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Legal Updates

1. Rules Issued on Asset Product Investments in Two Fund Types

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On October 25, 2019, the National Development and Reform Commission (the "**NDRC**") promulgated the *Circular on Matters Concerning Further Clarifying the Regulation of Investment of Financial Institution Asset Management Products in Venture Capital Funds and Government-funded Industry Funds* (the "**Rules**"), jointly with the People's Bank of China, the Ministry of Finance, the China Banking and Insurance Regulatory Commission, the China Securities Regulatory Commission, and the State Administration of Foreign Exchange. The Rules are a regulatory supplement to Article 2 of the *Guiding Opinions on Regulating the Asset Management Business of Financial Institutions* (the "**Guiding Opinions**"), which provide that "the provisions with regard to venture capital funds and government-funded industry funds shall be developed separately." We briefly summarize and analyze the key provisions of the Rules for your reference in combination with the *Press Conference Q&A Regarding Circular on Matters Concerning Further Clarifying the Regulation of Investment of Financial Institution Asset Management Products in Venture Capital Funds and Government-funded Industry Funds* (the "**Q&A**").

Applicable scope of the Rules

The Rules mainly apply to investments made by financial institution asset management products in venture capital funds ("**VC Funds**") and government-funded industry investment funds ("**Government Industry Funds**"; collectively, the "**two fund types**"), which is consistent with the logic of the Guiding Opinions[1]. In addition, the exemptions for "nesting restrictions" equally apply to investments in the two fund types by financial institution asset management products and ordinary private equity funds. "Financial institution asset management products" refer to asset management products issued by financial institutions such as a banking, trust, securities, funds, futures, or insurance asset management institutions, or financial asset investment companies, as provided in the Guiding Opinions.

Conditions for the two fund types to enjoy "support policies"

What are the two fund types? Under the Rules, the definitions of the funds do not see significant changes compared to previous documents. Specifically, the definition of "VC Funds" is essentially the same as that provided in the *Interim Measures for Administration of Venture Capital Investment Enterprises*[2] issued

[1] Please refer to Han Kun's Legal Review, entitled *Han Kun Series—Analyzing the Guiding Opinions on Regulating the Asset Management Business of Financial Institutions—for Private Equity Funds*, dated of April 28, 2018 (Chinese). http://www.pbc.gov.cn/en/3688253/3689009/3788480/3778722/index.html

[2] According to Article 2 of *Interim Measures for Administration of Venture Capital Investment Enterprises*, the term "venture capital investment enterprise" as used in these Measures refers to an enterprise incorporated within the territory of the People's Republic of China mainly engaged in venture capital investment. The term "venture capital investment" as used in the previous paragraph refers to a method of investment whereby equity investments are made in start-up enterprises in the hope of reaping capital gains mainly through equity transfers after the invested start-up matures or is relatively mature. The term "start-up enterprises" as used in the previous paragraph refers to growth enterprises being set up or re-established, which are registered and established within the territory of the People's Republic of China, excluding those already listed.

by the NDRC et al. in 2005, and the definition of "Government Industry Funds" is essentially the same as provided in *Interim Measures for Administration of Government-funded Industry Investment Funds*[3] issued by the NDRC at the end of 2016. However, not all of the two types of funds are eligible for support policies under the Rules. Funds must satisfy conditions stipulated in either Article 1 or Article 2 of the Rules to be eligible for the support policies.

The conditions for VC Funds include:

1. Conformity with the relevant provisions for VC Funds as stipulated in the Interim Measures for Administration of Venture Capital Investment Enterprises or the Interim Measures for Supervision and Administration of Private Investment Funds, and completion of the record-filing procedures as required;
2. The fund's investments conform to national macro management policies such as industrial policies and investment policies;
3. The investment scope of the fund is limited to unlisted enterprises, except for shares which are not transferred or allotted as held by the fund after the listing of the investee;
4. The operation of the fund does not involve debt financing, except for the issuance of bonds for purposes of improving investment capacity in accordance with law;
5. The duration of the fund is no shorter than seven years; structured arrangements are not allowed for fund shares, with the exception of preferred share classes for government-established and -funded venture capital guidance funds;
6. The name of the fund contains the words "venture capital", or the fund contract and prospectus describe a "venture capital" strategy.

Item 5 requires special attention among the six conditions above, that is, "[t]he duration of the fund is no shorter than seven years; structured arrangements are not allowed for fund shares, with the exception of preferred share classes for government-established and -funded venture capital guidance funds". The Rules encourage VC Funds to make long-term investments by stipulating a duration of seven years or more for VC Funds. Based upon our past experiences, most VC Funds we have encountered are of a duration of seven years or more, but there are also certain VC Funds (particularly special funds) whose duration is less than seven years. In addition, VC Funds with structured share classes will also face certain obstacles to become eligible for the support policies. In practice, preferred share classes are not only given to government-established and -funded venture capital guidance funds, but also may be extended to financial institution asset management products, depending on the business arrangements of relevant parties.

[3] According to Article 2 of *Interim Measures for the Administration of Government-funded Industry Investment Funds*, for the purpose of the Measures, the term "government-funded industry investment funds" refers to equity investment funds and venture capital funds which are sponsored by the government and are mainly used to invest in enterprises' non-publicly traded equity.

Government Industry Funds need to satisfy the following conditions:

1. Approval obtained from the people's government at the central or provincial levels, or municipalities with independent planning status (including a department thereof or institution directly thereunder) and the government capital commitments are clearly specified in the approval document or other documents; the proportion of government capital commitments shall not be less than 10% of the total fund size, where the establishment of the fund is approved by the CPC Central Committee and State Council, the proportion of government capital commitment shall not be less than 5% of the total fund size;

2. Conformity with relevant provisions of *the Interim Measures for the Administration of Government-funded Industry Investment Funds and the Interim Measures for the Administration of Government Investment Funds*;

3. The fund's investment scope conforms with national macro administrative policies, such as industrial policies and investment policies;

4. The operation of the fund does not incur implicit debts for local governments.

The above conditions clearly exclude application of the Rules to Government Industry Funds set up by governments below the provincial, autonomous district, and municipality levels (except for municipalities with independent planning status)[4]. Therefore, Government Industry Funds that are established by governments of municipalities directly under the central government or governments of prefecture-level municipalities are not included in the applicable scope which, however, account for a considerable portion of Government Industry Funds that are currently mature and active in the market. Government Industry Funds ineligible for preferential treatment for Government Industry Funds under the Rules may consider whether they satisfy conditions for VC Funds.

Based upon the definitions provided in the Rules, it appears that the scopes of the two fund types are limited to direct investment private equity investment funds that invest directly in unlisted companies. So, does this mean government industry parent funds and venture capital parent funds are exempted from the Rules? According to the Q&A, "some of the two fund types are 'parent funds' that directly serve the real economy. They do not violate restrictions of the Guiding Opinions that prohibit asset management products from 'leaving the real economy for the virtual economy' and 'circulating within the financial system'." According to the NDRC's explanations, we understand that the two fund types referenced in the Rules should also include "parent funds" that primarily invest in the equities or shares of other private equity funds, the details of which await to be further clarified and explained by the NDRC in practice.

Exemptions for nesting restrictions

According to the Guiding Opinions, "[a]n asset management product may further invest in a layer of asset management product, but the latter may not further invest in an asset management product other than a publicly offered securities investment fund", and "[p]rivate investment funds shall be governed by the

[4] As of the date of this Article, there were five municipalities with independent planning status, including Dalian, Qingdao, Ningbo, Xiamen, and Shenzhen.

special laws and administrative regulations on private investment funds, or, in the absence of explicit provisions in such laws and administrative regulations, by these [Guiding Opinions], and the provisions with regard to venture capital funds and government-funded industry investment funds shall be developed separately." Before the promulgation of the Rules, it had not been clarified in any laws or by any regulatory authority whether a general private equity investment fund established by a non-financial institution constituted "a layer of asset management product" in counting investment layers. In practice, many financial institutions may feel uncertain about complying with the nesting restrictions when investing in ordinary private equity funds. The Rules put an end to this uncertainty by clarifying the relevant issues in a formal written document jointly issued by the six ministries and commissions.

The Rules clearly specify that VC Funds and Government Industry Funds which meet the conditions are not considered a layer of asset management product when they receive investments from financial institution asset management products and private equity funds—such investments will not be considered nesting investments. The Q&A further explains the inherent logic of the exceptions made for the two fund types: the nesting restrictions for asset management product investments as stipulated in the Guiding Opinions are primarily intended to reduce the flow of funds within financial institutions; that is, to prevent asset management products from "leaving the real economy for the virtual economy" and "circulating within the financial system". The two fund types should not be considered as nesting layers because they directly serve the real economy. In this respect, the Rules basically resolve the concerns regarding the application of nesting restrictions on financial institution asset management products when investing in ordinary private equity funds. After the promulgation of the Rules, we expect that financial institution asset management products, Government Industry Funds, or market-oriented parent funds will prefer investees that meet the conditions stipulated in the Rules in order to reduce their own nesting compliance risk.

Effectiveness of existing products

Financial institutions may have already made investments into the two fund types prior to the issuance of the Guiding Opinions. However, those investments may be at risk of violating the restrictions as stipulated in the Guiding Opinions on asset management business carried out by financial institutions, thus making it difficult for financial institutions to determine the effectiveness of such investments.

According to the Rules, subscription agreements signed by and between financial institutions and VC Funds and Government Industry Funds that meet the conditions before the issuance of the Guiding Opinions will continue to be effective. During the transition period, financial institutions can make investments by issuing existing products (subject to fewer restrictions compared to new products as stipulated in the Guiding Opinions), but must gradually and orderly reduce the scale of the existing products on yearly basis. If the existing products issued by financial institutions have not yet expired at the end of the transition period, the Rules provide that these existing products will be "handled appropriately according to a plan approved by the financial regulatory department". Therefore, we understand that unexpired products after the transition period will be handled on case-by-case basis before obtaining further instructions from the relevant authorities.

In principle, the VC Funds and Government Industry Funds are governed by the Guiding Opinions in all aspects, other than matters subject to “separate provisions” or for which “exceptions” have been provided in the Rules. In our view, on the whole, the Rules benefit VC Funds and Government Industry Funds and, to some extent, relax investment restrictions on investments in these two fund types by financial institution asset management products. This will attract more capital flows into early investments, long-term investments, and investments in line with industrial policies and will bring vitality to the private equity investment market. We will continue to monitor issues that may arise during the implementation of the Rules and share and discuss our opinions with you in a timely manner.

2. Foreign-related OEM Held to Constitute Trademark Infringement — Comments on the Supreme People's Court's Judgment in the Honda OEM Case

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On September 23, 2019, the Supreme People's Court (the "**SPC**") entered a retrial judgment in a trademark infringement dispute case between the retrial applicant Honda Motor Co., Ltd. and the respondents Chongqing Hengsheng Xintai Trading Co., Ltd. ("**Hengsheng Trading**") and Chongqing Hensim Group Co., Ltd. ("**Hensim Group**", together with Hengsheng Trading, the "**Respondents**"). The judgment overturned the second instance civil judgment in the case by holding that the Respondents' foreign-related original equipment manufacturing ("**OEM**") **activities constituted trademark infringement**[5].

The judgment in Honda held that foreign-related OEM can constitute trademark infringement, **which differs markedly from the SPC's earlier rulings in the trademark** infringement cases of PRETUL in 2015[6] and Dongfeng[7] in 2018. In Honda, foreign-related OEM was found to constitute trademark infringement, indicating that the SPC's judicial views are undergoing **a major change.** The SPC in Honda returns to the law and legal principles compared with the previous judgments, which took greater consideration of the needs of national economic policies. The SPC's interpretation of certain important issues is more in accordance with the original intent of the law, such as in respect of "use of trademarks" and "relevant public".

Honda OEM case – factual background

Hensim Group accepted a commission from Myanmar Mei Hua Company to process and manufacture 220 sets of motorcycle parts.

Myanmarese citizen Thet Monaung holds the trademark right to "HONDAKIT" in Myanmar and serves as the managing director of Myanmar Meihua Company. Thet Monaung authorized Hensim Group to attach the trademark "HONDAKIT" to the corresponding goods, while Hengsheng Trading handled matters related to customs declaration and export, and exported all relevant goods to Myanmar.

Upon hearing the case arguments, the SPC found that the Respondents used the words and graphics of "HONDAKIT" on the motorcycle parts they manufactured and sold in a manner which **caused the "HONDAKIT" trademark to appear similar to the three trademarks claimed by Honda Motor Co., Ltd., by emphasizing the word "HONDA" in large letters while deemphasizing the word "KIT" in smaller letters, and marking with red the letter "H" and similar wing-shaped parts**. The SPC held that the alleged acts of infringement constituted the use of a trademark, which also had the possibility of causing confusion and mistaken recognition among the relevant public and could easily confuse the

[5] [Case of Trademark Infringement Dispute: Honda Motor Co., Ltd. v. Chongqing Hengsheng Xintai Trading Co., Ltd. et al.] (Sup. People's Ct., Civil Retrial Judgment (2019) No. 138; issued Sept. 23, 2019).

[6] Retrial Civil Judgement (2014) Min Ti Zi No. 38 made by Supreme People's Court.

[7] Retrial Civil Judgement (2016) Zui Gao Fa Min Zai No. 339 made by Supreme People's Court.

relevant public. Ultimately, the SPC held that the Respondents' OEM constituted trademark infringement.

Key Questions in the Honda OEM Case

I. "Use of a trademark" under the Trademark Law

1. The SPC's holding

In Honda, the SPC affirmed for the first time that the use of a trademark in OEM constitutes the use of a trademark "in the trademark sense". The SPC held that the use of a trademark usually includes many aspects, such as physical attachment, market circulation, etc., and whether the use of a trademark constitutes the use of a trademark under the Trademark Law should be integrally and consistently interpreted in accordance with the Trademark Law, and a single activity should not be separated and only viewed as a discrete aspect. If a trademark is used on manufactured, produced, or processed goods as a mark or otherwise, such use shall be deemed to constitute the "use of a trademark" under the Trademark Law, so long as it is possible to distinguish the origin of the goods.

2. Brief comment

In Dongfeng and PRETUL, the SPC did not find the use of trademarks in foreign-related OEM to constitute the use of trademarks "in the trademark sense" because the goods were wholly exported outside China. In fact, to some extent, those judgments considered certain national economic policy factors. Dongfeng and PRETUL stood to indicate that brands used in foreign-related OEM could not constitute trademark infringement, thus rendering it impossible for domestic trademark owners to prevent the use of their trademarks on such goods in China—an absolute rule that has been unfair to domestic trademark owners. The SPC held in Honda that the use of trademarks on OEM goods sold only outside China may constitute the "use of a trademark"—so long as the trademarks were used on the goods within China and had the function of identifying the origin of the goods. In Honda, the SPC has returned to a more rational interpretation of "use of a trademark".

II. Relevant public

1. The SPC's holding

In Honda, the SPC's interpretation of "relevant public" corrected the one-sidedness of "relevant public" in Dongfeng and PRETUL. The SPC held that, in the present case, the relevant public includes not only the consumers of the allegedly infringing goods, but also the **operators** closely related to the marketing of those goods. **This interpretation is more in line with the definition of the relevant public in the Trademark Law.** Moreover, with the development of e-commerce and the Internet, **even if the infringing goods at issue were exported abroad, it would be possible for those goods to return to the domestic market. At the same time**, with the continuous development of China's economy, **there are a large number of Chinese consumers traveling and spending abroad** and such consumers may also come into contact with and be confused by branded goods.

2. Brief comment

In the previous cases, the administrative and judicial authorities have had a relatively narrow understanding of the relevant public for goods wholly exported abroad and ignored operators who may be exposed to trademarks in production, transportation, and sales. The authorities also rarely considered factors such as “goods may return to China” and “Chinese consumers may come into contact with trademarks when abroad for tourism or consumption”. The SPC's latest holding on issues related to the relevant public in Honda deserves attention. While, the SPC includes “operators” in “relevant public” according to judicial interpretation, the SPC also considers other factors when determining the issue of “relevant public”, such as actual circumstances, economic development and the convenience of logistics having a great influence of the regionality of intellectual property rights and the potential influence of regional factors (such as “Chinese consumers coming into contact with trademarks when abroad for tourism or consumption”, “goods may return to China”).

Subjective malice of the Respondents in the Honda OEM case

It is worth noting that in the SPC’s judgment, it was emphasized that the trademark involved in Honda was used in a way that **“the word ‘HONDA’ was enlarged and the word ‘KIT’ was reduced in size”**. Although the SPC did not directly comment on the Respondents’ subjective malice, **the manner in which the Respondents used the trademark clearly reflected their subjective malice to ride the coattails of the well-known brand “HONDA”**. The circumstances of the Respondents’ subjective malice should have had a certain influence on the judges’ evaluation of evidence, the criteria for the judges to admit evidence, and the final judgment in the case.

Advice for foreign-related OEM contractors

After the SPC’s judgment in Honda, domestic judicial authorities may show a tightening trend toward whether foreign-related OEM can be found to constitute infringement. This is clearly positive news for those who have already registered trademarks in China, but for foreign trademark owners who only enjoy trademark rights abroad or whose domestic trademarks have been squatted, the changes in judicial attitudes may increase the legal risk of involvement in infringement actions with trademark squatters. The following are some suggestions for foreign trademark owners whose marks are being squatted in China:

1. Review Chinese trademarks before contracting for foreign-related OEM in China. If the same or similar trademarks are already registered in China, we suggest taking measures against those trademarks as soon as possible, such as through invalidation or opposition. Foreign trademark owners should also apply to register their trademarks in China.

2. From an efficiency standpoint, foreign trademark owners can consider anonymously acquiring the same or similar domestic marks in order to reduce the negative impact on exporting goods outside China. This will effectively reduce or eliminate the risk of infringement litigation in a short period of time.

3. Trademarks used in OEM should be entirely the same as the corresponding foreign-registered trademarks, and goods manufactured in China should only be exported to destinations where the trademark owner has rights to their marks.

Important Announcement

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