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Trade Secret Protection Is Getting Stronger In China

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Recent months have seen a continued progression of Chinese trade secret law toward greater protection for rights holders. This includes significant substantive changes to the relevant statutes, as well as procedural changes in the operation of the relevant tribunals and availability of certain forms of relief.

The recent 2019 amendment to the Anti-Unfair Competition Law, with its newly introduced burden-of-proof shifting and punitive damages rules, is expected to significantly enhance the protections for trade secret right holders. With respect to procedural changes, the establishment of specialized intellectual property courts and a nationwide unified appellate tribunal, as well as national rules for preliminary injunctions and an impartial technical investigating officer for IP cases are expected to deter local protectionism, provide consistent nationwide rules of decision, improve judicial professionalism, and provide enhanced technical expertise for Chinese trade secrets cases.

Key Changes in the 2019 Amendment to Anti-Unfair Competition Law

On April 23, 2019, the Standing Committee of the National People's Congress of China passed a bill amending the Anti-Unfair Competition Law, which took effect that day. China's AUCL governs trade secret misappropriation, commercial bribery, false or misleading advertisements and other types of unfair business conducts. While the last amendment to the AUCL in November 2017 only made minor changes to the trade secret law, the 2019 amendment bill solely focuses on trade secret protections.[1]

The most significant change in the 2019 amendment is a new burden-of-proof shifting provision for a right holder to establish (1) the existence of a trade secret, and (2) whether misappropriation has occurred. Under the new rules, the burden on the plaintiff is lowered to require only prima facie evidence on these two elements, after which the burden shifts to the defendant to disprove the element.

The first change is a significant departure from the previous rules, which placed a heavy burden on a trade secret plaintiff to show that the asserted trade secret was

not “known to the public,” which usually required the plaintiff to pay for an independent judicial appraisal agency to prepare a report for the court. Under the amendment, by contrast, the defendant will instead bear burden to produce evidence to rebut a claim of trade-secret status once the plaintiff has made a prima facie showing.

The second change can help overcome the difficulty of obtaining evidence solely in the possession of a trade secret defendant due to the lack of broad common law-style discovery in China. Some practitioners have expressed the concern that these changes are overly tilted to protect right holders.

It remains to be seen, however, how these new rules will be interpreted by the courts, and practitioners and interested parties would be advised to follow new developments closely.

The new AUCL allows the court to amplify exemplary damages up to five times in cases of willful and malicious misappropriation. The goal of this provision is to provide for punitive damages to deter the willful misappropriation of trade secrets, which previously required plaintiffs and the court to rely on other IP-related statutes with varying levels of success.

Article 17 of the new AUCL permits the court to grant punitive damages in its discretion based on willful misappropriation. The 2019 amendment is expected to yield larger damages awards, and a 2018 appellate decision may be understood as a bellwether to this approach.

In May 2018, Higher People’s Court of Zhejiang Province rendered an appellate decision in Zhejiang Nhu Company Ltd. v. Fujian Haixin Pharma. Co. Ltd. et al., affirming a lower court’s ruling that the defendants jointly pay over $5.16 million for misappropriation of trade secrets in connection with manufacturing methods of vitamin E intermediate products and equipment. This is one of the highest awards ever granted in a trade secret case in China and explicitly includes an award of punitive damages, albeit the court needed to rely on trademark law in order to do so.

The appellate court reasoned that the willfulness of infringement, unethical litigation conduct, and intentional delay in litigation supported the lower court’s awarding of punitive damages. While these factors may not be present in all trade secret cases, it provides a guideline for amounts of punitive damages that may be permitted under the amendment. With this explicit provision there may both be more trade secret cases brought, as right holders may be encouraged to assert trade secret claims that may have seemed too marginal under the old rules, and there may be higher overall damages awards granted as many trade secret cases can involve an element of willfulness.

Furthermore, the new AUCL also grants more enforcement powers to the administrative regulator, the State Administration for Market Regulation and its local branches. Previously the SAMR could pursue an administrative investigation into alleged trade-secret theft and was authorized to conduct on-site inspection and execute “dawn raids,” sealing and seizing property related to the alleged illegal acts, and further could obtain information on an alleged infringer’s bank accounts. The new AUCL further empowers the SMAR to forfeit the illegal gains from the misappropriation. In addition, the amendment further significantly escalates the range of fines that can be imposed by SAMR. These changes can be expected to increase the deterrence against trade secret theft in China.

Lastly, the new AUCL adds hacking as a kind of misappropriation, and broadens the scope of the persons that can also be held liable for trade secret misappropriation, not limited to the one falls with the defined scope of a business operator. The new AUCL also adds a paragraph for indirect infringement,

which provides that the person induces, contributes to or offers help on the misappropriation can also be held liable for trade secret misappropriation.

New IP Courts Will Bring Concentrated Jurisdiction Over Technical-Related Trade Secret Cases, Uniformity of Judgments and Deter Local Protectionism

China has been on a path of steady reform of its adjudicatory framework for intellectual property disputes. This began with the establishment of three specialized IP courts in Beijing, Shanghai and Guangzhou at the end of 2014, and has been furthered with the establishment of IP tribunals in a number of other regions.

To date, China has over 20 specialized IP courts/tribunals of first instance in over 10 provinces and two cities/municipalities around the country. All of these courts are located in major or regional economic centers in China. The most unique aspect of the specialized IP courts/tribunals is that they have cross-regional and exclusive first-instance jurisdiction over significant IP cases, which include technical-related trade secret cases, and a specialized judiciary focusing on IP-related disputes.

At the appellate level, on Oct. 26, 2018, the Standing Committee of the People's National Congress of the People's Republic of China passed decisions on several procedural issues relating to patent and other intellectual property cases, which established a specialized appellate court with nationwide and subject matter jurisdiction over patent and other "complex technical cases." This includes technical-related trade secret cases.[2] Technical-related trade secret cases appealed from the lower courts, which will generally be the specialized IP courts/tribunals as discussed above, will be heard exclusively by the newly established specialized IP tribunal within the Supreme People's Court. Previously, appeals of technical-related trade secret cases would typically be heard by the Higher People's Courts of local provinces and municipalities, which are at a level immediately superior to the specialized IP courts/tribunals.

In this legal landscape, a technical-related trade secret case will normally first be heard at one of the specialized IP courts/tribunals, with any appeal taken directly to the IP Tribunal of the SPC, skipping the local Higher People's Court. This should unify the trial practices of technical-related trade secrets around China, and mitigate the possibility of local protectionism. The judges in these specialized IP courts/tribunals and the IP Tribunal of the SPC, with the help from the recently introduced technical investigating officer as discussed below, are generally better prepared to handle technical-related trade secret cases.

Recent Changes to Preliminary Injunction Rules for Trade Secret Cases in China Pave the Way for Prompt Injunctive Relief in Urgent Situations

In trade secret litigation, obtaining a preliminary injunction is a strong weapon, so much so that in certain cases it is effectively case-dispositive as it can undercut a defendant's ability to operate and lead to prompt settlement. On Dec. 14, 2018, the Supreme People's Court of China released a final version of long-awaited judicial interpretations for preliminary injunctions in IP and competition cases.[3] These rules are anticipated to streamline and unify preliminary injunction practice throughout China. This preliminary injunction judicial interpretation is applicable to preliminary injunctions in the civil trade secret cases in China.

For trade secret rights holders, a notable aspect of the preliminary injunction judicial interpretation is expedited resolution of certain requests for an injunction. Chinese law allows for a plaintiff to request a

preliminary injunction either before or after the filing of a complaint, and if the request is deemed "urgent" the court should adjudicate the request within 48 hours of its submission. Article 6 of the preliminary injunction judicial interpretation expressly stated that one "urgent situation" is that "trade secrets of the petitioner are to be illegally disclosed." Where a plaintiff can allege that a defendant intends to disseminate plaintiff's trade secret, an expedited injunction is now part of its arsenal. This is likely to help rights holders speedily obtain the presuit and in-suit preliminary injunction to prevent imminent dissemination of the trade secrets.

Formalized Technical Investigating Officer Role Will Improve Court's Technical Capacities in Deciding Technical-Related Trade Secret Cases

After a four-year pilot program in the three specialized IP courts in Beijing, Shanghai and Guangzhou, the Supreme People's Court has formally issued provisions for the use of technical investigating officers in technical-related trade secret cases. The Supreme People's Court provisions on the participation of the technical investigating officers in legal proceedings of IP cases was released on March 18, 2019, and took effect on May 1, 2019.

The technical investigating officer is a court officer or court-appointed outside expert with a technical background that supports the presiding judges by participating in the case and providing technical advice. Although no strict counterpart can be found in U.S. trade secret cases, the technical investigating officer plays a similar role to technical advisers appointed on an ad hoc basis by some U.S. courts to aid judges in the performance of specific judicial duties, e.g., to assist the judge in understanding technical issues.

The technical investigating officers rules confer a broad range of responsibilities on technical investigating officers, mainly including participating in evidence collection and preservation, attending the hearing and trial, giving technical opinions, and attending the court's deliberation. With the consent from the judge, the technical investigating officer can ask the parties and their experts questions concerning the technical issues during a hearing or trial. The opinion of the technical investigating officer should be issued prior to the court's deliberation, which may serve as a reference for the court with the presiding judge having a final say on the case. The introduction of technical investigating officer will improve the court's technical capacities in handling technical-related trade secret cases.

U.S. IP practitioners should be aware of both this general trend in Chinese IP enforcement as well as these specific substantive changes. Some U.S. parties have historically hesitated to pursue trade secret misappropriation remedies in China due to concerns about low potential recoveries, bias in the local judiciaries or the perception that the lack of discovery effectively prevents the litigation of such cases. The recent trade secret law amendments change the field of play significantly in these areas. Where the misappropriating party is present in China, a judgment or order from a Chinese tribunal is much more likely to be convertible into effective relief, and warrants a careful revisit of the calculus of the best forum in which to proceed.

In sum, the recent developments in Chinese trade secret law make enforcement of the trade secret rights before the Chinese courts and administrative authorities more appealing and attractive. While it is too early to see how these rules will be put into force, practitioners are encouraged to monitor developments and to include Chinese enforcement options as a valuable tool when devising approaches to global rights protection.

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[1] While substantial changes were made to other areas covered by the AUCL, the only change to the trade secret law was to remove the requirement of "practical utility" from the definition of a trade secret to align with the international norms.

[2] Technical-related trade secret cases generally include cases where technological secrets are stolen, in contrast with non-technical trade secret cases where customer lists or other business information is misappropriated.

[3] The official title of the judicial interpretation is Provisions on Several Issues Concerning the Application of Law to the Examination of Behavioral Preservation Cases Involving Intellectual Property and Competition Disputes. A draft seeking public comments was previously released by SPC in February 2015.