

Hong Kong and Its Shadow Companies

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One of the difficult issues faced in protection of brands/trademarks in China and elsewhere in Asia is the Hong Kong Shadow Company.

The formation of companies in Hong Kong over the past several decades has changed dramatically. Years ago it was exceedingly difficult, especially for a Chinese national residing in the mainland, to form a company in Hong Kong. Over the years Hong Kong has become more and more closely tied to mainland China and its laws have eased considerably in terms of formation of a company. Now company formation in Hong Kong has become one of the economic engines responsible for Hong Kong's growth and continued prosperity.

Unfortunately, as the registration of companies in Hong Kong became easier (it can be done via internet using firms in Hong Kong that specialize in such purposes) it also became easier for those engaged in illegal activities in Asia to form companies to further their nefarious purposes. In particular, the "shadow company" was and remains an attractive entity for counterfeiters. A shadow company, simply put, is a company formed in Hong Kong which incorporates as part of its company name the well known trademark of another. Two examples I have personally dealt with over the years serve as good examples. New Balance, the American footwear company, faced an entity incorporated in Hong Kong as Hong Kong New Balance Limited. Absolut, the well-known Swedish vodka company, faced a similar situation, with Southeast Asia Absolut Hong Kong Ltd. Neither of these companies had anything to do with the brand owners.

Shadow companies are often used to issue what appears to be authentic looking authority to factories in China or elsewhere, granting a license to such factory to make goods bearing the famous trademark. When authorities in China visit the factory to confirm the authority to affix the key trademark, the factory proudly produces its "license" from the shadow company. The shadow company, being properly and lawfully formed under Hong Kong law is real. Thus the Chinese or other authorities are faced with a *prima facie* issue of trying to determine whether and what is real or not. Rather than risk being wrong, most of the time the authorities will withdraw and leave it to the trademark owner to solve the problem. The factory continues to produce unimpeded. When you check the Hong Kong Companies Registrar, as one does under these circumstances, you will more often than not find the site of the shadow company's office to be a metro center, or apartment building or a piece of empty land with no real office anywhere. When you examine the named shareholders and directors, you find they are from China. Since the information in Hong Kong must be truthful, those persons indeed exist. However when, and if, you find them, generally they are individuals who have simply been paid by others to "front" the company formation. The real persons behind shadow companies are well-hidden, often being the owners of the factory in China allegedly being licensed by that same company.

Counterfeiters often go a step further. Aside from registering a company name with a brand in it, if the brand owner has for some reason neglected to obtain its own registrations in relevant classes in Hong Kong and/or China, the shadow company will apply to Registrar trade marks that closely resemble the genuine trade mark. So long as the mark is distinctive, even if it is close to the real thing, the Hong Kong Trademarks Registrar will waste no time in approving the registration.

Hong Kong has faced the tough issue of finding a balance between protecting trademark owners' rights and continuing to encourage fast and easy company formation. The underlying difficulty has been exacerbated by the fact that the registration of trademarks in Hong Kong is an entirely different administrative function and set of laws from those applicable to the registration of names to the Company Registrar (Chapter 32 of Companies Ordinance). There is no cross searching between the two agencies. Thus in forming a shadow company, the owners are reasonably assured of success in formation and that there will be some time before they are found out. Even when discovered, the trademark owners' remedies are limited, although better now than in the past.

The Prior Conundrum

In years past, under Sec. 22 of the Companies Ordinance, the Company Registrar was empowered to direct a company to change its company name if it was the same as or "too like" the name of a company that has already been registered. The problem was the Registrar of Companies interpreted "too like" narrowly. Often the shadow company would claim to be in an unrelated business. If so, 99% of the time the Registrar would let the company name stand. No proof was required of an applicant that it *actually* was in the business it claimed.

Sec. 291 of the Companies Ordinance empowered the Registrar to strike off a company provided the shadow company was not doing any business. But the Registrar had to first send a letter to the company making inquiry. This would be replied to by the local agent for the company. On receiving a reply the Registrar would back away as it could not prove the shadow company was doing no business. Again, there was no requirement that any of the statements be truthful, or even accurate. The Registrar claimed to have neither authority nor manpower to investigate any other reality.

Court actions were the only remedy left. The reality was they too ultimately would fail. Although it was quite easy to obtain default judgments against the shadow companies, the case had to be brought as well against the individual shareholders and directors. If they were not individually brought in (almost impossible in Asia) any order of the Hong Kong court would be limited to the shadow company itself which was, in effect, meaningless, since the shareholders and directors would largely just keep on doing business as usual.

Finally, the law required that the brand owner move against the shadow company within 12 months of the company's formation and that the brand owner itself have a locally formed company using the trademark, which had to be formed before the date of incorporation of the shadow company. These two requirements often lead to a dead end on the part of a brand's efforts to protect itself.

Pressure on the Hong Kong Government from genuine brand owners, related associations, and various national governments intensified. It was clear the existing legal framework could not handle the issue of the shadow company in any economically sensible, legally predictable manner. As a result the government amended the Companies Ordinance in December of 2010 the result of which has been mixed at best.

The Fix

Trademark owners under Sec 22 of the Companies Ordinance may request the Company Registrar to direct a change to the name of a [shadow] company. *See Sec 22(2) and Sec 22(3B)*. The key change is in enforcement. No longer does the Registrar have to involve shareholders and directors. If the shadow company does not properly respond, the Registrar may *sua sponte* change the name of the shadow company to its registration number. This would seem on its face to be both straightforward and relatively easy to accomplish.

However, the government did not change the key requirements that that brand owner first Registrar its trademark and its company name (or a company name) incorporating the trademark

in Hong Kong before that of the shadow company and that any action be commenced within 12 months of the formation of the shadow company. As before, often discovery of a shadow company takes place when a counterfeit action is taken in China which can be well after the incorporation of the shadow company, making compliance with the 12 month rule impossible.

All is not lost however. If a trademark owner cannot comply with the regulations leading to direct action by the Company Registrar, the trademark owner may still resort to a civil court proceeding. It again must (and can rather easily) obtain an injunction against the shadow company continuing to do business under the existing name. The trademark owner can serve a copy of the court's order on the Company Registrar who will then change the shadow company's name from the brand to the company registration number. The key change here has been to eliminate the need to find, serve and bring in to the court action the shareholders and directors of the shadow company.

Nonetheless, the process remains fraught with difficulties and for a foreign trademark owner can be quite costly to enforce.

The Situation Today; Recommendations

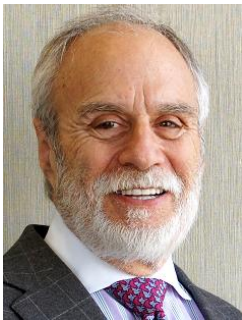
Overall matters have improved. The number of shadow companies actually registered has apparently decreased as has the boldness of the counterfeiters. Nonetheless, the lack of cross checking between the Trademarks Ordinance and the Companies Ordinance remains. There still remains no mechanism to prevent the registration of a shadow company in advance.. In addition, of course, registration of a form of shadow company that does not use the authorized trademark in its name but carries all the other characteristics of shadow company formation and use (false addresses, undiscoverable officers and shareholders, minimal capital, no real business) remains. These "quasi" shadow companies are often used to Registrar trademarks in China that in fact are owned by others, e.g. pirate registrations, since China is a first to Registrar country rather than a use based country. In addition, because the 12 month time limit remains the administrative remedy is simply not available if the trademark owner first discovers the problem after 12 months since shadow company formation has gone by. While civil proceedings are available and easier, the cost of enforcing a genuine trademark and the owner's rights against a shadow company in Hong Kong remains high. Legal proceedings in Hong Kong are generally on the very expensive side.

There are however a number of steps a company can and should take to protect itself, some of the most important being:

- Watch the trademark gazettes published in both Hong Kong and China showing approved but not yet registered trademarks. Oppose those registrations which are both identical and/or uncomfortably close.
- Registrar key trademarks in Hong Kong.
- Registrar the trademark in a company name in Hong Kong. The actual entity would be subject to tax and other guidance from counsel.
- Registrar key trademarks in China. Remember, registration in Hong Kong is not registration in China. Remember also, China uses a classification system that incorporates subclasses to the main international classes. To the extent financially possible, registration of trademarks should take place in as many subclasses as possible, even those fairly distant from the owner's core business and should be for both the English and Chinese language versions of the mark.
- Monitor the Company Registrar in Hong Kong. The Registrar is searchable via the internet link: https://www.icris.cr.gov.hk/csci/login_i.do?loginType=iquest. From there one can search via company name, particular, documents, directors and other fields. This should be done regularly, especially if the brand's profile begins to grow in the region.
- Act swiftly on discovery of a problem registration. Be mindful of the 12 month time limit to act administratively. It is far far less expensive to act within the time frame than later.

With simple administrative efforts the authentic brand owner can largely avoid the primary problem of the shadow company being formed with the authentic trademark as part of its name or at least cause it to be changed in a financially sensible manner. This is largely true with avoiding pirate registrations of trademarks (a full discussion will take place in another article) to the extent a trademark owner can afford multiple registrations. The key to a successful program is if possible, do not wait until a problem is discovered by reason of efforts against third parties in China or elsewhere. By following a few steps, the trademark owner can stay at least a bit ahead of the game.

For more information, please contact:



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Harley Lewin has over 40 years experience, travelling the world in an effort to protect trademarks, designs, ideas and his clients' businesses in general.

He handles the development and implementation of global brand protection strategies including groundbreaking efforts to track and stop the flow of fake or infringing goods around the world, working directly with governments, law enforcement agencies, courts and Customs in more than 75 countries and implementing new and cost-effective methods to protect his clients' assets.

Mr. Lewin is also focused on the litigation and international arbitration of trademark, trade dress, copyright, unfair competition, anti-counterfeiting, and infringement disputes. Mr Lewin has litigated in all of the federal district courts and many US state courts, as well as many foreign jurisdictions. He has served as an expert witness in many disputes.

Mr Lewin has engaged in leading edge litigation acting for plaintiffs where the use of a color mark on luxury shoes was at issue (Louboutin vs YSL); defended a US trade dress action involving energy drink graphics; represented a US footwear company in connection with an investigation and criminal and civil proceedings regarding illegal imports and seizure of over \$2.5 million in counterfeit merchandise; coordinated in Latin America a three-country customs effort to interdict the flow of counterfeit goods; and conducted multi-district litigation for multiple watch brands, seizing more than 800,000 watches and \$1 million in cash, breaking four global organizations and obtaining a \$4.5 million contempt judgment. At any one time Mr. Lewin is engaged in work in over 30 countries often representing brands located outside the United States.

Mr. Lewin's transactional team implements global licensing programs, and develops comprehensive document programs inclusive of manufacturing, supply, distribution, import, export, marketing and advertising as well as the selection, application and registration of trademarks throughout the world.

Mr Lewin is routinely sought as a legal authority and has appeared on Good Morning America, CNBC, CBS 60 Minutes, MSNBC and CNN International. He was the first non-celebrity to be featured in the biography section of The New Yorker Magazine, Fashion Edition, March 9 2007.