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Qingdao IP Tribunal clarifies the criteria of exhaustion in cases of product modification (2022)

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Precis: The ruling in a civil suit against Wuxi Smile IoT Ltd establishes that, when considering whether modified genuine products constitute trademark infringement, whether the alleged acts are detrimental to a trademark owner's legitimate rights is the key issue.

The Intellectual Property Tribunal of the Qingdao Intermediate Court in Shandong Province, China, rendered a decision on 26 November 2021 in favour of Haier's IP arm, Qingdao HSZC Management Consulting Ltd, in a civil suit against a smart laundry machine solution provider, Wuxi Smile IoT Ltd. The court held Wuxi Smile liable for trademark infringement and unfair competition, ordered cessation and awarded Haier's IP arm damages of Rmb3 million.

Wuxi Smile modified a slew of legally acquired Haier laundry machines, shoe washing machines and dryers, replacing the original control boards and adding signs of "smile & device" and its own Chinese trade name to the control panels. The original Haier QR code, which the user could scan by using a mobile device to pay for the laundry services, was also removed and replaced with Smile QR code. These modified machines were later sold to an array of universities and installed in the laundromats on the campuses.

Haier sought a permanent injunction for trademark infringement and unfair competition and damages of Rmb10 million from Wuxi Smile.

As a rebuttal, Wuxi Smile cited the doctrine of exhaustion and contended Haier's trademark infringement claim was without merit.

The Qingdao Intermediate Court opined that:

under the doctrine of exhaustion, the trademark right in a product that is legitimately sold by the trademark owner or the licensee thereof become 'exhausted' by the first sale of goods or placing the same in the market ...The doctrine applies on the premise that the reselling or using of the product...is not detrimental to the legitimate trademark rights of the trademark owner.

The court found that the defendant, by selling and operating the modified Haier products, undermined the source identifying and quality guarantee function, as well as the credibility of the plaintiff's trademark based on the following:

The modified products, which alter the original structure and function of the plaintiff's trademarked products, have become "new products".

The defendant added its sign on the modified products without giving an explanation, which is likely to mislead the relevant public into misconstruing the smile sign as part of the trademarked products, or that the defendant is somehow associated with the plaintiff or the trademark thereof.

In general, the modified products will be maintained by the operator rather than the original manufacturer.

In case of malfunction, consumers are likely to attribute the quality and maintenance problem to the trademark owner, thus leading to negative reviews and perceptions of the plaintiff's trademark.

The court therefore threw out the defendant's argument on the doctrine of exhaustion and found that trademark infringement could be established.

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Regarding the plaintiff's unfair competition claim, the court elucidated that competition shall be interpreted in a broad sense where the competing interests of one party may be harmed by the other. The defendant's modification, sale and promotion of the plaintiff's trademarked products was likely to hamper the competing interests, including trading opportunities and competitiveness of the plaintiff. The court therefore confirmed the competitive relationship between the plaintiff and defendant. It then ascertained that:

the defendant, by falsely advertising itself as a strategic partner of Haier and its products as "Smile – Haier Collaborative Product", promoted its products in a factually incorrect manner, which was likely to cause misunderstanding among consumers and thus constitutes false advertising; and the defendant repeatedly underlined "Haier laundry machine" in its promotional campaign on multiple platforms, which was likely to make the relevant public believe the modification was sanctioned by or associated with the plaintiff, thus creating confusion and misidentification.

The court awarded Haier damages of Rmb3 million by taking into account the reputation of the plaintiff's Haier trademark, the scale of the defendant's business operation, the severity of the defendant's acts, as well as the reasonable costs the plaintiff incurred in stopping the infringement.

Both parties appealed but later withdrew and the first instance decision has come into force.

The ruling of the case may serve as a frame of reference on the issue of whether modified genuine products constitute trademark infringement. The key focus is whether the alleged acts are detrimental to the legitimate trademark rights of the trademark owner.

It echoes the Supreme People's Court (SPC) ruling in DOMINO case ([2019] Zui Gao Fa Min Shen No 4241), which the SPC rendered in December 2020, reiterating that substantive modification severing the association between the trademark and the products will create "new products", thus causing confusion and constituting trademark infringement. Trademark owners that are harassed by modified products can stop such acts by proving that the modification undermines the source-identification and quality-guarantee function of their mark, or its credibility.