

Tips For Protecting Trade Secrets In China

Law360, New York (July 2, 2015, 10:16 AM ET) --

With the opening of the Beijing Intellectual Property Court on Nov. 6, 2014, the Chinese government commenced handling intellectual property cases through three specialized IP courts in Beijing, Shanghai and Guangzhou. The creation of these new IP courts was heralded as good news for IP protection in China. In addition, Chinese courts have special IP chambers (normally at the intermediate-level courts) that are also charged with hearing IP cases.

Trade secret protection is becoming a significant issue in Sino-U.S. business. Practitioners and general counsels interacting with Chinese entities and doing business in China need to understand the framework for civil enforcement in China, including how use the evolving legal framework to protect their trade secrets. This article will provide an overview of the legal landscape for trade secrets protection in China, including enforcement options and tips for pursuing enforcement (or averting it) through the remedies and preventive measures available in the Chinese legal system.



Ruixue Ran

IP Enforcement in China

IP protection ranked as the No. 2 issue, behind only competition with Chinese companies, in the U.S.-China Business Council (USCBC) 2014 annual member company survey. Ninety-one percent of responding companies reported that they were concerned about IP protection in China, and nearly half of responding companies indicated that China's level of IP protection limits their research and development activities in China.[1]

Litigation in U.S. courts reflects this concern as well. Since 2008, several U.S. and international companies have initiated trade secret actions with the U.S. International Trade Commission, with the majority filed against Chinese companies.[2] This trend underscores the clear concern over trade secret enforcement in China.

The impact of China's November 2014 launch of specialized IP courts in Beijing, Shanghai and Guangzhou has been positive. Though the establishment of these dedicated IP courts shows that China desires to enhance the available avenues for IP protection, it will take time to improve China's recognition and enforcement of IP protection, and to harmonize China's fragmented patchwork of laws and regulations governing trade secrets enforcement. Moreover, penalties for trade secret and other IP

infringement in China remain low. On the other hand, reported improvements such as easier filings, simplified trial procedures and shorter hearings at the new IP courts, provide hope that progress will continue.[3]

Legal Framework Protecting Trade Secrets

China does not have a unified trade secrets law. Companies or individuals seeking to protect trade secrets in China must navigate a number of laws and regulations governing civil, criminal and administrative enforcement options.

The Anti-Unfair Competition Law,[4] which became effective in 1993, is the primary statute protecting trade secrets in China. It defines a “trade secret” as “technology information” or “business information” which is unknown to the public, can bring economic benefits to the rights holder, has practical utility and for which the rights holder has adopted confidentiality-protection measures.[5]

The Labor Law,[6] the Labor Contract Law,[7] the Company Law,[8] the Contract Law,[9] and the Criminal Law[10] set forth additional legal standards.

China’s highest court is the Supreme People’s Court.^[11] The highest agency responsible for both criminal prosecution and investigation is the Supreme People’s Procuratorate (“SPP”).[12] Local Public Security Bureaus (“PSBs”)[13] have authority for criminal investigation of trade secrets misappropriation. The State Administration of Industry and Commerce[14] is the national authority responsible for administrative enforcement concerning industry and commerce, with local departments in every administrative region in China. Local AICs also have authority to investigate allegations of trade secret misappropriation.

A number of “interpretations” and administrative rules promulgated by the SPC, SPP and SAIC address additional questions relating to trade secrets protection. These include Certain Provisions on Prohibition of Infringement of Trade Secrets (SAIC, 1998 Revision), Interpretation by SPC and SPP on Several Issues of Concrete Application of Laws in Handling Criminal Cases of Infringing Intellectual Property (SPC and SPP, 2004),[15] Interpretation Of The Supreme People's Court On Some Matters About The Application Of Law In The Trial Of Civil Cases Involving Unfair Competition (SPC, 2007),[16] and various notices and replies of the SAIC, SPC and SPP regarding specific questions relating to trade secrets.

Enforcement Options

Based upon the foregoing laws and regulations, China’s trade secrets framework offers three enforcement options:

1. Seek administrative relief through the SAIC local branch
2. Bring a civil suit in the appropriate court
3. Ask local prosecutors to bring criminal charges.

Administrative Enforcement

Some Chinese citizens first pursue an administrative (AIC) remedy rather than relief in the court system. AICs have limited authority to collect evidence, but AIC proceedings can progress to conclusion within 90 days, and thus are speedier routes to relief, including injunctions. AICs are also local proceedings; there are roughly 3,000 AICs in China, and each government at and above the county level has its own AIC. However, AICs cannot order damages awards, but may only impose fines from RMB[17] 10,000 (\$1,600) to RMB 200,000 (\$32,000), and AICs will often decline to take cases involving complicated technical

issues, which may also take longer than the prescribed 90-day period. Thus, civil and criminal courts are more powerful than AICs and often the more appropriate fora in which to pursue relief.

Civil Enforcement

Civil and criminal cases may be pursued concurrently, or civil cases may be initiated after seeking AIC and/or criminal investigations. China does not have U.S.-style discovery procedures in civil cases, essentially leaving the plaintiff to assemble evidence through private resources. Yet the evidentiary burden in civil court is quite high, requiring the plaintiff to prove, with legally obtained, documentary evidence, that (1) it possessed a trade secret conforming to the statutory requirements; (2) the other party's information is identical or substantially identical to the trade secret, and (3) that the other party has adopted unfair methods.[18] The test in Chinese courts is similar to the "substantial similarity, plus access, without legitimate sources" rule used in U.S. trade secrets litigation when there is a lack of direct evidence of misappropriation, and Chinese courts will often expressly adopt the U.S. rule. Generally, the plaintiff will list the components of its alleged trade secret. The court will then appoint a third-party appraiser to evaluate whether this information is unknown to the public and whether the information acquired, disclosed or used by the defendant is the same or substantially similar to the plaintiff's trade secret. The defendant will have the opportunity to prove legitimate sources for its information, such as reverse engineering or independent development.

A plaintiff may file a civil case in the Intermediate People's Court[19] or other competent court where the defendant resides, where the misappropriation activity occurred (usually, the location of plaintiff), or where the stolen trade secrets are used. It should be noted, however, that selling products that are manufactured using misappropriated trade secrets is not an infringing activity under Chinese law. Thus, a court will not have jurisdiction over a trade secret case based solely on the fact that the infringing products are sold within its territory.[20]

Civil courts can order damages (either statutory damages or damages calculated similar to patent infringement damages, *i.e.*, lost profits, defendant's realized profits from misappropriation, or a reasonable royalty, or in an amount ranging from RMB 10,000 (\$1,600) to RMB 1,000,000 (\$160,000)), and may issue permanent and preliminary injunctions. The first trade secrets preliminary injunction issued under the Jan. 1, 2013, revised Civil Procedure Law was issued in July 2013, when the Shanghai First Intermediate People's Court issued a preliminary injunction, shortly after Eli Lilly and Company and Eli Lilly (China) initiated a trade secrets case against a former employee.[21] This preliminary injunction prevented the former employee from disclosing, using or permitting others to use particular Eli Lilly trade secrets.

Criminal Enforcement

Finally, complainants may seek criminal charges if the trade secret misappropriation causes "serious" or "particularly serious" economic losses. PSBs have greater power to collect evidence than do AICs, and criminal cases can lead to sentences of up to seven years' imprisonment, as well as fines.[22] The PSB (the local police station or police force) at the place where the criminal act is committed generally has jurisdiction; an alternative is the PSB at the place of the suspect's domicile. If the PSB accepts the case, the complainant can continue to work with the PSB during the investigation. Complainant involvement is particularly helpful for the PSB's submission of documentary evidence to the appropriate judicial appraisal institution. Assistance with the submitted evidence is critical to the complainant's success, because this submission will determine whether the misappropriated information constitutes trade secrets, and whether the information in the possession of the suspect is substantially similar to the

alleged misappropriated information.

Practitioners and general counsels must consider and understand the interplay between the different available enforcement procedures. For example, the most challenging aspect of trade secret cases frequently lies in evidence collection. Unsurprisingly, civil plaintiffs usually complain of their inability to obtain evidence of trade secret misappropriation, especially relating to misappropriated manufacturing processes believed to be used in competitors' factories. One strategy for addressing this challenge is to pursue an AIC proceeding or criminal investigation before filing the civil action, as these proceedings may result in admissible evidence for use in the civil trial.

It is also critical to understand the interplay between Chinese proceedings and related proceedings in other countries. For larger competitor vs. competitor suits, trade secret legal actions are often initiated as coordinated, global attacks requiring a coordinated response.

Preventive Steps for Protecting Trade Secrets in China

For any type of IP enforcement, advance planning is critical, in light of the evidentiary and legal requirements inherent in a Chinese legal or administrative proceeding. This section will provide some tips for companies that plan to share confidential information with suppliers, vendors or employees in China.

1. Establish a system for managing confidential information in and provided to Chinese subsidiaries and joint ventures.

First, companies sharing trade secrets with employees, subsidiaries, joint ventures, vendors, suppliers, or other third parties should require a signed confidentiality agreement in advance, as well as an acknowledgement of receipt of confidential information that identifies in detail the disclosed confidential information. A summary description is not likely to provide sufficient protection, given the emphasis on documentary evidence to support Chinese enforcement options. Under Chinese law, the confidentiality agreement does not need to set forth a time limit, and the confidentiality obligation can be perpetual, so long as the relevant confidential information has not become public.

2. Include trade secret-related rules and protections in all contracts.

Companies doing business in China or with Chinese entities or employees should negotiate and set forth trade secret-related rules and protections in their contracting practices and procedures. For instance, questions such as who owns trade secrets at the time of contracting, and who will own trade secrets in the event either party undertakes additional research and development following the date the contract is executed, should be decided in advance and included in all relevant contracts.

3. Establish trade secret-related rules and protections in your employment management systems.

In addition to confidentiality agreements of unlimited duration, employment agreements may incorporate noncompete provisions binding the employee during and after the employment term. However, post-termination noncompete agreements may only be imposed for up to two years, with reasonable monthly compensation (*e.g.*, as agreed upon by the parties, or as specified by local rules or regulations) to be paid to the restricted departing employee for the duration of that period.[23] The scope of the noncompete must be reasonable, for example, in terms of the applicable business scope and the geographic region. Furthermore, the compensation must be agreed upon in advance, and note that certain (but not all) localities impose minimum thresholds with respect to the compensation,

generally ranging between one-third to two-thirds of the employee's salary.[24] Noncompete obligations are usually restricted to senior managers, senior technical personnel and other personnel with confidential obligations.[25]

Companies should also take protective measures to ensure that their employees maintain confidentiality. Measures such as using passwords, encryption, locked hard copy files, and limited distribution or access should be enforced and training provided. Companies should conduct exit interviews with all departing employees to flag potential issues as early as possible.

—By Ruixue Ran, Sheng Huang and Michelle Morin, Covington & Burling LLP

Ruixue Ran is a partner and Sheng Huang is an associate in Covington & Burling's Beijing office. Michelle Morin is an associate in the firm's Silicon Valley office.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] USTR 2015 Special 301 Report Feb. 24, 2015 Hearing Transcript, available at <https://ustr.gov/sites/default/files/02242015-Special301.pdf>, at 164:6-12, 166:16-18.

[2] Since the decision in *TianRui Group Co. v. U.S. International Trade Commission*, see 661 F.3d 1322, 1324, 1326 (Fed. Cir. 2011) (affirming the Commission's issuance of an exclusion order), six of the eight Section 337 investigations involving trade secrets have related to China. See, e.g., Andrew Riley, A Survey of Trade Secret Investigations at the International Trade Commission: A Model for Future Litigants, <http://www.finnegan.com/resources/articles/articlesdetail.aspx?news=074629d6-20b9-418d-9138-eef40d5a9b2d> (June 15, 2015).

[3] See, e.g., Huang Jingjing, Intellectual Clarity, Feb. 25, 2015, <http://www.globaltimes.cn/content/908863.shtml>.

[4] Zhōnghuá Rénmín Gònghéguó Fǎnbù Zhèngdàng Jìngzhēng Fǎ.

[5] See AUCL, Art. 10.

[6] Zhōnghuá Rénmín Gònghéguó Láodòng Fǎ.

[7] Zhōnghuá Rénmín Gònghéguó Láodòng Hétong Fǎ.

[8] Zhōnghuá Rénmín Gònghéguó Gōngsī Fǎ.

[9] Zhōnghuá Rénmín Gònghéguó Hétong Fǎ.

[10] Zhōnghuá Rénmín Gònghéguó Xíng Fǎ.

[11] Zuìgāo Rénmín Fǎyuàn.

[12] Zuìgāo Rénmín Jiǎncháyuàn.

[13] Gōng ān jú.

[14] Guówùyuàn Gōngshāng Xíngzhèng Guǎnlǐ Zǒngjú.

[15] <http://www.wipo.int/edocs/lexdocs/laws/en/cn/cn118en.pdf>.

[16] <http://www.wipo.int/edocs/lexdocs/laws/en/cn/cn104en.pdf>.

[17] Rénmínbì (also called Chinese yuan, or ¥).

[18] See 2007 SPC Interpretation Of The Supreme People's Court On Some Matters About The Application Of Law In The Trial Of Civil Cases Involving Unfair Competition, available at <http://www.wipo.int/edocs/lexdocs/laws/en/cn/cn104en.pdf>, Art. 14. The SPC Interpretation further provides that the evidence for proving that a trade secret satisfies the statutory requirements “shall comprise the carrier, specific contents, and commercial value of this trade secret as well as the specific confidentiality measures taken for this trade secret.” Id.

[19] Zhōngjí Rénmín Fǎyuàn.

[20] http://www.lawtime.cn/info/jingjizhongcai/lunwen/2011070518767_3.html.

[21] See, e.g., 潘静波 [Pan Jingbo], 上海发出首份商业秘密行为禁令, 人民法院报 [People’s Court News], Aug. 5, 2013, <http://www.acla.org.cn/html/fazhixinwen/20130805/10507.html>.

[22] “Serious” losses of RMB 500,000 (US \$80,000) to RMB 2,500,000 (US \$400,000) can result in imprisonment of up to three years; “particularly serious” losses of more than RMB 2,500,000 (US \$400,000) can result in three to seven years’ imprisonment.

[23] Labor Contract Law (中华人民共和国劳动合同法), Articles 23 and 24. In practice, a non-compete clause is usually incorporated into either the initial employment agreement or included in a stand-alone Confidentiality Agreement listed as an attachment to the employment agreement.

[24] In the event of a dispute, “reasonableness” of the compensation will be determined by the court.

[25] Id.

All Content © 2003-2015, Portfolio Media, Inc.