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Wielding the Double-Edged Sword: Creating the Perception of a Chinese Enterprise to Obtain and Enforce Patent Protection in China

David A. Fazzolare

I. INTRODUCTION

Obtaining and enforcing patent protection in China is a double-edged sword. On the positive side, China has one of the fastest growing economies among one of the world’s largest potential consumer markets. On the negative side, China has rampant piracy and counterfeiting issues, as well as unsatisfactory enforcement of patent rights.

A practical strategy for international businesses seeking to successfully wield the double-edged sword of obtaining and enforcing patent protection in China involves diminishing the incentives for corruption, bribery, and local protectionism that favor Chinese pirates, counterfeiters, and infringers. International businesses can diminish these incentives by creating the perception of a Chinese enterprise—that is, a business founded and operated in China, presumably by Chinese nationals.

First, Part II of this Comment reviews concerns that international businesses face in deciding whether to obtain and enforce patent protection in China. In Part III, this Comment provides reasons for obtaining patent protection in China. Part IV explains why creating the perception of a Chinese enterprise can diminish the incentives for corruption, bribery, and local protectionism that traditionally favor Chinese pirates, counterfeiters, and infringers. Part V then analyzes Chinese laws limiting foreign investment in Chinese industries and laws governing the structural organization and ownership of foreign investment capital. International businesses must operate within the limits of these laws to create the perception of a Chinese enterprise. Finally, Part VI provides specific strategies that international businesses can use to successfully create the perception of a Chinese enterprise.

* J.D., J. Reuben Clark Law School, Brigham Young University (2009). The author is a licensed patent agent.
II.Factors to Consider When Deciding Whether to Obtain Patent Protection in China

International businesses must consider several factors when deciding whether to obtain patent protection in China. They must be aware of negative trends—namely corruption, bribery, and protectionism—that currently undermine justice in the Chinese judicial system. These contribute to a lack of impartiality, a lack of transparency, unsatisfactory enforcement of patent rights, and remedies that favor imitators over inventors.

A. The Judiciary's Lack of Impartiality

Corruption, bribery, and protectionism undermine impartial decision making in China. First, judicial corruption stems from the Communist Party's control over appointment and promotion of senior judges. With that control, Chinese courts exercise judicial authority on behalf of the state, and thus on behalf of the Chinese Communist Party. In fact, some suggest that the judiciary is strictly controlled by the Chinese Communist Party. Given the direct influence over the appointment and promotion of senior judges, it is hard to imagine how judicial decisions in China can reflect anything but the official Communist Party platform and its underlying motivations and interests. Moreover, the use of informal relationships to bypass formal legal processes has produced pervasive corruption of the Chinese judiciary. Personal connections are often used to directly impair impartiality through the bribing of judges.

Second, pirates, counterfeiters, and infringers resort to bribery as a means to thwart proper enforcement of patent protection. In particular, "Chinese provincial authorities, 'far away over the mountains,' benefit financially or politically from the proceeds of piracy or, instead, turn a blind eye to powerful local interests that
Under the influence of bribery, judges and administrators fail to act impartially at the outset of investigating allegations of infringement. As a result, otherwise meritorious claims of infringement may be summarily dismissed; efforts to investigate the infringement claims may be relaxed; or early remedies, such as preliminary injunctions to stop infringement, may not be awarded.

Third, local protectionism pervades the judicial landscape in China. De facto local protectionism results from the ability of local people's congresses to remove judges. Fear of removal from comfortable positions of power unduly influences judges to ensure that local businesses and agencies—often engaging in piracy, counterfeiting, and infringement—succeed in lawsuits irrespective of the merits of a case. Thus, impartiality is forgone in favor of protecting the interests of local businesses and agencies—usually to the detriment of international competitors.

B. Lack of Judicial Transparency and Predictability in the Judiciary

In addition to facing issues such as corruption and local protectionism, international businesses accustomed to common law systems face unpredictable judicial determinations when they seek to enforce patent rights in China. This unpredictability stems from China's lack of judicial transparency in three important areas: the precedential value of case law, the reporting of judicial decisions, and the construction of patent claims.

First, judicial determinations in China lack predictability because the Chinese legal system does not accept or recognize cases as a source of law. China has a civil law instead of common law system. Unlike common law, the Chinese system is based around several codes that guide the law. Therefore, international businesses cannot look to judicial decisions for indications of the way a court may rule in a patent infringement proceeding. And even if China did recognize cases as legal precedent, opinions reduced to writing

8. Id.
9. See Volper, supra note 1, at 326.
10. Id. at 327.
12. See id. at 328.
14. See generally Ho, supra note 13.
15. Id.
are characteristically brief, without much analysis or legal reasoning to assist international businesses in determining their legal positions with much accuracy.\textsuperscript{16}

However, international businesses may find refuge in recent trends where the published decisions of cases involving foreign parties have provided more legal analysis and legal reasoning.\textsuperscript{17} Despite this helpful trend, written decisions still provide little practical value if the decisions cannot stand as binding precedent. Consequently, the reporting of decisions that are not recognized as a valid source of law in China makes judicial determinations unpredictable for international businesses.

Second, reported judicial decisions provide little guidance for international businesses seeking to enforce patent rights in China. For starters, few opinions are published and fewer opinions become public without editing by China's high court.\textsuperscript{18} The Supreme People's Court (SPC) publishes some of its opinions in its official Gazette, but these opinions are also edited.\textsuperscript{19} Even decisions of the lower courts that may appear in the Gazette are often revised by the SPC.\textsuperscript{20} Of the cases that are decided, there exists "no comprehensive and searchable system for reporting judicial decisions in China."\textsuperscript{21} Given the highly edited nature of reported cases and the inability to search for these cases in a comprehensive manner, there is little transparency in the reporting of judicial decisions in China.

Third, judicial determinations of patent infringement in China are much more unpredictable because Chinese courts have not established uniform canons of patent claim construction to assist patentees and alleged infringers in predicting how courts will interpret patent claims.\textsuperscript{22}

\section*{C. Unsatisfactory Enforcement of Patent Rights}

Along with its poor record of judicial transparency, China has developed a reputation for unsatisfactory enforcement of patent rights, despite its desire to be known as a respecter of international patent rights. This is mainly due to China's insufficient efforts to end

\begin{itemize}
  \item \textsuperscript{16} Chua, supra note 2, at 136.
  \item \textsuperscript{17} See id.
  \item \textsuperscript{18} Volper, supra note 1, at 313.
  \item \textsuperscript{19} Id.
  \item \textsuperscript{20} Id.
  \item \textsuperscript{21} Id. at 329.
  \item \textsuperscript{22} Id. at 337.
\end{itemize}
infringing and illegal activity. China’s unsatisfactory enforcement stems from both its inability to persuade authorities to take a serious look at infringing activities and the largely ineffective sanctions leveled against infringers. For example, a spokesman of the State Intellectual Property Office (SIPO) suggested that bribing local officials may frequently be a prerequisite to initiate investigation of infringement allegations. Even more troubling, in cases that necessitate investigation in China, the end result is often “toothless administrative enforcement” rather than effective police action. The natural consequence of such policies is that administrative seizures and fines have become accepted as a necessary business cost by infringers.

To China’s credit, recent judicial decisions have heightened restrictions on patent infringement. The criminal threshold quantity for patent infringement was lowered from 1000 units to 500 units, but the United States maintains that such quantities still permit pirates and counterfeiters to operate under a safe harbor on a commercial production scale. With safe harbors for commercial scale production of pirated goods and Chinese infringers accepting administrative fines and seizures as a necessary business cost, China’s record of enforcement of patent rights remains unsatisfactory.

D. Remedies Benefit Imitators Rather than Innovators

In China, available remedies are not only unsatisfactorily applied, but also benefit imitators rather than innovators because (1) stringent evidentiary standards coupled with inadequate discovery procedures make patent enforcement outcomes unfavorable for patent owners, and (2) patent owners with otherwise meritorious infringement claims often find their damages awards eviscerated by determinations of patent invalidity in separate proceedings.

China’s stringent evidentiary standards, when coupled with inadequate discovery procedures, make it more difficult to obtain

23. Id. at 326. China’s record of unsatisfactory enforcement of patent rights led the United States Trade Representative (USTR) to initiate a WTO action against China in April 2007. Id. at 309–11. The USTR frequently receives complaints about the lack of uniform, fair, and consistent enforcement of intellectual property rights and regulations in China’s courts. Id. at 331.

24. Id. at 326.

25. Id.

26. Id.

27. Id. at 325–26.
preliminary injunctions and adequate damages awards, thus complicating patent enforcement efforts. First, an international business seeking a preliminary injunction to halt infringement must clearly prove both infringement and irreparable harm. But clearly proving both infringement and irreparable harm may prove insurmountable without adequate discovery procedures to obtain the underlying evidence. In fact, preliminary injunctions may be nothing more than a fictional remedy in China because the SPC has instructed lower Chinese courts that preliminary injunctions are unavailable in cases that involve “non-literal infringement or complicated technologies.”

Damages awards in China are subject to the same strict evidentiary standards, making it extremely difficult to obtain adequate awards through successful patent infringement litigation. Additionally, infringer’s profits form the basis for assessing patent damages and plaintiffs must rely on preservation of evidence to gather the pertinent sales and accounting data from the defendant. Proving damages can be particularly difficult considering the lack of formal discovery mechanisms in China. Consequently, damages awards in China are extremely low in comparison to the United States.

Even after international businesses prove damages, patent owners often find their damages awards eviscerated by determinations of patent invalidity in separate proceedings. In China, alleged patent infringers often seek stays of infringement cases by initiating invalidation actions with the Patent Reexamination Council (“PRC”) to challenge the validity of the infringed patent. Patent invalidation proceedings may occur parallel with patent infringement litigation of the underlying patent at issue; if the invalidation proceedings occur after the infringement litigation, a stay of the infringement award

29. Id. at 449.
30. Id. at 459.
31. Id. at 449.
32. Id. Chinese courts are permitted to include reasonable expenses and attorney fees in calculated damages. Id. This might compensate for the costs of assuming the risk of patent litigation, but recovery of attorney fees in China is rare. Id.
33. Chua, supra note 2, at 154. In fact, international businesses are increasingly becoming subject to invalidation proceedings before the PRC. Bai et al., supra note 28, at 449.
may occur.34

Invalidation proceedings usually involve invention patents, while infringement litigation usually applies to utility model patents and design patents.35 International businesses owning invention patents should expect parallel invalidity and infringement proceedings.36 Indeed, it is not uncommon for a patent found to be infringed by the People’s Courts to be subsequently invalidated by the Patent Reexamination Board (PRB).37 International businesses in these circumstances will find little assurance in the fact that the intermediate court reverses decisions of the PRB less than twenty percent of the time.38 International businesses thus face multiple legal hurdles in the quest for patent protection.

E. Effects of the Negative Judicial Trends

International businesses looking to obtain Chinese patent protection should not only be concerned with the challenges of obtaining patent protection, but also widespread infringement, piracy, and counterfeiting after a patent is obtained.39 This patent

34. See generally Bai et al., supra note 28.


36. See generally Bai et al., supra note 28.


38. Id.

39. Infringement estimates of all forms of intellectual property in China exceed 90%. Volper, supra note 1, at 309. Among the infringing products seized at United States customs, more than 80% originated in China. Id. Estimates of counterfeit goods originating in China exceeds billions of dollars and is growing in double-digit percentages each year. Kirk Hermann et al., Protecting Nanotechnology Intellectual Property (“Nano-IP”) In China, 2 NANO TECH. L. & BUS. 96, 108 (2005). International software companies should be concerned that an estimated 90% of software being used in China is pirated. Id. Additionally, a substantial number of well-known brands being sold in China are estimated to be counterfeit—approximately 15 to 20%. Samir B. Dahman, Protecting Your IP Rights in China: An Overview of the Process, 1 ENTREPRENEURIAL BUS. L.J. 63, 63 (2006). According to the U.S. Bureau of Customs and Border Protection, China is the largest counterfeiter. Emma Schwartz, China
infringement harms businesses in at least two ways.

First, patented goods pirated in China result in lost sales and diluted good will for the patent holder. If infringing goods are permitted to be sold in China, international businesses do not benefit from the patent monopoly granted by a Chinese patent and must determine whether it makes sense to incur the time and expense required to obtain a Chinese patent.

Second, Chinese businesses making and exporting infringed goods directly reduce global sales and cause brand name dilution. If Chinese infringers are permitted to make patented products within China and sell the patented products to countries in which the patentee has not applied for a patent, it seriously diminishes the incentive for international businesses to incur the time and expense required in obtaining patent protection in China.

III. REASONS FOR OBTAINING CHINESE PATENT PROTECTION

Despite China’s record of unsatisfactory patent enforcement, there are compelling reasons for obtaining patent protection in China. These include the size of the Chinese market, global trends of business competitors, Chinese accession to most relevant international intellectual property treaties, and recent Chinese reforms.

A. The Chinese Market

The vast size of the Chinese market and the anticipated growth of the Chinese economy may warrant obtaining patent protection in China. China’s potential consumer market is the largest in the world with approximately 1.3 billion people living in China. In addition, China’s economy is among the fastest growing and is expected to one day be the world’s largest. While the size of the Chinese


41. _Id._


43. The Chinese economy could surpass Germany and Japan within ten years and may eventually overtake the United States to become the world's largest economy within thirty-five years. Robert C. Bird, _Defending Intellectual Property Rights in the BRIC Economies_, 43 Am. Bus. L.J. 317, 318 (2006). Within three years of the prior publication, China has already surpassed Germany in terms of GDP making China the third largest economy in the world. Press Release, China Daily, China Overtakes Germany in Terms of GDP (Jan. 15, 2009),

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market alone may not be enough to tip the scales in favor of obtaining patent protection in China, it is an encouraging factor.

Assuming that the reforms mentioned below in Section D are implemented, Chinese patent protection may provide international businesses with more satisfactory enforcement. Given the five-year period for implementation of the reforms, and the twenty-year term for patent protection, satisfactory patent enforcement seems much more plausible during the latter years of the patent term. If patent enforcement becomes satisfactory as a result of these reforms, the vast size of the Chinese market becomes a compelling factor. The patent will then provide a limited monopoly for the remainder of the patent term, thus paying huge dividends for the international businesses that are willing to assume the risk of obtaining patent protection with the hopes that enforcement becomes satisfactory.

B. Global Business Competitors

Trends in global competition suggest that many international businesses are attempting to establish a dominant patent position in China.44 China has seen a noticeable increase in the number of international businesses applying for patent protection within its borders45 since it signed the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Accord).46 At the same time, there has been a huge increase in the number of Patent Cooperation Treaty (PCT) applications being filed at the World Intellectual Property Organization (WIPO) from Chinese competitors.47 Consequently, international businesses are likely to find themselves

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46. The TRIPS Accord was an attempt to provide and implement uniformity with respect to intellectual property rights. WTO, Understanding the WTO: The Agreements, Intellectual Property: Protection and Enforcement, available at http://www.wto.org/english/theWTO_e/whatis_e/tif_e/agrm7_e.htm. Under a common set of international regulations, signatories (fellow WTO members) must establish a minimum level of protection, thereby striking an agreed-upon balance between long-term benefits and short-term costs of protective provisions. Id.
47. Volper, supra note 1, at 324. The PCT was formed by the World Intellectual Property Organization. It is an international agreement that allows for the filing of a single patent application to have effect in all of the signatory states. Patent Cooperation Treaty, June 19, 1970, 28 U.S.T. 7645, 1160 U.N.T.S. 231.
facing increased competition for Chinese patent rights not only from other international companies, but also from Chinese companies themselves. If global competitors are assuming the risks of obtaining Chinese patent protection, following suit may be necessary to remain competitive on a global scale.

C. China is a Signatory to Most Major International IP Treaties

China’s status as a signatory to a majority of the important international intellectual property treaties argues in favor of obtaining patent protection in China. Treaties that China has signed include the Paris Convention, the Madrid Agreement, the Protocol relating to the Madrid Agreement, the Berne

48. Chua, supra note 2, at 150.
Convention,\textsuperscript{52} and the Patent Cooperation Treaty\textsuperscript{53}—arguably the most important international treaty concerning patent protection. China’s willingness to participate in all major intellectual property treaties suggests that it is attempting to become a responsible player in the international patent arena. Because the country has, at least superficially,\textsuperscript{54} agreed to abide by these international norms, obtaining patent protection in China will be an increasingly important part of an international patent strategy.

\textbf{D. Chinese Reforms}

Probably the most significant reason for obtaining patent protection in China going forward is the growing potential for reform. Not only have Chinese officials publicly acknowledged the country’s unsatisfactory enforcement record\textsuperscript{55} and the need to

\begin{footnotesize}


\textsuperscript{54}“Superficially,” because international agreements such as these typically have no real enforcement mechanism. However, the drawing up of such an agreement and China’s signature to it represent early steps to the creation of an international patent standard.

\textsuperscript{55}In a recent intellectual property compendium, China’s State Council recognized that “China’s intellectual property system is imperfect,” people in China have a “poor sense on intellectual property,” and “intellectual property infringements are serious.” Circular of the State Council on Printing and Issuing of the National Intellectual Property Strategy Compendium, § I(3) (Circulated by the State Council on June 5, 2008) (P.R.C.), available at http://www.fdi.gov.cn/pub/FDILEN/Laws/lsaw_info.jsp?docid=94069 [hereinafter IP Strategy Compendium].
\end{footnotesize}
improve intellectual property protection before becoming a truly developed nation, but China has taken concrete action towards initiating patent enforcement reforms. Likewise, Chinese businesses are increasingly showing respect for patent laws, rather than opposing or ignoring them. Perhaps most importantly, though, the SPC has recognized that interference from the executive branch exists, and that Chinese parties do in fact benefit from corruption, bribery, and protectionism.

The Supreme People’s Court (SPC), in an effort to counter these perceptions, has introduced regulations and judicial interpretations combating piracy, infringement, and counterfeiting. As part of this effort, the SPC instituted two five-year reform plans. The first Five-Year People’s Court Reform Plan was unveiled in 1999. It included the goals of implementing anti-corruption regulations and creating a limited form of discovery in an effort to promote a more adversarial-type, common law system of proceedings. The second Five-Year People’s Courts Reform Plan was unveiled in 2005. It included the bold, new concepts of guaranteeing financial independence for Chinese courts, employing significant cases as guidelines for interpreting legal outcomes in order to establish a more meaningful system of precedent, and bringing uniformity to the understanding of Chinese laws by courts and practitioners throughout China.

More recently, in 2008, the Communist Party of China (CPC) revealed its own ambitious five-year plan to prevent and punish corruption. The CPC called for unprecedented reforms, such as intense supervision of government officials at all levels, with requirements that they be closely examined for abuse of their positions in acquiring money, bribes, or otherwise interfering with markets or trade. Additionally, the plan calls for media oversight by encouraging constructive criticism of the government and the public.

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56. Tian Lipu, the Commissioner of the State Intellectual Property Office, expressed China’s need to switch from “made in China” to “invented in China.” Volper, supra note 1, at 323.
58. Chua, supra note 2.
59. Id. at 150.
60. Id. at 137.
61. Id. at 138.
63. Id.
Although the actual impact these reforms will have on improving enforcement of Chinese patents is as yet unknown, they are, at least, a step in the right direction. If SPC reforms can create a judicial system that more closely comports with international expectations regarding transparency, impartiality, and satisfactory enforcement, then much of the concern surrounding China's judicial system will be alleviated. Given the twenty-year term for Chinese patent protection, these reforms could improve the patent landscape in China long before the expiration of patents currently being issued.

IV. CREATING THE PERCEPTION OF A CHINESE ENTERPRISE
DIMINISHES THE INCENTIVES FOR NEGATIVE TRENDS

Creating the perception of a Chinese enterprise diminishes the negative impacts of corruption, bribery, and local protectionism on international businesses operating in China. This perception blurs perceived distinctions between such businesses and local Chinese enterprises. A given company's success in creating such a perception is directly proportional to its presence within China—the greater the number of local Chinese citizens employed as managers, researchers, and laborers, the more successful the international business will be in creating the perception of a Chinese enterprise. Likewise, the greater the percentage of ownership retained by local Chinese citizens, the more it will blur the perceived distinctions between the international business operating in China and local Chinese enterprises that are engaged in piracy, counterfeiting, or infringement.

When an international business fails to successfully create the perception of a Chinese enterprise, judicial officials have strong incentives to rule against the international business, regardless of the merits of the case. Upholding the patent monopoly of an international business will have a direct, negative impact not only on local entrepreneurs who are parties to the action, but on the entire local economy. For example, a permanent injunction against the sale of infringed goods has the potential to shut down a factory that

64. See id. Consistent with these calls for reform the CPC's highest "anti-graft" official has also called for improving anti-corruption laws. He Guoqiang, CPC Central Commission for Discipline Inspection Secretary, has stated that "anti-graft laws should be strictly implemented and violators... severely punished... to cultivate a legal environment in fighting corruption." ChinaCourt, Top Chinese Anti-graft Official Urges Better Laws Against Corruption (Nov. 10, 2008), available at http://en.chinaCourt.org/public/detail.php?id=4385.
reproduced the goods. The consequences of such action could be devastating to a local economy in a rural Chinese setting. Factory workers would lose their jobs, tax revenues would decrease, and the people could even become unruly. Avoidance of such consequences provides a strong incentive for the perpetuation of corruption, bribery, and local protection, often resulting in awards that are favorable to pirates, counterfeiters, and infringers.

On the other hand, international businesses that successfully create the perception of a Chinese enterprise invite administrative and judicial officials to focus more on the merits of patent enforcement actions and less on the identity of the parties involved. Such businesses diminish the incentives for corruption by altering the cost-benefit analysis and the consequences of the enforcement decision. When an international business successfully creates the perception of a Chinese enterprise, the benefits of invalidating its patents and ruling in favor of pirates, counterfeiters, and infringers are less apparent. The decision becomes more outcome-neutral because a ruling against the international business then also has direct, negative consequences for the local economy. That is, if the patent of an international business with the perception of a Chinese enterprise is invalidated and infringement is not found, the international business, whose sole reason for doing business in China is to exploit its patent monopoly, may be forced to close its Chinese operations. This, in turn, could lead to the loss of local jobs and decreased tax revenues much in the same way that a judgment against an entirely local enterprise would. The more Chinese citizens employed by an international business, the greater the negative impact of unsatisfactory patent enforcement.

Thus, creating the perception of a Chinese enterprise weakens the notion that international businesses asserting their patents will destabilize local Chinese economies. International businesses that successfully create the perception of a Chinese enterprise become indistinguishable from other local Chinese enterprises that otherwise resort to piracy, counterfeiting, or infringement.

V. CHINESE LAWS RESTRICT THE CREATION OF A PERCEPTION OF A CHINESE ENTERPRISE

Chinese law limits opportunities for international businesses to create the perception of a Chinese enterprise in two important ways: (1) it proscribes foreign investment in certain industries, and (2) it proscribes foreign ownership of domestic Chinese enterprises.
A. Chinese Law Proscribes Foreign Investment in Chinese Enterprises

International businesses looking to create the perception of a Chinese enterprise must first determine whether the industry of their inventions is one in which the Chinese government encourages, restricts, or prohibits foreign investment. The Chinese government prohibits foreign investment in industries with substantial implications on economic security, resource utilization, environmental protection, the public interest, and national security. Foreign investment in these prohibited industries is foreclosed.

Foreign investment in China is therefore limited to those industries designated as encouraged or restricted. Ideally, international businesses seeking to create the perception of a Chinese


66. Prohibited Catalogue, supra note 65. Article I of the Prohibited Catalogue proscribes Farming, Forestry, Animal Husbandry, and Fishery Industries; Article II proscribes certain Mining and Quarrying Industries; Article III proscribes particular aspects of the Manufacturing Industry; Article IV proscribes resource utilization of Production and Supply of Power, Gas and Water; Article V proscribes public interest industries involving Communication and Transportation, Storage, as well as Post and Telecommunication Services; Article VI proscribes Leasing and Commercial Service Industry; Article VII proscribes industries pertinent to opening research facilities in China, including Scientific Research and Technical Services Industries, and Geological Prospecting; Article VIII proscribes industries where environmental impact may be a concern including Irrigation, Environment, and Public Utilities Management; Article IX proscribes the public interest in Education; Article X proscribes industries which may have a national security impact such as Art, Sports, and Entertainment Industries; and Articles XI and XII proscribe catch-all of Other Industries involving projects impacting military facilities or industries governed by treaties. Id.


68. Encouraged Catalogue, supra note 65. Encouraged foreign investment industries are those industries in which research, development, and manufacturing of goods and services may lead to improved national infrastructure, high-technology transfer, knowledge transfer, or improved resource utilization, to name a few. See id. Encouraged investment industries generally overlap those in which investment is restricted or prohibited. For example, Article I of the Encouraged Catalogue carries the same title of Article I of the Restricted Catalogue, as well as Article I of the Prohibited Catalogue covering Farming, Forestry, Animal Husbandry and Fishery Industries. See generally Foreign Investment Catalogue, supra note 65. The primary difference lies in the scope of the permissions or prohibitions within each category. Id.

69. See Foreign Investment Catalogue, supra note 65.
enterprise should fall within an encouraged industry because of the potential for incentives to the business, such as favorable tax treatment or relative ease in obtaining operational permits and licenses. Thus, international businesses falling within an encouraged industry stand the greatest chance for success.

International business falling within a restricted industry may have more difficulty creating the perception of a Chinese enterprise as restrictions may be prohibitive. For example, difficulty in obtaining requisite governmental operating permits and licenses may be increased. The complete range of incentives and restrictions vary by industry, necessitating the retention of local Chinese counsel for businesses contemplating entry into a restricted industry. Such prohibitions discourage businesses falling within the restricted industries from creating the perception of a Chinese enterprise.

B. Chinese Law Proscribes Foreign Ownership of Chinese Enterprises

Another barrier to international business creating the perception of a Chinese enterprise is the restriction of foreign ownership of Chinese enterprises. Foreign ownership interests in domestic Chinese enterprises are limited to four primary vehicles: (1) Sino-Foreign Equity Joint Ventures, (2) Sino-Foreign Contractual Joint Ventures, (3) Wholly Foreign-Owned Enterprises, or (4) mergers and acquisitions of domestic Chinese enterprises.

1. Sino-Foreign Equity Joint Ventures

One way to acquire ownership interests in Chinese enterprises is through Sino-Foreign Equity Joint Ventures (EJV). EJVs are

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71. Cf. id. China has been scaling back favorable policies towards foreign investment, especially preferential tax policies. Id.
72. Restricted foreign investment industries may require the Chinese party to hold a majority of the shares. See generally Restricted Catalogue, supra note 70. Restricted foreign investment industries may alternatively limit ownership interests to equity joint ventures or contractual joint ventures. See id. art. 1, ¶2; China Business Review, supra note 67.
74. Foreign ownership interests in domestic Chinese enterprises are subject to the categorical investment restrictions set forth in the Foreign Investment Catalog. See supra text accompanying notes 65–68.
75. See generally Regulations for the Implementation of the Law on Sino-foreign Equity
established as Chinese limited liability companies. They are incorporated and managed jointly by the international business and a Chinese party. "Numerous rules and regulations enacted on different legislative levels complete the rather comprehensive legal framework governing EJVs." One particular provision related to ownership and control is that parties to an EJV may jointly contribute capital "in cash or in kind." For EJVs, "[t]he parties to the venture shall share the profits, risks and losses in proportion to their respective contributions to the registered capital."

International businesses choosing the EJV organizational structure should assess both profit and loss expectations, as well as retention of operational control and managerial decision making, in proportion to the respective capital contributions. Thus, international businesses choosing EJVs as an investment strategy may find limited ability to control the strategy and direction of the Chinese enterprise. However, one possible advantage of an EJV is that it may be perceived as a Chinese enterprise in direct proportion to the extent to which Chinese ownership is retained.

2. Sino- Foreign Contractual Joint Ventures

Another means of acquiring ownership interests in Chinese enterprises are Sino-Foreign Contractual Joint Ventures (CJVs).
CJVs, like EJVs, are Chinese enterprises established by joint investment between international businesses and Chinese entrepreneurs, which the Chinese Government must approve. Unlike EJVs, which require strictly proportioned shares, CJVs offer greater flexibility in freedom to contract and organizational structure. An additional aspect of CJV flexibility is the way respective values of capital contributions are determined. Parties to a CJV can decide the method of evaluating contributions, as well as the actual value of the contributions themselves.

“A [CJV] project usually involves the foreign partner to provide most or all of the funds and technology, key machineries whilst the Chinese partner will contribute land, facilities, natural resources and perhaps a limited amount of funding.” Given the changing economic climate in China, CJVs are less common. One reason for their decreased popularity is the increased bargaining position of Chinese entrepreneurs in terms of capital and technical know-how—a result of Chinese economic expansion and an influx of foreign investment over the last several decades.

Despite the decreased popularity of CJVs, flexibility in value assessments of contributions to a CJV can be particularly attractive to international businesses with dominant patent portfolios. These businesses find CJVs attractive because the value of contributions in determining ownership and managerial retention can be based on knowledge and technology. Thus, international businesses with dominant patent portfolios in a given industry can theoretically negotiate a premium for their contributions, resulting in a disproportionately high share of ownership and managerial control.

However, government supervision of these contracts could result in the rejection of CJVs that attempt to provide a disproportionate benefit to international businesses. Nonetheless, savvy international


82. See id. arts. 1–6; see also Four Investment Types, supra note 80.

83. In particular, profit and loss sharing is determined as set forth by contract rather than dictated by equity interests. See CJV Laws, supra note 81, art. 2; see also Four Investment Types, supra note 80.

84. In addition, operational and management control are determined by the CJV, subject to government approval. CJV Laws, supra note 81, art. 11.

85. Four Investment Types, supra note 80.

86. Id.

87. Article 1 of the CJV Laws states that CJVs are established upon principles of
businesses with dominant patent portfolios may be able to invest via CJVs while also negotiating favorable contracts that place a premium on their patent protection. In this regard, international businesses can theoretically contribute less capital in the form of cash so that the endeavor can be perceived predominantly as a Chinese enterprise, while the international business retains a majority stake in operational control and profitability.

3. Wholly-Owned Foreign Enterprises

Ownership in a Chinese enterprise may also be established through creation of Wholly-Owned Foreign Enterprises (WOFEs).88 In contrast to the joint structure of EJVs and CJVs, WFOEs are, as their name implies, fully invested and operated by international businesses as a Chinese limited liability company.89 Thus, liability is limited to initial capital and asset contributions.90 WOFEs provide international businesses with full control over “major decisions, products, costs, and employee culture. They also allow strategic alignment with the parent company and greater protection of intellectual property.”91

Despite these advantages, WOFEs may be difficult investment vehicles for creating the perception of a Chinese enterprise, because the legal status is one of a wholly-owned foreign enterprise. As such, local courts and officials, knowing the entity to be owned by foreign interests, may not perceive the international business as a Chinese

equality and mutual benefit. Articles 5 and 6 of the CJV Laws discuss government approval. Thus, the approval authorities are able to reject contractual joint ventures that do not comport with equality and mutual benefit—disapproval is probably likely where the greater disadvantage lies with the Chinese partner. CJV Laws, supra note 86, art. 1.

88. See generally Law of the People’s Republic of China on Foreign-capital Enterprises, (order of the President, No. 41, Oct. 31, 2000), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51034 [hereinafter WOFE Laws]. WOFEs are set up in China by international businesses with only their own capital. See id. art. 2. But branches of international businesses set up in China are not included. See id. WOFEs are permitted to advance development of China’s national economy. Id. art. 3. In particular, “[t]he State may encourage the establishment of foreign capital enterprises that are export-oriented or technologically advanced WOFEs.” Id. In this regard, WOFEs are subject to examination and approval by the Chinese government. See id. art. 6.

89. Four Investment Types, supra note 80, at 2.

90. Id.

91. Id. WOFEs operational and managerial control are only limited by their “approved” articles of association. WOFE Laws, supra note 88, art. 11. Thus, once the appropriate governmental authority approves a WOFE’s articles of association, the management and operation of the WOFE is “free from any interference” provided that it otherwise operates within the confines of Chinese law. See id. art. 11.
enterprise in the same way as an EJV or CJV.

While maintaining control over Chinese operations is an important aspect to successfully obtaining and enforcing patent protection in China, the decreased ability of WOFEs to create the perception of a Chinese enterprise may outweigh the advantage of maintaining complete control. Yet, where complete control is essential to a business objective, WOFEs should not be overlooked.

4. Mergers and acquisitions of domestic Chinese enterprises

International businesses can also acquire ownership interests in domestic Chinese enterprises through mergers and acquisitions.92 Mergers and acquisitions of domestic Chinese enterprises may occur through Equity Mergers and Acquisitions (EMAs) or through Asset Mergers and Acquisitions (AMAs).93

EMAs come in two forms. International businesses can either buy equity stakes from shareholders of Chinese enterprises,94 or they can "subscribe to the increase in the registered capital" of the Chinese enterprise such that the Chinese enterprise becomes a foreign-investment enterprise (FIE).95 EMAs confer the advantage of ownership of the Chinese enterprise in proportion to its equity purchase, but EMAs pose greater risks than AMAs because of the increased risk of debt acquisition.96 In this regard, international businesses may learn that in addition to acquiring an ownership

92. See generally Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, (Ministry of Commerce, Order No. 10, Sept. 8, 2006), available at http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=66925 [hereinafter MA Laws]. The MA Laws were adopted, inter alia, with a goal of "introducing advanced technologies and management experience from abroad" and "improving the utilization of foreign investment." Id. art. 1. In addition, mergers and acquisitions are "subject to the approval of the examination and approval authorities[.]" Id. art. 6. As such, mergers and acquisitions that do introduce technical knowledge or expertise into China may not be approved by the Chinese government. Mergers and acquisitions of Chinese enterprises are also subject to the limitations set forth in the Guidance Catalog of Foreign Investment Catalogue. See, e.g., id. art. 4.


94. See MA Laws, supra note 92, art. 2. However, the Chinese enterprise cannot be engaged in foreign investment. See id.

95. See id.

96. See Zhang & Chen, supra note 93.
interest in the Chinese enterprise may also result in acquiring the burden of paying back debts owed by the Chinese enterprise.\textsuperscript{97}

AMAs reduce the risk of these debt traps because the only possible liabilities associated with the acquisition of assets arise if the Chinese enterprise had previously mortgaged the newly acquired asset.\textsuperscript{98} This mortgage trap transfers liability to the international business regardless of whether the Chinese enterprise misrepresented facts about the mortgage.\textsuperscript{99} To minimize these risks, an international business should check the status of the target acquisition assets before acquiring them.\textsuperscript{100}

AMAs can also take two forms. International businesses can form an FIE and use it to facilitate acquisition of a Chinese enterprise’s assets by agreement to operate the assets.\textsuperscript{101} Alternatively, the international business can buy the assets of the Chinese enterprise through agreement and let the asset investment form the basis to set up an FIE to operate the assets.\textsuperscript{102} In addition to the avoidance of debt traps, AMAs allow selective acquisition of desirable assets of the Chinese enterprise.\textsuperscript{103}

Mergers and acquisitions of existing Chinese enterprises may be the best way to create the perception of a Chinese enterprise because the Chinese enterprise will already have a proven record as a local enterprise and could already be benefiting from local protectionism, bribery, and corruption. The proportionate change in ownership may not be enough to affect any existing relationships between the newly acquired Chinese enterprise and the local community. Nor will the perception of the Chinese enterprise likely change as a result of the merger and acquisition.

International businesses might consider buying into existing Chinese enterprises where the enterprise has an excellent reputation in the community as well as the manufacturing capacity and existing workforce necessary to produce the patented product on a commercial scale. In addition, international businesses might consider buying into existing Chinese enterprises that are already

\begin{enumerate}
\item \textsuperscript{97} Id.
\item \textsuperscript{98} See id.
\item \textsuperscript{99} Id.
\item \textsuperscript{100} Id. Status information of “immovable property and land can easily be obtained from the relevant government authorities.” Id.
\item \textsuperscript{101} See MA Laws, supra note 92, art. 2; see also Zhang & Chen, supra note 93.
\item \textsuperscript{102} See MA Laws, supra note 92, art. 2; see also Zhang & Chen, supra note 93.
\item \textsuperscript{103} Zhang & Chen, supra note 93.
\end{enumerate}
engaged in pirating, counterfeiting, or infringing their patented technology, effectively eliminating the illegal competition while creating the perception of a Chinese enterprise.

VI. CREATING THE PERCEPTION OF A CHINESE ENTERPRISE TO OBTAIN AND ENFORCE CHINESE PATENT PROTECTION

Creating the perception of a Chinese enterprise is essential to successfully wield the double-edged sword of obtaining and enforcing patent protection in China. Methods of creating the perception of a Chinese enterprise include: (1) opening research facilities in China to develop and patent inventions in China, (2) acquiring a total or partial stake in a Chinese enterprise and licensing the patented technology to the acquired Chinese enterprise, and (3) granting exclusive licenses to the Chinese enterprise to market the patented technology within China.104

A. Opening Research Facilities in China to Develop and Patent Inventions

International businesses seeking to create the perception of a Chinese enterprise can benefit from several distinct advantages by opening research facilities in China to develop and patent inventions within China. This strategy will command more respect from Chinese officials because the international business employing this strategy will be directly advancing China’s national interest in transforming its reputation from “made in China” to “invented in China.”105 Therefore, international businesses conducting research in Chinese facilities probably would file a Chinese national patent application first.106 Later, they can file a PCT application claiming the benefit of the Chinese patent’s filing date.107 Using this pattern of

104. Volper, supra note 1, at 315.
105. See supra text accompanying note 56. China’s national interest is to “build an innovative country.” See generally IP Strategy Compendium, supra note 55.
106. Under China’s Patent Law inventions made in China must be filed domestically in China first. However, a recent amendment to China’s Patent Law adopted by the National People’s Congress, which becomes effective Oct. 1, 2009, permits inventors to apply for patents in foreign countries before filing domestically in China. But foreign patent filings are subject to government review for a determination as to whether the subject matter of invention should be kept as a national secret. The amendment is intended to encourage innovation and improve China’s “international competitiveness.” See generally China Court, China Revises Patent Law to Encourage Innovation (Jan. 13, 2009), available at http://en.chinacourt.org/public/detail.php?id=4390.
107. For an overview of PCT application filing procedure, see generally Erstling &
filing patent applications will directly advance China’s national interest because China can then claim that technology invented by the foreign owners of the research facilities was invented in China. International businesses employing this strategy will likely benefit from the local good will that ordinarily attaches to local Chinese enterprises.

Inventing and patenting technology in China that culminates in a Chinese national patent increases the likelihood that Chinese courts will uphold the patent during a patent infringement action or validity challenge. Because owning and asserting a Chinese patent creates the perception of a Chinese enterprise, this strategy reduces the home-field advantage that Chinese pirates, counterfeiters, and infringers might otherwise maintain. From the perception of a local Chinese court evaluating the patent, the playing field becomes that of a Chinese innovator versus a Chinese competitor, rather than a foreign innovator versus a Chinese competitor. Cases will thus be decided more on the merits and less on local biases.

Retaining complete ownership and control of the enterprise is also a prudent practice for international businesses developing inventions in China. Without complete ownership, local Chinese investment partners may be able to assert ownership of any proprietary technology and subsequent patents directed thereto, regardless of whether the investors’ contributions warrant ownership or not. Greater ownership levels can be accomplished through investment in WOFEs and complete acquisitions of existing Chinese enterprises.

B. Acquiring a Total or Partial Stake in a Chinese Enterprise and Licensing the Patented Technology to the Acquired Chinese Enterprise

International businesses seeking to create the perception of a Chinese enterprise can also acquire a total or partial stake in a Chinese enterprise and then license their own patented technologies to the Chinese enterprise. This acquisition and licensing strategy confers two advantages. First, the international business retains ownership and control over the patented technology while substantially increasing the perception of a Chinese enterprise. Second, this may also be more profitable, as income is generated

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Boutillon, supra note 53.
108. Volper, supra note 1, at 315.
109. Id.
from licensing royalties and sales of the patented technology in proportion to the ownership stake from the acquisition of the Chinese enterprise.

For example, if an international business making a partial acquisition chooses to invest via an EJV, its ownership would be limited in strict proportion to its capital contributions. If it invested via a CJV, however, the international business may be able to negotiate a greater ownership stake than it otherwise could have based strictly on its capital contributions. This is especially true where the international business has a dominant patent portfolio with a highly sought after technology. Pursuing this aspect of the acquisition and licensing strategy increases profits while minimizing legal ownership and capital contributions. In either case, acquiring partial ownership of the Chinese enterprise will enable the international business to present itself predominantly as a Chinese enterprise while retaining full ownership and control over the patented technology via the licensing agreement.

Another advantage of partial acquisition is that the Chinese enterprise can maintain its local Chinese reputation, relationships, and any benefits it derives therefrom. Likewise, to the extent the Chinese enterprise benefits from local protectionism, these protections transfer to the international business.

Acquiring a total ownership stake of the Chinese enterprise, on the other hand, will effectively transform the Chinese enterprise into a WOFE. Total acquisition strategy also has its advantages. The international business will retain complete ownership of the patented technology and receive all of the profits. Additionally, a licensing agreement is no longer necessary when an international business acquires complete ownership of the Chinese enterprise.

One potential drawback of total acquisition, however, is that the perception of a Chinese enterprise may be diminished. Chinese courts and administrative officials will undoubtedly have access to ownership records. As such, international businesses that totally acquire Chinese enterprises may be indistinguishable from other international businesses seeking to enforce their patents in China. Thus, a total acquisition strategy may do little to counter local corruption, bribery, and protectionism.

An international business could avoid this drawback by acquiring a complete ownership stake in a Chinese enterprise that is already pirating, counterfeiting, or infringing the international business's patented technology. Pursuing a total acquisition strategy in this
manner offsets any disadvantages arising from the diminished perception of being an authentic Chinese enterprise, while gaining the advantage of removing unlawful competition from the market. Additionally, acquiring Chinese pirates, counterfeiters, and infringers allows the international business to retain any benefits previously derived from local protectionism. Thus, where piracy, counterfeiting, or infringement of an international business's patented technology is substantial, total acquisition of the Chinese enterprise engaged therein may be a viable strategy.

C. Granting Exclusive Licenses to Chinese Enterprises to Make, Use, and Sell Patented Technology

International businesses seeking to minimize risk while attempting to create the perception of a Chinese enterprise should consider granting exclusive licenses to existing Chinese enterprises to make, use, and sell their patented technologies within China. This strategy provides at least three benefits.

First, it minimizes risk and liability while providing licensing royalties from sales of the patented invention. International businesses seeking to exploit the Chinese market in this fashion need not invest any capital in an existing Chinese enterprise or open up a research facility. As such, the international business does not assume any risk of loss from day-to-day operations or insufficient demand of the patented technology.

Second, international businesses may grant exclusive licenses to make, use, and sell their patented technology to Chinese enterprises. This helps derive the full benefits of creating the perception of a Chinese enterprise without investing capital or assuming the liability risks of opening research facilities and acquiring existing companies. Under this strategy, the international business also grants the Chinese enterprise rights to assert the patented technology against competition in China. In this regard, the Chinese enterprise assumes the responsibility of enforcing the patent rights against unlawful competition and asserting its monopoly to exploit the Chinese market. By granting an exclusive license, the international business can retain royalties from sales while avoiding the costs associated with enforcement of the patent rights in China. The Chinese enterprise exclusive licensee will probably be on a level playing field when asserting rights against unlawful Chinese competitors engaged in piracy, counterfeiting, or infringement of the patented technology because local officials and judges investigating allegations of
infringement can objectively assess the merits of patent rights without local prejudice.

An international business might also consider granting an exclusive license to an existing Chinese enterprise that actively engages in pirating, counterfeiting, or infringing the international business’s patented technology. International businesses seeking to pursue this route of the exclusive licensing strategy can use the threat of litigation or administrative enforcement as a stick and carrot to convince the infringer that accepting the licensing agreement will enable it to continue business as usual without ever having to worry about future enforcement. Because China is making the necessary reforms to increase enforceability of patents, such licenses will only increase in value, thus making this strategy more popular over time.

The international business could further attempt to convince the pirate, counterfeiter, or infringer that the licensing royalties would amount to no more than the administrative sanctions or damages award if found liable by local officials. Therefore, the incentives for accepting a royalty-bearing license for sales of the patented technology are increased because the time and expense of defending enforcement actions are forgone in favor of continuing business as usual.

Moreover, the threat of preliminary or permanent injunction is completely eliminated upon acceptance of a licensing agreement so there is absolutely no risk in having to stop operations altogether by agreeing to such a licensing provision. Given the availability of criminal enforcement of patent rights in China, a Chinese infringer operating on a large enough scale might find such a licensing agreement a favorable alternative to administrative sanctions or imprisonment.

VII. CONCLUSION

Obtaining and enforcing patent protection in China is a double-edged sword. On the negative side, corruption, bribery, and protectionism permit widespread piracy, counterfeiting, and infringement in China. On the positive side, the Chinese market is among the largest potential consumer market and China’s economy has experienced exponential growth. More importantly, trends in global competition suggest international businesses are increasingly seeking to obtain patent protection in China. China’s record of recent reforms is promising, including its status as a signatory to all of the most significant international intellectual property treaties. Thus,
despite the negative concerns, substantial positive reasons exist for obtaining patent protection in China. Given that corruption, bribery, and protectionism typically favor Chinese enterprises, international businesses that create the perception of a Chinese enterprise can help diminish the incentives for Chinese courts to reward pirates, counterfeiters, and infringers.

An international business that successfully creates the perception of a Chinese enterprise will be difficult to distinguish from the pirates, counterfeiters, and infringers that typically benefit from local corruption, bribery, and protectionism. As this distinction is blurred, Chinese judicial and administrative officials can begin to focus less on the identity of parties and more on the merits of the patent claims. In this regard, creating the perception of a Chinese enterprise is an effective practical strategy to obtain and enforce patents in China.

International businesses can create the perception of a Chinese enterprise in three principal ways. First, they can open research facilities in China to develop and patent technology in there. Second, they can employ an acquisition and licensing strategy to purchase a stake in a local Chinese enterprise and to license the patented technology to the Chinese enterprise. And finally, they can choose to grant an exclusive license to existing Chinese enterprises. International businesses should consult with Chinese counsel to determine which strategy will best suit their needs and best effectuate their desire to wield the double-edged sword of patent protection in China.