

# The Limited Monopoly™

## Christmas in China

by Robert Gunderman, PE and John Hammond, PE

What would Christmas be these days without mentioning the words “Made in China.” From Christmas lights to wrapping paper, and even the gifts left by Santa Claus, the little gold “Made in China” sticker is ever present. It seems that the elves have moved their workshop from the north pole to regions farther south and east. Maybe the elves are happier in a warmer climate, although we have heard the reindeer miss those cold starlit nights way up north.

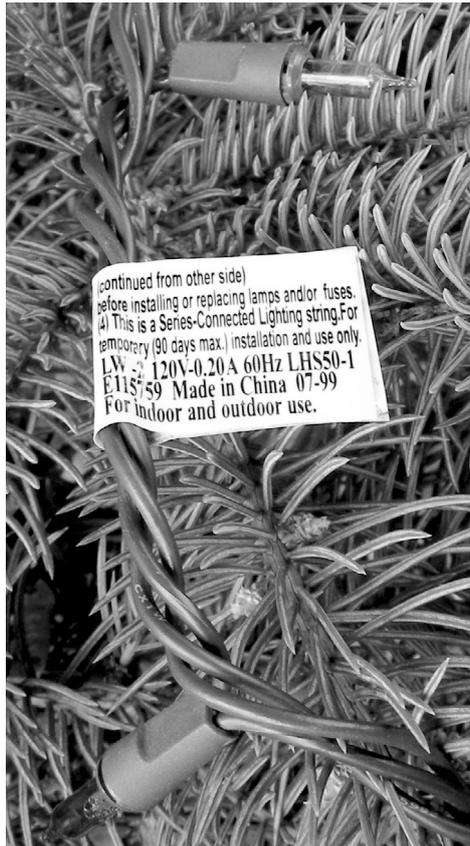
Much could be written on the exodus of U.S. manufacturing to China, the land of cheap labor and lower environmental standards. We will skip all that, and focus on Intellectual Property, patents in particular. If you look beyond the gold “Made in China” sticker, you may possibly find patent numbers on some of the merchandise you are buying for Christmas. There are certainly stories and drama behind many of these products. If your business is contemplating sourcing product manufacturing to China, or if you are doing so already, read on. We have learned of incredible things related to patents in China, and incredible is not always good.

### Chinese Patents- A historical perspective

Most will agree that China’s attitude toward patents is not the same as the rest of the industrialized world. Perhaps this attitude is due to the country’s history. When Mao Zedong and the Communist Party took over the country in 1949, most forms of private property were abolished. This perspective also permeated the world of intellectual property in China at the time. The Communists created a patent system where all patents were the property of the government and the people could use these patents in any way they wanted. Thus, there was no real concept of intellectual property “rights.” This attitude still lingers with many Chinese businesses today, even though there is now a modern patent system in place.

### Modern Chinese patent law

The Chinese patent law was enacted on March 12, 1984, and was made effective on April 1, 1985. The Chinese patent law has been revised twice since that time. The first revision was enacted on September 4, 1992 (effective January 1, 1993) and the second revision on August 25, 2000 (effective July 1, 2001). A third revision has been in the works since April 2005. The patent law in China is administered by SIPO, the State Intellectual Property Office.



As we all know, the economy in China is in overdrive. Many believe the pace cannot be sustained, and even now it is tracking with the overall global recession. Yet the quality of many Chinese products has been going up from near worthless status some time ago to a level that is at least respectable. There has been a trend to build better and

more innovative products in China as a way to sustain and grow their economic engine. An infusion of innovation could certainly be an economic catalyst in their already full-speed production machine. The Chinese economy must move away from an environment of counterfeiting and piracy in order to sustain its growth. According to the United States Patent and Trademark Office, 80 percent of all border seizures for counterfeit products originate in China. Piracy and counterfeiting are estimated to cost the U.S. economy \$250 billion annually<sup>1</sup>. Clearly this trend must go down if China is to become a respected economic entity. Until that time, if you are considering a move to China, understand that U.S. laws and U.S. patents have no bearing there.

### A Limited Monopoly only in the U.S.

A United States Patent allows you to exclude others from making, using or selling your invention in the United States. A pending U.S. patent application has even less strength, and neither have any bearing outside the United States. So if someone else makes your U.S. patented product in China, you have no ability to stop them, until they bring the copied product into the U.S. Once an infringed product is imported into the United States, it is subject to U.S. law. Of course there may be challenges in dealing with the Chinese manufacturer of your infringed product. Fortunately there is often a U.S. based distributor for the Chinese manufacturer, making the task of enforcement at least a bit easier.

### Nightmares in China

Let’s suppose that you are interested in shopping your new product around in China to find the best Chinese manufacturer. There are significant pitfalls with this strategy, and several of our clients have experienced them firsthand. While it is not possible for us to share the details of our clients’ experiences in China, many of them have a recurring theme. Using your hypothetical U.S. company as the example, the basic story goes as follows:

You believe that your profit margin could be much higher on an existing or new product if it were made in China. So you identify several possible Chinese manufacturers and send drawings and other product information to see what kind of deal you can get. Perhaps you do not have any form of patent protection in place,

*“So if someone else makes your U.S. patented product in China, you have no ability to stop them, until they bring the copied product into the U.S.”*

or if you do, it is a United States Patent or Patent Application, neither of which matter in China. In an attempt to protect your company, you request that a non-disclosure agreement be signed by the Chinese manufacturer prior to releasing the product details. This provides false comfort at best.

Now you settle on one manufacturer and forget about the rest of them. Or perhaps you decide not to go to China at all. Or you switch manufacturers in China due to quality or business problems. Later you find your product is being made by a Chinese manufacturer you talked with some time ago. If the product is being imported into the U.S., and you have an enforceable U.S. patent, you can take legal action against the Chinese company and its distributors. This of course is challenging and expensive, but can be effective.

But oftentimes it doesn't end with your product being “knocked off.” The Chinese company that you delivered your product drawings to, but that you elected not to do business with, has now filed a Chinese patent application for your product under its name. This may sound incredible, but it happens routinely. Worse yet, your adversary is now suing both you and your current Chinese manufacturer in China for patent infringement. If it succeeds, the Chinese government can enter your Chinese manufacturer's factory and seize the product tooling, production equipment, drawings, and computer files - essentially cutting off your production and your ability to supply your U.S. customers.

This is a nightmare that many U.S. companies have seen. A recent example was written up in *The Times of Trenton* (NJ) where Fiber Optic Designs, producer of Forever Bright LED Christmas lights, went to China for manufacturing. Sales were good, and FOD contracted with a second and then a third Chinese manufacturer to meet production demands. The third manufacturer liked the

product so much that it filed an application for a Chinese patent on the Forever Bright lantern design covering the LED lights. The patent issued in China, and Fiber Optic Designs and its first two Chinese manufacturers were sued for patent infringement in China, threatening their very existence. (Talk about the spirit of Christmas...) Variations of this nightmare have been repeated over and over again.

### Protecting Your Invention

While the Chinese patent system still has not earned the respect it needs, it is a beginning, and appears to be getting better. Don't make the mistake of ignoring the possibility of filing for a Chinese patent just because the system is far from perfect. China must continue to improve on its intellectual property rights if it is to continue to thrive globally. And don't falsely rely on non-disclosure agreements because they are cheap. If you plan to do business internationally, and this includes manufacturing operations in foreign countries such as China, be sure that your invention is protected to the fullest extent possible. A Chinese patent application can be filed by way of a U.S. patent practitioner working directly with an associate in China. We regularly work with a reputable firm in Beijing. Patent filing options include filing

directly in China or filing by way of the Patent Cooperation Treaty<sup>2</sup>. Either way, if you are going to make a sizeable investment in your product, be sure to use the patent laws of China and other countries to protect your investment. The cost may be minor compared to dealing with one of the horror stories we have described here.



1. United States Patent and Trademark Office two day program on protecting intellectual property in China, April 2-3 2008, Houston, Texas.
2. See our November 2007 article entitled “Filing International Patent Applications, Tuning in To The Patent Cooperation Treaty” for more on the Patent Cooperation Treaty. A copy can be obtained free of charge at [www.patenteducation.com](http://www.patenteducation.com).

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