade secret in violation of an agreement or against the owner's demand for keeping the trade secret.

Thus employees or commercial partners who infringe a company's trade secrets are in breach of this law and may be condemned to pay high compensations. In addition, the law establishes similar liability for a third party that obtains, uses or discloses another party’s trade secrets, if he/she knew or should have known that the trade secret in question was under infringement.
One limitation for the pursuit of trade secret infringement under the PRC Unfair Competition Law is the specific definition of trade secrets. It would be too easy (and too restrictive) for just any kind of information to be regarded as a trade secret. Therefore, for information to be deemed a trade secret, it must be either technical information (e.g. designs, technical specifications) or business information (e.g. customer lists, sales figures), but certain conditions must be met for the law to recognise confidential information as such.

- The information must be unknown to the public, and people in a related field of business should have difficulty obtaining such information.
- The information shall have either actual or potential commercial value, and should be able to bring the legal owner a competitive advantage.
- The legal owner must have taken suitable measures to keep the information confidential.

The degree of security should be proportional the information’s commercial value, and may include limiting access (such as within the factory or offices) and disclosing the information only on a need-to-know basis; locking the medium for the confidential information (such as computer or safe) or adopting other preventative measures, such as passwords and codes; marking the information ‘confidential’; and subjecting parties to a confidentiality agreement. It is important to bear in mind that any technology which can be ‘reverse-engineered’ - meaning that a technology or invention can be understood and replicated using a commercially available example of the technology - would not be protected as trade secrets. If a business intends to publically use technology which could be reverse-engineered then it is advisable to protect that technology by registering it as a patent.

3. Contractual Protection

Considering the strict conditions to information falling under the legal definition of trade secrets as protected under the law, it is advisable to create an additional layer of legal protection through contractual means. This can be achieved by agreeing to binding contractual terms on what is considered as confidential information, how it should be protected, and what penalties arise if these obligations are breached.

Interestingly, contractual clauses do not only provide additional protection but also increase the chances of making a successful claim for trade secrets - since one of the key conditions to the constitution of a trade secret is measures to protect the relevant information.

Even when not seeking to protect key know-how or technology as a trade secret, confidentiality terms should be agreed with all business partners that have access to sensitive information - including suppliers, customers, agents and of course employees that are directly exposed to the business secrets. These should identify in as much detail as possible:

a. The nature of the confidential information to which the party is exposed.

b. The obligations that counterparts have in keeping confidential information secret (including within their organisation).

c. The penalties that apply to a breach of confidential information (a confidentiality agreement with no penalty has no teeth!)
SME Case Study

Talaria S.r.l. is a small Italian company with a history for producing bespoke lightweight carbon fibre body parts for high-performance sports cars. Reputed for their durability and speed-enhancing effects the company has adapted some of the parts for commercial cars and have decided to manufacture in China with a view to sell the products in the European market. They identify Tianjin Techno Ltd as a promising partner and enter into an agreement with them. Following successive profitable quarters, Talaria decide they are ready to internationalise and plan to pursue sales in the burgeoning Chinese domestic market.

Talaria applies to register their name and logo as a trade mark in China and are surprised to discover that they have already been registered by Yashow Traders Ltd. Further investigation reveals that the Chinese domestic already exhibits inferior carbon fibre products at a reduced price under the mark ‘Talaria’. The company halts manufacturing with Tianjin Techno only to discover that their final shipments of parts are being blocked from export by Customs as they infringe the trade mark rights held by Yasho Traders.

After enquiry, Talaria discover that they cannot claim the trade mark from Yashow Traders as it was legitimately (if unscrupulously) registered in China by them; Talaria has little recourse except to negotiate the purchase of the “Talaria” trade mark from Yasho Traders. However, Talaria’s investigation also reveals that the factory owned by Tianjin Techno sold surplus and faulty Talaria parts to third parties including Yashow Traders. Prudently, Talaria’s original agreement with Tianjin Techno specified that all surplus stock was to be destroyed and they are able to initiate proceeding against the company and prevent further samples of their products from illegitimately entering the market as well as receive compensation for breach of contract.

Lessons Learnt:

- Registering your trade mark in China is important even if it is not your primary market and should be done as early as possible.
- Put in place contractual barriers to strength prevent your intellectual property from being misused.
- Monitor your market for infringing products and allocate budget to be ready to take action if infringement is discovered.
Take-Away Messages

The automotive industry involves a broad range of intellectual Property, including trade marks, patents and trade secrets. Irrespective of the kind of IP, the first step for owners is to ensure that IP rights are valid and effective in China. For trade marks and patents this means that they need to be registered in China, and for trade secrets (a type of confidential information) certain active steps must be taken.

In general, all automotive companies that are in China or want to enter this market should be clear on their IP protection strategy, which should include a focused understanding of the IP they want to protect, and the measures taken to execute such protection.

Guide Glossary*

Disclosure (Patents) - Disclosure refers to making an invention available to the public. A disclosure made outside the patent system, deliberately or not, will make the invention unpatentable. Within the patent system, the applicant must make a full and clear disclosure in the application of the invention for which protection has been solicited. In return a patent protection (exclusive rights for a limited time period) will be granted.

Patents - Patents are licenses which protect innovations and must be filed before the invention becomes known to the public. In China there are three types of patent - invention (20 years duration), utility model (10 years duration), and design (10 years duration). It should also be noted that a European registered patent has no legal effect in China.

Trade marks - A trademark is a visible sign composed of words, devices, letters, numerals or shapes, that indicates the source of goods or services, thus allowing consumers to distinguish goods or services of one producer from those of another. A trademark can be registered either through the 'national system' with China's Trademark Office (TMO) directly, or through the 'international system' with the World Intellectual Property Organisation (WIPO).

Trade secrets - A trade secret is any non-public information with actual or potential commercial value that is guarded by confidentiality measures. Trade secrets can ensure business advantage over competitors but must remain secret - once a trade secret becomes publicly known, it can no longer be protected as a trade secret. Most theft of trade secrets cases involve current or former employees.

Utility Model Patents - UMs are very similar to invention patents; however UMs only protect products with new shape or structural physical features.

Related Links

China Trade Mark Office - www.saic.gov.cn/sbjenglish/
World Intellectual Property Organisation - www.wipo.org
State Administration of Industry and Commerce - www.saic.gov.cn
State Intellectual Property Office - www.english.sipo.gov.cn/

Do you still have a question about IP in China? Call our Hotline number at +86 (10) 8527 6922 or E-mail us at question@china-iprhelpdesk.eu and the Helpdesk expert will answer your question within three business days.
The China IPR SME Helpdesk provides free, confidential, business-focused advice relating to China IPR to European Small and Medium Enterprises (SMEs).

Helpdesk Enquiry Service: Submit further questions to the Helpdesk via phone, email (question@china-iprhelpdesk.eu) or in person and receive free and confidential first-line advice within seven working days from a China IP expert.

Training: The Helpdesk arranges training on China IPR protection and enforcement across Europe and China, tailored to the needs of SMEs.

Materials: Helpdesk business-focused guides and training materials on China IPR issues are all downloadable from the online portal.

Online Services: Our multi-lingual online portal (www.china-iprhelpdesk.eu) provides easy access to Helpdesk guides, case studies, E-learning modules, event information and webinars.

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