

How Chinese courts are ratcheting up damages awards for wilful infringement

While some feel that damages awards in China are still insufficient, recent cases show that the courts are becoming much more sophisticated in calculating damages and awards are increasing – especially in cases of wilful infringement

China's newly amended Trademark Law is due to come into effect on May 1 2014. One of the most significant changes for many brand owners and trademark professionals will be the increase in damages in trademark infringement cases. The law will raise the amount of statutory damages to Rmb3 million – almost six times the previous limit. It will also recognise punitive damages and ease the burden of proof for brand owners in establishing damages.

All of these changes sound promising. In order for brand owners and other legal professionals to compare this with their own experience in enforcing trademarks in China, this article reviews the relevant binding rules, current court precedents and judicial policies. It also offers practical tips for obtaining and collecting damages against infringers and predictions of future trends – especially the implications of the pending judicial reforms on damage awards in China.

Existing regime

The Trademark Law was the first IP statute enacted when China opened its doors to the world at the end of 1970s. The current Trademark Law was originally passed in 1982 and was further amended in 1993 and 2001. The practice and relevant rules of trademark law have also had a significant impact on patent law and copyright law.

The rules on damages have always been friendly to brand owners. Article 56 of the law allows brand owners to calculate damages using one of two methods:

- the profit gained by the infringer as a result of the infringement; or
- the actual losses suffered by the rights holder due to the infringement (including reasonable expenses paid by the rights holder to stop the infringement).

The law further provides for statutory damages for brand owners (ie, where it is difficult to determine compensation using these two methods, the people's court may use its discretion to order compensation of up to Rmb500,000).

The same provision also makes it clear that the reasonable amount of enforcement shall be compensable as part of the actual loss suffered by the rights holder.

In 2002 the Supreme People's Court further clarified how to determine the amount of the infringer's profits and the rights holder's actual losses under the Trademark Law through its Judicial Interpretation of the Supreme People's Court Concerning the Application of Laws in the Trial of Cases of Civil Disputes Arising from Trademarks. According to Article 14 of this interpretation, the infringer's profits can be calculated by multiplying the unit profit by the quantity of units of the infringing product sold. Where it is impossible to ascertain the unit profit, the unit profit of the rights holder's own genuine product shall be used. According to Article 15, the rights holder's actual losses can be calculated based on the loss in product sales it suffered as a result of the infringement, or by multiplying the sales amount of the infringing product by the unit profit of the rights holder's products.

The interpretation does not solve all problems; however, there are plenty of difficulties in determining damages because of practical barriers to obtaining relevant evidence. Many infringers do not maintain reliable financial records or refuse to disclose them. Chinese judges rarely sentence such defendants to imprisonment for contempt, even though they arguably have the power to do so. As a result, Chinese courts mostly rely on statutory damages to award damages. In many cases between 2002 and 2008, the damages awarded fell far below the cap of Rmb500,000. However, over the past five or six years, the courts have been increasing damages awards in trademark infringement cases to a level that is beginning to approach the statutory cap, and in some cases are even finding ways to exceed it. This clearly reflects a shift in attitude on the part of Chinese courts.

Third round of amendments to Trademark Law

China started the third round of amendments to the Trademark Law in 2006. Effective compensation of rights holders in civil cases was always a key issue. In fact, it turned out that damages-related provisions were among the most significant changes in the final version of the law – in particular, the raising of the statutory cap to Rmb3 million, which only happened at the last minute when the National People's Congress carried out its final reading of the amendments. This last-minute change demonstrates the legislature's willingness to enhance the remedies available to rights holders.

The third round of amendments featured a total of 53 changes to the Trademark Law. The most significant changes in terms of damages are as follows:

- New method to calculate compensation – the new Trademark Law preserves the two methods set out in the current law (ie, the infringer's profits and the rights holder's losses), while Article 63 of the new law provides an additional method of a reasonable multiple of the royalty fee.
- Punitive damages for wilful infringement – Article 63 of the new law stipulates that in cases of wilful trademark infringement, the court may impose an amount of between one and three times the damages determined through the abovementioned three calculation methods.
- Elevated cap of Rmb3 million (about \$500,000) for statutory damages – pursuant to Article 63 of the new law, if it is difficult to determine compensation through all three methods, the courts may impose compensation of up to Rmb3 million by taking into account the circumstantial evidence.
- Alleviated burden of proof for rights holders – Article 63 stipulates that if the infringer refuses to provide financial records or other related evidence, the court may decide on the amount of damages by reference to the evidence provided by the plaintiff. This is designed to deter infringers who cover up or falsify evidence.
- Requirement of prior use to establish damages – pursuant to Article 64, the rights holder must have used the registered trademark within the past three years in order to obtain compensation. This is new and is designed to help legitimate rights holders to defend claims from bad-faith trademark squatters.

The changes have been welcomed as positive steps through which China can improve trademark enforcement using the civil court system. It is anticipated that similar packages may be adopted by subsequent amendments to the Copyright Law and the Patent Law.

Key challenges

However, despite the improvements introduced by the latest amendments, for some commentators these changes only confirm what has long been generally accepted by the international community: while China has the right rules in place, there are still concerns about enforcement.

Rights holders and courts face at least two challenges. The first relates to evidence – how rights holders can locate sufficient evidence to prove their own losses or the infringer's earned profits, and what kind of evidence is admissible with respect to royalty rates and expert testimony. The second relates to the judges – in the absence of clear evidence of damages, how may the court impose an appropriate amount of damages in such a way that rights holders are compensated fairly? How can courts work within the statutory cap (Rmb500,000) and make it work for rights holders?

The first challenge is closely linked to the role of the Chinese judiciary. Many practitioners advise their clients to apply for evidence preservation orders to secure copies of sales records. However, the courts do not always grant such orders for various reasons, which include that they are often overburdened with demands and IP cases are not generally given high priority. If the judges grant the evidence preservation actions, the defendants may not fully comply with them and may still refuse access to their records. Judges rarely impose civil sanctions in such situations in order to avoid confrontations.

The second challenge is probably less of a problem, although it can frustrate rights holders that are able to find convincing evidence to show losses or the defendant's earned income. While judges find it difficult not to award big sums of money in the face of evidence, they remain concerned about the consequences of a big damages award

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from a policy perspective. In 2007 Pepsi lost a trademark infringement case to a local company for its use of the BLUE STORM mark in Chinese mark, with the local court ordering it to pay Rmb3 million in damages. The court found that the Pepsi factory in China made a net profit of Rmb131.8 million that year, but the plaintiff was unable to prove what percentage of the net profit derived from the use of the BLUE STORM mark. The local court eventually awarded Rmb3 million to the plaintiff, far exceeding the Rmb500,000 statutory cap.

Below we examine some more recent cases to see how the judiciary has been dealing with these challenges and identify some likely trends.

Plentiful evidence leads to high damages in controversial case

Panati Wine (Shanghai) Co, Ltd v Castel Frères SAS involved in a long-running battle between Castel and a Shanghai-based wine distributor, Panati Wine, over the KA-SI-TE trademark name (卡斯特) – the phonetic rendition of 'Castel' in Chinese – in China.

Panati Wine was founded by Spanish-Chinese entrepreneur and owner Li Daozhi in the late 1990s, with the intention of introducing Spanish wines to the Chinese wine market. In 1998 Panati filed to register the KA-SI-TE mark with the Chinese Trademark Office and received approval for it in 2000. In 2002 the registered mark was directly transferred to Li. In 2008 Li founded a second company, Cavesmaitre Wine Co, Ltd, which focused on importing French wines and used 'Ka-Si-Te' as its Chinese brand name.

Castel started investing in factories and bottling wine under the Chinese name of Ka-Si-Te in 1998. In 2002 Castel began trying to register and acquire trademarks, but while it registered CASTEL successfully, it could not acquire the KA-SI-TE mark from Li. In 2005 Castel attempted to cancel Li's KA-SI-TE mark on the grounds of non-use, but was ultimately unsuccessful. Over the next few years, the two parties continued to negotiate on a price for the transfer of the mark, but could not reach an agreement.

In 2009 Li filed suit at the Wenzhou Intermediate People's Court for trademark infringement of its KA-SI-TE mark, requesting Rmb40 million in compensation. On April 10 2012 the Wenzhou Intermediate People's Court ruled against Castel, awarding damages of Rmb33.73 million. This judgment was appealed to the Zhejiang Provincial Higher People's Court, which not only upheld the previous verdict, but also required Castel to issue a public apology through the *China Industry & Commerce News* publication.

This case is extremely controversial as many believe that the original filing constituted a bad-faith trademark registration and thus there should have been no finding of trademark infringement.

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This case is worth paying attention to as the judgment explains the court's reasoning for the amount of damages imposed upon Castel.

A large amount of evidence was submitted to the court. With regard to the question of damages, relevant submitted evidence included sales contracts between Castel and its Shenzhen partner for 2006 to 2008, customs data on Castel's wine imports, Castel's annual reports, tax forms and Administration for Industry and Commerce business data.

In reviewing the evidence, the court noted that since neither Castel nor its Shenzhen partner submitted figures as to the profit made on each infringing product, the court could only determine the infringement profit based on the evidence submitted by Li. Two possible calculation methods for, respectively, Castel and its Shenzhen partner were identified to determine the extent of infringement for compensation.

The first calculation was for Castel and was equivalent to the product of total imports and the cost of the import's operating margin. The court determined that the value of the products judged to bear joint liability was Rmb31.96 million. As Castel did not provide information on its profit margins, the court used the export margins of its joint venture, calculated as 34.07% in 2008. As such, Castel's portion of the compensation was determined to be Rmb10.89 million.

The second calculation method was to multiply the product sales revenue by the operating profit margin to determine the amount of compensation that the Shenzhen partner would bear. The court used the same product value as above for the product sales revenue. To determine operating profit margin, it identified the average import product cost as 26.57 and average profit as 18.99 and then divided the latter by the former to obtain 71.47%. Therefore, the Shenzhen partner would bear Rmb22.84. Counting the sum of the two compensation portions, led to a cumulative damages award of Rmb33.73 million to the plaintiff Li.

It appears that the local court applied the rules literally under the current Trademark Law and relevant judicial interpretation. If a similar approach is followed in other trademark infringement cases, we will see many more large awards.

Right now, this case is pending before the Supreme People's Court. There are reports that the Supreme Court has agreed to suspend the Rmb33.73 million damages levied on Castel temporarily, overturning an earlier ruling by the Zhejiang Provincial Higher People's Court. A retrial is pending and the final decision is expected later this year.

Soy sauce-gate

In October 2013 the judgment in *Foshan Haitian Seasoning Food Co, Ltd v Foshan Gaoming Weiji Seasoning Food Co, Ltd* was published

by the Supreme Court as a leading example of trademark damages. Haitian is China's largest soy production and export enterprise and has been ranked as the country's largest seasoning manufacturer for 14 consecutive years. The Weiji condiment brand was built and used by Haitian, and was registered as a trademark on February 24 1994.

Gaoming is a competing condiment company established in 1998. Haitian filed suit for trademark infringement and unfair competition against Gaoming for unlawful use of its trademarks, as well as for making misleading statements to the public.

The litigation was triggered by the so-called 'soy sauce-gate' incident, where Gaoming illegally used industrial salt to produce soy sauce products. Because it had confused the public as to the difference between Haitian and Gaoming, the incident resulted in serious damage to Haitian's brand and a severe fall in product sales. Haitian requested compensation and immediate cessation of trademark infringement by Gaoming. The Foshan City Intermediate People's Court held Gaoming liable for trademark infringement.

In terms of damages, there was evidence showing that the plaintiff suffered a large amount of losses. However, the available evidence was insufficient to prove the amount of actual loss resulting directly from infringement. The data showed that Haitian's sales losses apparently ranged from anywhere between 14.9% and 57.14%, and that the court was sceptical as to the accuracy of the survey data. Therefore, the court held that it was difficult to determine the actual loss accurately.

Instead, the court relied upon the audit report and other relevant evidence to determine compensation damages. The court calculated an average three years' profit and came up with lost profits for a period of 16 days on a *pro rata* basis. As such, the court determined that Haitian's lost profits due to sales losses resulted in damages of Rmb3.5 million. In the court's opinion, this would lead to an amount closer to the actual loss.

The court also determined that Gaoming should help pay for Haitian's advertising costs, which it incurred mitigating the impact on its reputation from soy sauce-gate. The court determined that this compensation was necessary and reviewed the relevant invoices supplied by the plaintiff in order to come up with a reasonable amount for the advertisement fees.

The court thus used its discretion to determine which costs were reasonable for Gaoming to compensate Haitian for and order additional compensation of Rmb3 million. The court further recognised that Haitian should be compensated for reasonable enforcement and ordered that Gaoming pay Rmb50,000 for Haitian's court expenses.

Gaoming was ordered to pay damages of Rmb6.55 million in total to Haitian, as compensation for the latter's economic losses. It is illuminating to see how the court categorised different types of losses and combined quantitative data along with its discretion in awarding the damages. It is likely that this kind of approach may be promoted as best practice among Chinese courts in the future.

Court makes example of wilful infringer

BMW AG v Century Bao Chi Clothing Co, Ltd is another leading case that was endorsed by the Supreme People's Court in October 2013. BMW AG had registered a variety of trademarks – including its famous BMW brand, its Chinese transliteration BAOMA and the BMW pictorial logo – in Classes 12, which covers cars and other related goods, and 25 – which covers apparel.

Century Bao Chi Clothing Co, Ltd produces a variety of apparel goods displays logos such as FENG BAOMA FENG, some featuring the BMW pictorial logo. These logos were also prominently displayed on Bao Chi's website and online shop. The company even

used 'German Century BMW Group Co, Ltd' as its corporate name on clothing labels, websites and promotional images.

BMW sued Bao Chi for trademark infringement and unfair competition in Beijing No 2 Intermediate People's Court, requesting that the court order Bao Chi to stop infringing and pay compensation of Rmb2 million for its economic losses. The court held that Bao Chi had infringed BMW's trademark rights and had done so contrary to good faith and accepted business practices. Its intention to use the goodwill associated with BMW's brand to seek illegal interests constituted unfair competition.

Interestingly, the court believed that bad faith (or wilful) infringement constituted 'serious circumstances' which it could use to justify higher amount of damages. The court held that BMW's submitted evidence proved "obvious malice" on the part of Bao Chi, proving that it had infringed BMW's famous trademark for a long time and on a large scale. Not only did the court fully support the claimed Rmb2 million compensation, but it also imposed a further Rmb100,000 in further civil sanctions and submitted a judicial proposal to the State Administration of Industry and Commerce suggesting that it conduct a comprehensive investigation of Bao Chi's infringement. In early 2013 the administration specifically issued a notice to its local departments to investigate suspected violations of BMW's registered trademarks immediately and comprehensively.

This case is a vivid demonstration of the various types of remedy that a brand owner may pursue through the Chinese courts.

It would be interesting to see how the same court were to rule if the plaintiff sued under the newly amended Trademark Law, which now allows for punitive damages.

Conclusion

While many in the industry continue to feel that the damages awarded by Chinese courts do not meet international standards, these recent cases make interesting reading, along with the fact that the Supreme People's Court is openly endorsing them. There are clear signs that courts are becoming much more sophisticated in calculating damages, and the resulting awards are larger and more significant, especially in cases where wilful infringement is clearly present. This is consistent with the increasing awareness of brand value in China.

China has announced that it is exploring establishing specialised IP courts at the Third Plenum Resolution. Even though it remains unclear whether these courts would be federal or would be launched at a local level on a pilot basis, a separate IP court would be likely to devote more attention to the enforcement of trademarks and provide more effective remedies. Rights holders and trademark practitioners need to keep adopting best practices and pushing for better results. [WTR](#)

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