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Under the exhaustion-of-rights principle, once an IP-protected product is sold, the IP owner's exclusive rights over that specific product are exhausted. In other words, once a product legally enters the market under a registered trademark, the trademark owner loses any right to prevent any following sales of the product.

However, this principle does not prevent manufacturers from organising their distribution networks and imposing certain conditions or restrictions on their distributors. These restrictions may lead the distributor to step outside of contractual boundaries or even adopt unethical behaviours, such as code scratching. Three recent cases demonstrate significant differences in Chinese court judgments on whether such behaviour constitutes infringement.

To meet sales targets or performance evaluations set by manufacturers, distributors may be required to purchase large quantities of products, which can lead to overstocking. When faced with mounting inventory and cashflow challenges, they may resort to selling products at heavily discounted prices or redirecting them to other regions to quickly liquidate excess stock.

This is where code scratching comes in. Code scratching refers to the deliberate removal or alteration of product codes (eg, barcodes, QR codes or serial numbers) on packaging or labels. This practice is typically used to obscure the traceability of products, making it difficult to track their origin, distribution channel or intended market. This allows distributors to bypass contractual limitations or evade responsibilities tied to specific distribution channels.

Whether the removal of product identification codes constitutes infringement is a point of legal contention. Recent court decisions have provided varying interpretations from the perspectives of trademark infringement and unfair competition, but there is no consistent conclusion across courts.

Opple Lighting v Zhang Zhonghua

In *Opple Lighting v Zhang Zhonghua*, the Wuhan Jiangnan District People's Court, in its first-instance judgment, found that Zhang Zhonghua had removed barcodes from the external packaging of authentic Opple products – but the Opple trademark and independent barcodes/QR codes on individual packaging were still intact. Since consumers would not be confused about the source of the products, the resale did not infringe trademark rights. Additionally, as Zhang Zhonghua was a reseller rather than a manufacturer, these actions did not reduce Opple's market share, meaning no competitive relationship was harmed.

However, the Wuhan Intermediate People's Court, in its second-instance judgment in July 2024, held that the code removal compromised the product's integrity, potentially causing consumers to misunderstand its quality due to the lack of crucial information. This harmed Opple's reputation and undermined consumer rights, violating the good-faith principle under Article 2 of the Anti-Unfair Competition Law.

Opple Lighting v Dingfeng Company

In this January 2024 case, the Shenzhen Nanshan District People's Court ruled in the first instance that Dingfeng's online sale of products with removed codes:

- damaged the integrity of the product packaging;

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- disrupted traceability and warranty functions;
- undermined fair competition among distributors;
- increased consumer redress costs; and
- infringed on consumers' rights, thereby constituting unfair competition.

However, the Shenzhen Intermediate People's Court held in its second-instance ruling that the products were genuine with clearly visible trademarks and manufacturer information. Consumers could still verify authenticity and access after-sales service via the packaging's QR code. Therefore, there was no confusion surrounding the source of the products and the conduct did not fall under Article 6 of the Anti-Unfair Competition Law.

Moreover, the code removal only partially impacted Oppl's internal distributor tracing system without harming its competitive advantage. Since the transaction was conducted openly and did not disrupt fair market competition, applying the good-faith principle was deemed unnecessary.

Mary Kay v Ma Shunxian

In this case, the Zhejiang High People's Court overturned the first-instance infringement decision. The court reasoned that the products in question were genuine goods obtained through legitimate channels, and even though QR codes and batch numbers were removed, the quality and source information on the packaging remained unchanged. Therefore, the trademark's function to indicate origin was not compromised and product quality remained under Mary Kay's control. Since consumers were explicitly informed that the products came from non-official channels, the brand's value was not damaged. The court thus ruled that there was no trademark infringement.

It also applied the proportionality principle when determining whether Ma Shunxian's actions constituted unfair competition. Although Mary Kay's business model suffered some losses, Ma Shunxian's sales of discounted, authentic products still fell within the realm of fair competition and did not warrant regulation under the Anti-Unfair Competition Law. Further, since Ma Shunxian clearly disclosed the true nature of the code-removed products to consumers during online sales, consumer choice and market competition were not compromised. In the e-commerce context, the sale of such products was deemed consistent with the principles of honesty and recognised business ethics.

The Supreme People's Court ultimately upheld the second-instance judgment, rejecting Mary Kay's retrial request.

Key takeaways

These three cases demonstrate the significant differences in how the courts tackle code scratching. In the two Oppl Lighting cases, the courts reached different conclusions regarding similar code removal, highlighting the complexity of balancing consumer rights, product integrity and market competition. In the Mary Kay case, the defendant's explicit disclosure to consumers that the products were parallel imports was a key factor and played a critical role in the court's judgment.

There is currently no definitive answer as to whether code scratching constitutes infringement. Outcomes often depend on how courts balance trademark exhaustion and considerations related to consumer rights and market competition. The ultimate resolution of this issue may require clearer legal norms and more consistent judicial precedents.