



**R&P China Lawyers** is a boutique Chinese law firm headquartered in Shanghai, providing high-end legal services to foreign businesses active in China.

**Doing Business in China: a Practical Guide** is written to provide a comprehensive overview on factors and issues when doing business in China.

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## Doing Business in China: A Practical Guide

*This guide is partly based on the book 'Chinese Commercial Law – a practical guide' (2010) by Maarten Roos (Managing Director of R&P China Lawyers).*

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## Introduction

*In an environment that presents such an abundance of business opportunities as China, it is certainly not surprising that many companies have been extremely successful. However, many companies also have been struggling to find the right approach in China, which is often caused by a lack of knowledge and preparation. China has a unique business culture and a very different legal framework. Practice has taught that navigating the commercial and legal environment effectively and possessing the right information can mean the difference between success and failure. This guide is written to provide an overview of the most important aspects of doing business in China. However, it is strongly recommended to consult experienced experts in this field in order to actually being able to create a success.*

### 1. Choosing the right legal entity in China

Several structures are available to a foreign investor that invests directly in China. For those businesses that want to partner with a local company, there is the Chinese-Foreign Joint Venture (JV). However, most companies prefer a structure that allows them to fully control operations. They can set up a Representative Office (RO) or a Wholly Foreign-Owned Enterprise (WFOE), the latter usually in manufacturing, trade or consultancy. WFOEs and JVs together are called Foreign-Invested Enterprises (FIEs). In order to choose the most suitable legal form for a certain business, it is important to have a clear understanding of the main legal and tax differences between these options. When deciding which structure to choose, two of the most decisive factors are 1) the intended activities of the subsidiary and 2) the investor's commitment – financial and otherwise – to the business and to China.

#### 1.1. The main legal differences

Foreign investors can directly establish a local company in China. A Foreign-Invested Enterprise represents the deepest possible (capital) commitment of a foreign investor when setting up a business in China. For foreign investors that want to make a more limited commitment, the Representative Office can serve as suitable alternative.

#### Representative Office (RO)

Foreign investors that want a presence in China but do not want to make a deep capital commitment can set up a Representative Office (hereafter: RO) relatively quickly and at low cost. The RO is a very efficient way to establish a limited presence in China, to discover the market or to build relationships with Chinese suppliers. It requires no capital commitment beyond set-up costs and the cost of the Chinese operations; the latter will be borne by the parent company through periodic international remittances to the office's Chinese bank account. Most important, through this office the parent company has ready access to funds in China, so that it can pay for local personnel engaged in liaison, marketing or other non-operational activities. It is important to understand that an RO may not engage in any commercial activity, which means that it is prohibited from buying and selling goods for trading purposes, selling services or engaging in manufacturing. Any such business should be conducted directly between the parent company and its Chinese counterparts.

Another restriction that comes with the RO has to do with hiring employees. While the office can directly hire up to four foreign employees, Chinese staff must be hired through a third-party labor services provider, with which the office will sign a separate

employee dispatch agreement. Such an agreement gives direct access to and control over these employees, but the labor services provider will remain the legal employer.

Also, as the RO is not a legal entity, the parent company ultimately remains responsible for its debts and other obligations. Moreover, because it is not permitted to engage in commercial activities, it cannot financially sustain itself. In most cases the RO is regarded by government authorities as an income generator for the parent company, and therefore will be taxed in China. Chapter 2 provides further detail.

### Wholly Foreign-Owned Enterprise (WFOE)

As opposed to the RO, the WFOE is a fully-owned, independent legal entity or limited company owned entirely by its foreign investor. This structure is straightforward to establish, convenient to operate and relatively easy to control – as long as the right systems of checks and balances are in place. The key issue when establishing a WFOE is to determine what kind of business activities it will engage in; the nature of the business determines what type of WFOE should be established.

**Consultancy WFOE:** to replace the RO function, it may be sufficient to establish a Consultancy WFOE, since this company can provide the same activities as the RO, such as marketing, liaison and quality control functions to headquarters or to third parties in China and abroad, with much less restrictions than the RO and subject to more flexible fiscal policies. In addition, the WFOE can retain employees directly, which has advantages in terms of lower service fees, better protection against claims and control of intellectual property (IP) and confidential information.

**Trading WFOE:** to get a better grip on the market, foreign companies that source from or sell to China can consider going one step further; they can establish a local trading company. A trading WFOE (sometimes called a Foreign-Invested Commercial Enterprise, or FICE), can import and export, purchase and sell domestically. It allows for a more direct relationship with domestic suppliers and customers, as well as the possibility of warehousing in China. Moreover, it provides the opportunity to buy Chinese goods and sell them directly to Chinese customers (even under the foreign brand name!) without exporting these goods first, thereby avoiding transportation costs and customs duties. The trading WFOE is more complicated to establish than the Consultancy WFOE and generally requires a slightly larger investment. Thus investors that want to start slow to support their existing sales or sourcing activities often choose to establish a Consultancy WFOE first. Once the business is large enough and local invoicing is required, they can then expand the business scope to include trading as well.

**Manufacturing WFOE:** the term manufacturing is generally understood to cover any kind of process in which raw materials or other components are purchased, and through the application of processes are turned into other products, which are then sold. The right to sell self-manufactured products, through both export and domestic sales, is generally an automatic right conferred to the manufacturing WFOE. A manufacturer is different from a trading WFOE in that the former must add value to the product itself, while the latter earns its margins only through the sale of that product. In practice however, whether or not an activity is regarded as manufacturing or merely trading can be difficult to determine; when being challenged, one may have to convince the government department that boundaries have not been overstepped. Fortunately, these boundaries are less significant than they have been in the past, and so relatively few problems arise.

## Joint Ventures

The Joint Venture structure in China is used by foreign investors when they are obliged to partner with local companies, or where such partnering has their preference. The main principle behind the JV is that foreign parties can take advantage of the local knowledge and resources of their domestic counterparts, whereas Chinese parties can acquire further valuable knowledge on foreign management, technologies etc. However, JVs have not been without trouble in the past; many Chinese-foreign JVs have ended in dispute. Nonetheless, the JV continues to be popular in some industries and where the particular circumstances make a China contribution beneficial. For foreign investors that choose this structure, it is extremely important to have a thorough understanding of this vehicle and its legal features, and to know which steps can be taken to maximize the opportunity that the JV will become a success.

There are two types of JVs, namely the Equity Joint Venture (hereafter: EJV) and the Cooperative Joint Venture (hereafter: CJV). EJVs are the most common type and have capital investments from both local and foreign investors. This vehicle is a limited liability company, which means that the shareholders shall be liable for the company only to the extent of the registered capital they contribute to the JV. Under CJVs, parties can choose to be an independent legal entity with limited liability or to continue operating as separate legal entities under the umbrella of the CJV; in the latter case the parties bear their liabilities independently. Also, the amount of capital contributed does not necessarily determine the terms of their cooperation within a CJV, which provides parties with more possibilities but also can lead to more complex negotiations.

### 1.2. Establishing the legal entity

#### Registered capital

Foreign investors need to establish a minimum amount of funds before setting up a FIE in China; this amount of funds is called the registered capital. In most industries, investors are permitted to pay these contributions in multiple installments as long as 15 to 20 per cent of the total is paid within three months upon the issuance date of the business license. The remainder must be paid within two years (for a holding company this is five years).

Chinese law establishes that the minimum amount of registered capital is RMB 30,000; for a single-investor limited liability company this starts at RMB 100,000. One can easily see that this amount of registered capital is rarely enough in practice to cover the start up costs. As the Chinese government has notable discretion when approving the establishment of a company, it usually demands higher amounts. Experience shows that in larger Chinese cities the minimum registered capital requirement often exceeds RMB 500,000. Next to cash contributions, registered capital may also include tangible and intangible assets (including IP rights), though these must be monetarily valued by an appraisal organization registered in China and must be legally transferable.

## Registration steps

To establish a WFOE, the following steps usually must be completed. Note that there are variations to these procedures depending on the location of establishment and the scope of business. In order to establish a RO, the third and fourth steps are not required.

Step	Action
1	<b>Negotiating and signing the lease contract:</b> as a WFOE in China requires a legal address, a signed lease agreement for the office is needed prior to registration.
2	<b>Preparing information, documents and materials:</b> including the investor's Certificate of Incorporation, Credit Letter, Audit Report, and Feasibility Study Report, submission documents and company documents (including the Articles of Association).
3	<b>Pre-approval of company name:</b> companies in China must register a name in Chinese, which has to include the brand name, place of investment, industry and 'Co. Ltd'. After confirming the availability of the name, the Administration for Industry and Commerce (AIC) will give pre-approval. This means that the name is reserved for a certain period.
4	<b>Approval to establish the company:</b> the establishment of a foreign-invested company must be approved the establishment of a foreign-invested company must be approved by the district and the Bureau of Foreign Trade and Economic Cooperation (BOFTEC) which is a department of the MOFCOM. Note that other approvals may be required as well, depending on the industries and/or activities.
5	<b>Registration of business license:</b> the registration with the AIC completes the formal establishment. The company file will be kept by the AIC and may be inspected by third parties to confirm the registration status. <i>Thus, upon issuance of the Business License, the subsidiary will be legally established.</i>
6	<p><b>The post-formation procedures, including:</b></p> <ul style="list-style-type: none"> <li>- Carving of stamps</li> <li>- Registration with the Quality and Technology Supervision Department;</li> <li>- Registration with the State Administration for Foreign Exchange (SAFE);</li> <li>- National and local taxation registration;</li> <li>- Finance registration;</li> <li>- Registration as a Foreign Trade Operator (if relevant);</li> <li>- Opening of the capital account, the basic account and other bank accounts;</li> <li>- Registration with the customs authorities;</li> <li>- Some minor subsequent procedures.</li> </ul> <p>By law, these post-formation procedures should be completed within one month of the business license issuance, however this is not always realistic.</p> <p><i>After carving the stamps, the company can start to execute contracts such as employment contracts.</i></p> <p><b>Capital contribution:</b> after the completion of the SAFE registration opening the bank accounts, the investor should contribute (part) of its investment, which upon verification by a Certified Public Accountant (CPA) and settlement is then remitted to the company's basic bank account for use in operations. The Business License needs to be amended to reflect the registered capital contribution.</p> <p><i>Upon receipt of the first installment, settlement into local currency and transfer to the basic bank account, your subsidiary will be fully operational.</i></p>

The establishment of a WFOE generally takes approximately 3 to 6 months upon being fully operational. This time frame, however, does not take into account any delays in finding the appropriate premises or in preparing relevant materials by the investor. As this is not always easy, it is important to work with advisers who have done this kind of work before, and know what to ask.



## 2. Taxation

The legal entities described in paragraph 1.1. (including the RO, even though it is not actually an independent legal entity) are subject to taxes in China. The most important tax categories are corporate income tax, business tax and Value-added Tax (VAT).

### Corporate income tax

Most companies in China are subject to this taxation at a rate of 25 per cent. Corporate income tax is not only required for Chinese-registered companies; foreign companies that are operating businesses in China may also have to pay this tax under certain circumstances. The basic principle is that *income derived from China should be taxed in China*.

ROs are treated in a different way as it cannot directly receive income; however it is still subject to corporate income tax as this vehicle is generally regarded as an establishment. Corporate income tax is calculated based on a deemed income over total cost, which since 2011 is at least 15%. So RO's pay corporate income tax on their total costs, at 25% of 15% of such costs.

### Business tax and VAT

Business tax is a sales tax levied on the provision of (taxable) services, the transfer of intangible assets and the sale of immovable properties. For most items the rate is 5 per cent. It is important to note that it does not make a difference whether the services are provided inside or outside China, as long as either the provider or the receiver of the services is located in China.

In 2012 several pilot systems were launched throughout China to replace the business tax with a common VAT system. Recently China's State Council announced that this pilot program – which is at the moment of writing this guide only applicable in certain cities like Shanghai and Beijing – would become applicable for the whole nation in, 2013. Companies with a revenue of more than RMB 5 million per year will be required to register as general VAT taxpayers; these companies are able to deduct input VAT. The VAT rates for “VAT-taxable Services” (which includes transportation and modern service sectors) are 6 per cent, 11 per cent or 17 per cent, depending on the types of services. Smaller companies (revenue of less than RMB 5 million per year) can use a reduced VAT rate of 3 per cent.

## 3. Employment

With the adoption of the PRC Labor Contract Law in 2007, a big step was made to improve employee rights. However, as employment disputes are chiefly settled locally, implementation of the law continues to vary considerably from place to place and from time to time, depending on the prevailing economic and social circumstances of the day. As a result, the protection of employees varies on a case-by-case basis.

The PRC Labor Contract Law sets out some rules that companies must follow when hiring employees. All companies are required to sign employment contracts with their employees (and are subject to penalties if they fail to do so). The term of an employment contract can be either fixed, indefinite, or for the completion of a specific task; the first two types are by far the most common. As explained above, ROs are not permitted to sign contracts directly with Chinese staff; they must hire their employees through labor service providers. However, foreigners can be employed directly.

Besides signing a contract, employers have certain other obligations. For example, they are required to i) file their staff employment with specific government authorities; ii) contribute to the benefits of their employees; iii) withhold individual income tax on behalf of their employees and; iv) keep an employee personnel file. An employee personnel file displays the education and history of an employee; the responsibility to maintain this file is transferred between employers in case the employee changes jobs.

## Employment handbook

An employer is permitted – and should be encouraged – to draft and issue a set of internal rules and policies, which are often collected in the employment handbook. The employment handbook is considered to be a legal document and can be used as a legal mechanism to control employee behavior with agreed-upon rules and consequences in case of breach or for labor arbitration disputes. Under PRC law, employees or their representatives should be consulted before adoption of such a handbook; smaller companies can ensure effectiveness by having individual employees sign their acceptance to be bound by such rules.

## Compensation

The minimum monthly wage as per 2013 is RMB 1620 in Shanghai and RMB 1400 in Beijing. Besides base salary, the employer can also provide incentive payments. An employer also has the option to provide allowances; examples of such allowances are transportation, meals during lunch and clothing, which may be deductible for individual income tax purposes.

Both employers and employees are obliged to contribute mandatory benefits under PRC law. These benefits are also required for foreign employees, although in some cities this rule has not been implemented; for example, benefits for foreign employees are optional in Shanghai but mandatory in Beijing.

The table below shows some typical percentages for benefits as of April 2013:

Social Benefits	China (percentages as of April 2013 for Shanghai)	
	Employer	Employee
<b>Pension</b>	Usually 20% (22% in Shanghai)	Uniform rate of 8%
<b>Medical insurance</b>	Usually between 7-12% (12% in Shanghai)	Usually 2% (2% in Shanghai)
<b>Unemployment insurance</b>	Usually 2% (1.7% in Shanghai)	Usually 1% (1% in Shanghai)
<b>Work-related Injury insurance</b>	Usually between 0.4-3%, depends on location and risk level (0.5% in Shanghai)	-
<b>Maternity insurance</b>	Usually between 0.5-1% (0.8% in Shanghai)	-
<b>Housing fund</b>	Usually between 7-13% (7% in Shanghai)	Usually matching contribution (7% in Shanghai)

*This table is for reference only. Actual figures may vary.*



## Overtime

The number of working hours per week may be freely agreed upon between the company and its employees; however, a work week in China shall generally not exceed forty hours. Under the law, any time spent in excess of normal working hours is considered overtime, and this carries additional compensation paid out proportionally at 150% of basic hourly salary on a working day, 200% during the weekend or a day off and 300% for work on legal holidays. In case of a dispute on overtime pay, the burden is on the employer to prove whether or not the employee has worked overtime. To meet this evidentiary burden, employers should introduce time-keeping systems that provide a clear written record and refer to such system in the employee handbook and/or employment contracts. Also, one can establish a system of pre-approval, whereby the employee's overtime is recognized only if advance approval is obtained from the supervisor. Another common solution is to divide salaries into a base salary and overtime compensation; the base salary will then be lowered. Although the PRC law seems to disallow lumping overtime compensation, various courts and labor departments have affirmed this practice as long as total overtime compensation is sufficient to cover actual overtime.

## Termination

The PRC Labor Contract Law provides a limited number of situations under which the employer may dismiss an employee. Thus additional grounds agreed upon by parties in the employment contract will not be recognized (except for foreign employees in Shanghai, which fall under a special regime). The evidentiary burden rests with the employer when an employee contests the termination. Some of these grounds allow immediate dismissal without any severance pay or compensation, while others require a thirty day notice period or one-month salary in lieu thereof, and the payment of severance. Severance is calculated at one-month salary for each year (rounded up to the next half year) that the employee has worked for the company and up to a maximum of twelve months under certain circumstances. The one-month salary is calculated – with limitations – at the employee's average monthly salary during the last twelve months. For any period after 1 January 2008 where this salary is more than three times the average monthly salary in the location of employment, the latter will be used to calculate severance pay.

In case of unlawful termination the employee can claim economic compensation or reinstatement. Reinstatement is the most damaging for the employer; if the employee wins the case, then the employer may have to pay salary for the months that the parties were in dispute. If reinstatement is not feasible (at the discretion of the labor arbitration tribunal), then only economic compensation can be awarded. This amount is calculated at two times the average monthly salary in the twelve months before dismissal – including bonuses, commissions and allowances (but capped at three times the applicable average salary in the location of employment) – multiplied by the number of years (up to twelve). For employers with high-income employees this cap is extremely important.

## 4. Corporate governance

Corporate governance can be described as the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled within an organization, thereby ensuring the interests of the organization's shareholders and stakeholders. Practice has demonstrated that many foreign-invested subsidiaries will sooner or later face corporate governance challenges. Establishing an effective system of checks and balances is the best way to control such risks.

Before going into more detail on how the management and supervision of foreign-invested subsidiaries can be structured, it is important to gain a basic understanding of some of the specific corporate governance challenges that foreign investors face in relation to the control of their Chinese entities. The first difficult – and also one of the most obvious – is the physical distance

between the subsidiary and its foreign parent company or, where it is not the same, the actual headquarters of the group. Not only does this translate into Chinese managers reporting to managers who are based abroad, also the manifest cultural difference between Chinese and Western companies causes divergence in those values and business practices that are fundamental in Western corporate governance. Another challenge is the lack of familiarity and understanding by foreign management of the subsidiary's commercial and regulatory environments. Managers may find it difficult to grasp the intricacies of the subsidiary's business operations and challenges, and as a result they struggle to accurately and timely monitor the local management. This can result in either too little freedom, which leads to foregoing opportunities, or too much freedom, which leads to a lack of control and an over-reliance on these local managers. The latter will provide managers with the opportunity to build up individual positions, which can result in an undesirable situation. For example, local managers can abuse their power by collecting personal commissions from suppliers and customers or hiring family members.

### Key positions

A WFOE has by statute three layers of decision-making. The highest level of authority is vested in the shareholder or shareholders' meeting. The board of directors is the second level and monitors the third level, which consists of the senior management, led by the general manager. Good corporate governance is determined by a well-balanced division of authority and responsibility at and between these levels, including effective monitoring.

The shareholder's meeting is composed of all the company's investors. Voting rights are divided proportionally to each equity stake. The PRC Company law conceives the shareholders' meeting as a physical meeting. There are four areas on which shareholders need to jointly decide by law, namely i) issuing corporate bonds; ii) increasing or reducing the company's registered capital; iii) the company's assignment, split-up, dissolution, liquidation, or changing the company form and; iv) revising the company's internal statutes or bylaws, the articles of association. In case of many WFOEs there is only one foreign shareholder, which will simplify the rules of decision-making at the highest level; nonetheless, also a sole shareholder needs to be careful to pursue the optimal level of control at the highest level.

The board of directors, consisting of at least three persons, is mandatory under the PRC Company Law. The directors are appointed by the shareholder(s) and registered with a competent registration authority. Small-scale companies can have a simpler decision-making structure with only one executive director. The board of directors (or in its place, the executive director) has the authority to decide on matters as determined in the articles of association; these powers are normally formulated in broad terms. When appointing directors to a WFOE one faces a trade-off between the value that an individual can bring to the company and the need to assert control over certain decisions. In case of a dispute between the shareholders and the appointed directors, the issue of director liability is a relevant one. The law determines that directors may be subject to civil, administrative and even criminal liability in case their own acts or decisions adopted by the board of directors are in violation of the law, administrative regulations or the articles of association. Also, directors have a fiduciary duty to the company for their decision-making. In case there is a disagreement between a shareholder and a director on a decision related to the company, the shareholder can only override the objections of the director by replacing him for another director; this requires another layer of approvals and registration.

Companies are usually required to have one general manager, to be appointed by and responsible to the board of directors. Its main functions are to implement decisions of the board of directors, handle day-to-day operations and report back on the performance of the company. The Articles of Association determine the general manager's authority, to be supplemented by specific rights and responsibilities conveyed to him in resolutions of the board of directors. Practice shows that it is important to be crystal clear about his duties and responsibilities. Besides the general manager, the board of directors may also appoint other senior managers, such as a financial controller, deputy general manager and a commercial manager. It is important to contemplate

how these managers are to work together, and where relevant, to fix these processes in the articles of association and in the resolutions of the board of directors. A common approach is to divide authority between different positions; under PRC law, only the split of the functions treasurer and accountant is mandatory, but one can choose to have more divisions. Also, when making certain managers directly accountable to the board of directors, one can divide control over the company's operations and strengthen the grip on the managers.

### Legal representative and company's stamps

Legal entities in China can and must appoint only one natural person as the authorized legal representative. This appointment needs to be registered with the competent Administration for Industry and Commerce (AIC), so that third parties can independently confirm which person is authorized to represent the company. The legal representative can authorize persons to act for the company on his behalf, and investors are advised to establish such authorization in detailed documents to prevent abuse.

In China, the value of the company stamp is far greater than the signature of the CEO, general manager or other authorized representative. Every company will have carved and registered its company stamp with the Public Security Bureau (PSB). Next to the company stamp a company may also have other stamps registered like the finance stamp, contract stamp and the customs stamp; these are important for larger companies where different people have the final authority over different matters. Also the legal representative should register his stamp. Documents bearing this stamp will be legal and binding upon that company, whether that document bears a signature or not. Therefore, in order to avoid abuse, the use of the company's stamps should be strictly controlled. Although internal rules – such as a rule that prohibit the sales manager from using the contract stamp to sign contracts valued above a certain limit) can be helpful, it is of utmost importance to find a right balance between convenient access and restricting use of the company's stamps.

### Monitoring

The paragraphs above indicate the most important elements for a well-designed decision-making structure; however, monitoring compliance is at least as important. Essential elements include a frequent and elaborate reporting system, external audits by independent, unbiased third parties and the effective use of a supervisory organ.

## 5. Commercial contracting in China

The use of commercial contracts is indispensable when doing business in China, but it is also difficult due to the different values that prevail between Chinese and Western companies. Although contracts in China are not always performed to the letter, the presence of a contract decreases the risk that a counterpart breaches the agreement. There are four goals of contracting that are crucial for the success of any commercial transaction:

1. The contract clarifies in a precise way the intention of the parties and outlines the agreed-upon terms and conditions of the transaction;
2. Spelling out the consequences of breach in order to encourage the parties to perform the terms as agreed upon;
3. The contract establishes formal procedures for dispute resolution;
4. The contract can serve as evidence in courts as they place a heavy demand on evidence; a written contract with specific terms and conditions is the safest way to ensure the court will understand the intentions of the commercial transactions

and can uphold the original terms of the deal. If no contract is signed, it is almost impossible to enforce rights against a breach of the agreement by the counterpart.

### Chinese practices

Many foreigners have learned that Chinese counterparts have the tendency to renegotiate contracts after they have been signed. The signing of the contract is often only the beginning of negotiations. Although Chinese counterparts will sometimes try to renegotiate contract terms to increase their own benefits, in practice a party will only risk the transaction by insisting on renegotiation if it is in a relatively strong position and thus does not fear compulsory enforcement of the original terms. One should keep in mind that although it might be possible that Chinese parties renegotiate in order to benefit from weak law enforcement, also in Europe and the US parties can have some tactics for example to delay the legal process.

In order to avoid any doubts about the execution of the contract, one can request its Chinese counterpart to affix its official company stamp to the contract. Another further precaution is to have every page of the contract stamped separately or initialed. A contract may be deemed invalid if it does not comply with Chinese laws or administrative regulations; in other words, the transactions contemplated in a contract must be lawful. The most common ground for invalidity is where the business contemplated in the contract falls outside the business scope of the Chinese party and the latter violates legal provisions on restricted business operations. Therefore it is extremely important to confirm a counterpart's business scope before signing the contract. This can be found on the company's business license or in the company's file of the State Administration for Industry and Commerce (SAIC). Asking for a warranty would be another possible solution.

## 6. Protecting Intellectual Property in China

The protection of Intellectual Property (IP) rights should be considered as very important for a company that has business activities in or related to China. All kinds of products are subject to IP infringement; as soon as copyrights, patents, trademarks, domain names and trade secrets will gain value, opportunism of Chinese counterfeiters will become a real risk. For that reason it is important to ensure that valuable IP rights are protected under PRC Law; however, in practice many companies make insufficient effort to do this.

### Trademarks

Trademarks are of great importance to companies due to their distinctiveness and the ability of consumers to associate them with the companies that are using them. One of the big advantages of foreign companies in China is often that they are from abroad; a message which is spread by the use of the trademark. Under Chinese law trademarks must be registered with the State Trademark Office (STO) to ensure the company's exclusive rights in China against third parties; an exception includes well-known trademarks where protection can be based on other legal grounds such as copyright, contractual rights or unfair competition. One of the disadvantages of applying for an exclusive right to a trademark in China is that it can take several years before the registration is fulfilled. For that reason it is important to file for registration as soon as possible, even when an expansion to China is just taken in consideration. Moreover, China applies the first-to-file rule for trademarks. Although there are some grounds for opposing a filed application or cancelling a registered trademark, these procedures tend to be time-consuming and can be very difficult. There have been many examples in practice of squatting, whereby Chinese individuals registered internationally well-known trademarks in order to sell it for a high price in the future.

There are a few steps to be taken in order to register a trademark;

1. **Select the trademark:** the company should consider which trademarks have sufficient value to register. The most obvious trademarks are the company's name, the names of brands, logo's etc. But one should also consider whether a Chinese-language equivalent of an existing, international mark should be devised and registered as well; namely, many Chinese people identify such a product by its Chinese name. In case such a name does not officially exist, the market often creates it. Also one should choose the class in which a trademark is registered – if protection is entailed for goods or services that fall under different classes, a filing should be made for every relevant class. Next to classes, one also has to choose sub-classes of products and services.
2. **Filing:** for filing one needs two documents, namely the Power of Attorney and an information sheet on the intended scope of protection with a copy of the trademark. One has to file applications with the STO and this is even possible through an online application system.
3. **Approval:** the STO examines the trademark with respect to legal requirements and similarity with other trademarks. After approval, for three months as of the day of official publication by the STO, third parties have the opportunity to file an opposition against the registration.

## Copyrights

Copyright arises automatically upon creation of an original work for example in literary or artistic field, as long as it can be reproduced in tangible form. You do not need to register the copyright in order to have an enforceable right in China; however, the enforcement process will be much easier with a registered copyright as registration is considered to be persuasive evidence of copyright ownership. Therefore it is strongly recommended to voluntarily register the (economically) important copyrights.

## Patents

Patents require an application at the State Intellectual Property Office (SIPO). China recognizes three kinds of patents (industrial designs, inventions and utility models), and required novelty and inventiveness. Where a patent is already filed in another jurisdiction, then the Chinese application must be filed within six (designs) or twelve (utility models and inventions) months. Exclusive rights to a patent are granted for ten years for designs and utility models and twenty years for inventions.

## Trade secrets

Trade secrets cannot be registered due to their nature. A company can claim technical information, business information or other know-how as being among its trade secrets when three conditions are met, namely; i) the information must be unknown to the public and people in a related field of business should have difficulty obtaining such information; ii) the information must have either actual or potential commercial value and should be able to bring a competitive advantage; and iii) suitable measures must have been taken in order to keep the information confidential.

## Domain names

Domain names on the other hand can be registered due to their nature. Filing for Chinese domain names (.cn) with the China Internet Network Information Centre (CNNIC) is actually convenient, fast and cheap. However, also with domain names squatting is not uncommon.



## IP enforcement and protection

The PRC Copyright Law, PRC Trademark Law, PRC Patent Law and other laws provide opportunities to pursue infringements. However, there is another legal basis which can be applied in some circumstances. Contracts for instance may include IP protection clauses; in case of breach, the party that suffered the breach may claim against the breaching party in court or in arbitration – depending on the contract. It is therefore important to include such clauses in your employment contracts and commercial contracts. Next to private and criminal actions, administrative departments also often have the jurisdiction to combat IP infringements. The evidentiary standards of an administrative action as a means to enforce IP rights are usually lower than in civil proceedings and administrative action is usually quicker. On the other hand, the success of such an action depends on the willingness of the involved administrative department to act and the deterrence value of the available punishment is relatively low.

Before taking on an administrative action or going to court, it is sometimes worthwhile to try to pressure the infringer into ceasing the infringement or to negotiate some kind of deal; in China this is usually done with the use of a cease and desist letter drafted and sent in Chinese by a Chinese law firm (also called a lawyer's letter). While not always effective, experience suggests that such letters get a response more often than not. As such, this is an inexpensive approach to protecting IP - especially if there is unlikely to be sufficient evidence or resources for a more forceful legal action.

## 7. Questions?

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