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## Strategies for Trade Secrets Protection in China

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N O R T H W E S T E R N  
JOURNAL OF TECHNOLOGY  
AND  
INTELLECTUAL PROPERTY

**Strategies for Trade Secrets Protection in China**

*J. Benjamin Bai & Guoping Da*



# Strategies for Trade Secrets Protection in China

By J. Benjamin Bai\* & Guoping Da\*\*

## I. INTRODUCTION

¶1 Over the past two decades, China has developed a comprehensive set of laws, regulations, and judicial interpretations designed to protect the rights of trade secret owners. Enforcement of trade secrets, however, is not straightforward. This is primarily because China does not have a U.S.-style discovery system, and the evidentiary burden for a plaintiff to bring a trade secret misappropriation case in Chinese courts is relatively high. Notwithstanding the difficulties, there have been numerous cases of successful enforcement, both civil and criminal. Experience shows that it is possible to protect and enforce trade secrets in China, but the devil is in the details. This article aims to provide a comprehensive background on the legal regime for protecting trade secrets. It then discusses various preventive measures for trade secret protection and provides tips for enforcing trade secrets in China.

## II. IP CASE STATISTICS

### A. Intellectual Property (IP) Civil Cases

¶2 In 2009, China saw 30,626 IP civil cases filed in its first instance courts,<sup>1</sup> which represent a 25.49% increase over 2008. In contrast, there were about 8,261 IP cases commenced in the U.S. federal district courts in 2009. As a matter of fact, China became the world's most litigious country for intellectual property disputes in 2005, surpassing the U.S. in the number of intellectual property lawsuits filed annually.<sup>2</sup> The following table and chart represent the detailed breakdown of 2009 IP civil cases in China and the United States.

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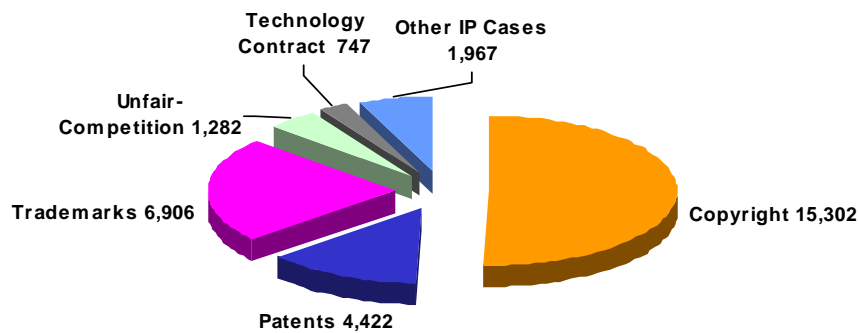
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<sup>1</sup> China has a two-instance court system: the first instance courts are trial courts; the second instance courts are appeals courts.

<sup>2</sup> Benjamin Bai et al., *How to Litigate Patents in China*, CHINA IP FOCUS, Apr. 1 2007, at 1, available at <http://www.managingip.com/Article/1329560/How-to-litigate-patents-in-China.html?ArticleId=1329560&p=3>.

TABLE 1 2009 IP CIVIL CASES IN CHINA AND THE UNITED STATES

|                                 | China <sup>3</sup> | United States <sup>4</sup> | Comments (Chinese Cases) <sup>5</sup> |
|---------------------------------|--------------------|----------------------------|---------------------------------------|
| Civil Cases (commenced)         | 30,626             | 8,261                      | 25.49% increase over 2008             |
| Civil Cases (terminated)        | 30,509             | 8,934                      | 29.73% increase over 2008             |
| Copyright                       | 15,302             | 2,018                      | 39.73% increase over 2008             |
| Patent                          | 4,422              | 2,800                      | 8.54% increase over 2008              |
| Trademark                       | 6,906              | 3,443                      | 10.80% increase over 2008             |
| Unfair Competition <sup>6</sup> | 1,282              | N/A                        | 8.19% increase over 2008              |
| Technology Contract Dispute     | 747                | N/A                        | 19.90% increase over 2008             |
| Others                          | 1,967              | N/A                        | 46.79% increase over 2008             |

FIGURE 1 2009 IP CIVIL CASES IN CHINA<sup>7</sup>

<sup>3</sup> *China's Intellectual Property Protection in 2009*, STATE INTELLECTUAL PROPERTY OFFICE OF THE P.R.C., (Jun. 6, 2010), <http://www.nipso.cn/onews.asp?id=9599> [hereinafter SIPO].

<sup>4</sup> *Table C-2, U.S. District Courts—Civil Cases Commenced, by Basis of Jurisdiction & Nature of Suit, During the 12-Month Periods Ending December 31, 2008 and 2009*, U.S. COURTS, <http://www.uscourts.gov/uscourts/Statistics/StatisticalTablesForTheFederalJudiciary/2009/dec09/C02Dec09.pdf>; *Table C-4, U.S. District Courts—Civil Cases Terminated, by Nature of Suit and Action Taken, During the 12-Month Period Ending December 31, 2009*, U.S. COURTS, <http://www.uscourts.gov/uscourts/Statistics/StatisticalTablesForTheFederalJudiciary/2009/dec09/C04Dec2009.pdf>.

<sup>5</sup> SIPO, *supra* note 3.

<sup>6</sup> Unfair competition cases include trade secret cases.

### B. IP Criminal Cases

13 China is among the few countries where serious IP infringement may subject the infringer to criminal penalties. In 2009, Chinese courts prosecuted 5,836 people for IP crimes, of whom 5,832 were convicted.<sup>8</sup> The following table summarizes the 2009 IP criminal cases in China.<sup>9</sup>

TABLE 2 2009 IP CRIMINAL CASES IN CHINA

|                                   | China | Comments                  |
|-----------------------------------|-------|---------------------------|
| Criminal Prosecution (commenced)  | 2,072 | 92.92% increase over 2008 |
| Criminal Prosecution (terminated) | 3,660 | 10.04% increase over 2008 |
| People Prosecuted                 | 5,836 | 8.31% increase over 2008  |
| People Convicted                  | 5,832 | 8.28% increase over 2008  |

### C. IP Cases Involving Foreign Parties

14 While most of these IP lawsuits are among Chinese parties, foreign parties are increasingly becoming more involved in such suits, both voluntarily and involuntarily. In 2005, among the 13,424 IP dispute cases, only 268 cases involved foreign parties (about 2.0%), but this small number represents a 77% increase over 2004.<sup>10</sup> In 2009, among the 30,509 IP dispute cases concluded, 1,361 cases involved foreign parties (about 4.5%), which is a 19.49% increase over 2008.<sup>11</sup> The following chart shows that the growth rate for foreign related IP cases in China seems to be exponential. More and more foreign companies are being sued for IP infringement in China. Additionally, more foreign companies are beginning to assert their IP rights there. A few foreign companies are resorting to Chinese courts in battling their foreign rivals as well.

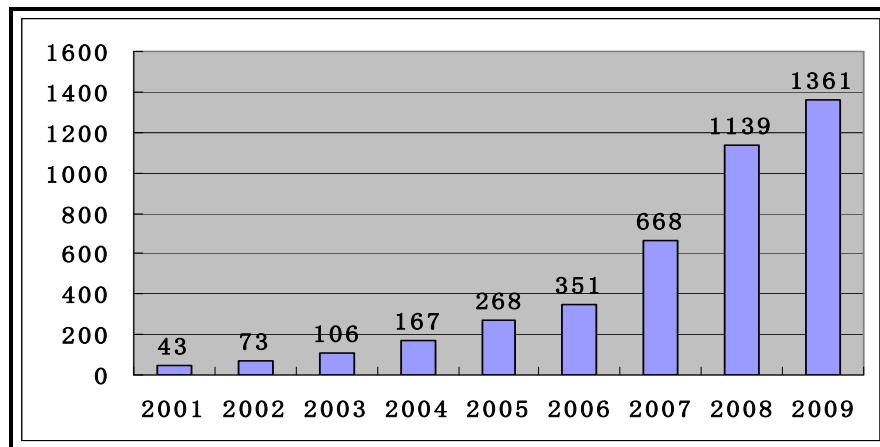
<sup>7</sup> SIPO, *supra* note 3.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> *China's Intellectual Property Protection in 2005*, STATE INTELLECTUAL PROPERTY OFFICE OF THE P.R.C., (June 4, 2010, 5:56:20 PM), <http://www.nipso.cn/onews.asp?id=9478>.

<sup>11</sup> SIPO, *supra* note 3.

FIGURE 2 2001–09 FOREIGN RELATED IP CASES IN CHINA<sup>12</sup>

#### D. Trade Secret Cases

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Compared to patent, trademark, or copyright infringement cases, there were fewer trade secret disputes in China. The reason for fewer trade secret cases is perhaps due to the challenge for plaintiffs to prove misappropriation under certain circumstances.<sup>13</sup> The following table shows the number of trade secret misappropriation cases since the 1993 enactment of the Anti-Unfair Competition Law; however, no such data were available for the recent years because the incidence of trade secret cases was reported in the category as unfair competition cases. No data are available for 2006 and beyond, but it is expected that the numbers are substantially similar to the prior years.

<sup>12</sup> *Id.* Data collected from SIPO website for the years 2001-2009.

<sup>13</sup> *See infra* Part V.

TABLE 3 1995–2005 TRADE SECRET CASES IN CHINA

| Year | Trade Secret Disputes |
|------|-----------------------|
| 1995 | 587                   |
| 1996 | 700                   |
| 1997 | 914                   |
| 1998 | 658                   |
| 1999 | 645                   |
| 2000 | 714                   |
| 2001 | 830                   |
| 2002 | 271                   |
| 2003 | 349                   |
| 2004 | 379                   |
| 2005 | 500                   |

### III. APPLICABLE CHINESE STATUTES

¶30 China has a myriad of statutes that protect trade secrets or confidential information, but the primary law on the topic of trade secrets is the Anti-Unfair Competition Law, which was promulgated on September 2, 1993. Moreover, Chinese Company Law, Contract Law, Labor Law, and Labor Contract Law provide additional statutory protection for trade secrets. The relevant parts of these applicable statutes are briefly discussed below.

#### A. *Anti-Unfair Competition Law*

¶31 Under the Anti-Unfair Competition Law, a claim for trade secret misappropriation consists of two issues for analysis.<sup>14</sup> First, is there a trade secret that deserves legal protection? Second, if so, is the acquisition, use, or disclosure of the trade secret prohibited and thus considered to be a misappropriation?

¶32 **Definition of Trade Secret.** Article 10 of the Anti-Unfair Competition Law defines “trade secret” as:

- (1) Technical and business information that is unknown to the public;
- (2) Which has economic value and practical utility; and

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<sup>14</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Sept. 2, 1993), art. 10 (China).

- (3) For which the trade secret owner has undertaken measures to maintain its confidentiality.<sup>15</sup>

Therefore, trade secrets may include operational information, such as processes, methods, or recipes, or other information, such as marketing strategies, customer lists, materials, terms, and prices, so long as they meet all of the above requirements.

¶33 **Misappropriation of Trade Secret.** Article 10 of the Anti-Unfair Competition Law further prescribes the following three forms of wrongdoer liability for trade secret misappropriation:

- (1) Acquiring trade secret of another by theft, inducement, duress, or other illegal means;
- (2) Disclosing, using, or allowing others to use trade secret of another acquired by the above illegal means; or
- (3) Disclosing, using, or allowing others to use trade secret in breach of an agreement or a confidentiality obligation imposed by a legal owner.<sup>16</sup>

In addition to these three forms of wrongdoer liability for trade secret misappropriation, Article 10 also defines third-party liability, where a third-party acquires, uses, or discloses trade secrets that he knew or should have known to have been misappropriated in any of the aforementioned ways.<sup>17</sup>

¶34 **Elements of Trade Secret Misappropriation Action.** Accordingly, to prevail in a trade secret misappropriation action, a trade secret owner must prove by admissible evidence in a Chinese court that:

- (1) The asserted trade secret is not publicly known;
- (2) The asserted trade secret has economic benefits and practical utility;
- (3) The trade secret owner has taken measures to protect the confidential nature of the asserted trade secret; and
- (4) There is misappropriation of the asserted trade secret by a wrongdoer or a third party.

### *B. Contract Law*

¶35 Article 43 of the Contract Law generally prescribes that neither party may disclose or inappropriately exploit the trade secret obtained in negotiating a contract, whether or not the contract is executed.<sup>18</sup>

¶36 Section 3 of Chapter 18 of the Contract Law regulates technology licensing matters, including trade secrets, as follows:

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<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> Zhong Hua Ren Min Gong He Guo He Tong Fa (中华人民共和国合同法) [Contract Law of the P.R.C.] (promulgated by the Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), art. 43 (China).



- (1) The licensor and licensee may stipulate the scope of the use of the trade secret in a technology licensing agreement, provided that no restriction may be imposed on technological competition and technological development.
- (2) The licensee of a trade secret license agreement shall undertake confidentiality obligations according to the terms of the agreement.
- (3) The licensee of a trade secret license agreement who exploits the trade secret exceeding the agreed scope or unilaterally permits a third party to exploit the trade secret in violation of the agreement shall cease the act and be liable for breach of contract. A party violating the agreed confidentiality obligations shall be liable for breach of contract.<sup>19</sup>

### C. Company Law

¶37 Article 149 of the Company Law provides that directors or managers of a company shall not illegally disclose the company's trade secrets.<sup>20</sup>

¶38 Article 150 of the Company Law also stipulates that where the above persons violate trade secrets protection during the course of employment and causes harm to the company, such persons shall be liable for damages.<sup>21</sup>

### D. Labor Law

¶39 Article 22 of the Labor Law provides that an employer and employee can enter into a confidentiality agreement regarding the employer's trade secrets in a labor contract.<sup>22</sup>

¶40 Article 102 of the Labor Law provides that, if an employee breaches a labor contract in violating the confidentiality agreement and causes economic losses to the employer, the employee shall be liable for damages.<sup>23</sup>

### E. Labor Contract Law

¶41 Article 23 of the Labor Contract Law prescribes that the employers may impose confidentiality obligations on the employees in a labor contract regarding the employer's trade secrets and other intellectual property.<sup>24</sup>

## IV. JUDICIAL INTERPRETATION

¶42 On January 12, 2007, the Supreme People's Court of China issued the Judicial Interpretation of Supreme People's Court on Some Issues Concerning the Application of

<sup>19</sup> *Id.* § 3, Ch. 18.

<sup>20</sup> Zhong Hua Ren Min Gong He Guo Gong Si Fa (中华人民共和国公司法) [Company Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006), art. 149(7) (China).

<sup>21</sup> *Id.* at art. 150.

<sup>22</sup> Zhong Hua Ren Min Gong He Guo Lao Dong Fa (中华人民共和国劳动法) [Labor Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995), art. 22 (China).

<sup>23</sup> *Id.* at art. 102.

<sup>24</sup> Zhong Hua Ren Min Gong He Guo Lao Dong He Tong Fa (中华人民共和国劳动合同法) [Labor Contract Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2007, effective Jan. 1, 2008), art. 23 (China).

Law in the Trial of Civil Cases Involving Unfair Competition (the “Interpretation”) in an effort to clarify litigation issues relating to unfair competition claims and to strengthen IP protection based on such claims in China.<sup>25</sup> The Interpretation went into effect on February 1, 2007 and has touched upon various aspects of trade secret protection.

¶43 As discussed before, trade secrets are defined as:

- (1) Technical or business information that is unknown to the public;
- (2) Which has economic benefits and practical utility; and
- (3) For which the trade secret owner has undertaken measures to maintain its confidentiality.<sup>26</sup>

The Interpretation provides a detailed explanation of the meaning of “unknown to the public,” “economic benefits and practical utility,” as well as “confidentiality measures.”<sup>27</sup> In addition, it has addressed other issues, such as defenses to misappropriation, customer lists as trade secrets, burden of proof, damages determination, and injunctions in trade secrets misappropriation cases.<sup>28</sup>

#### A. *Unknown to the Public*

¶44 According to the Interpretation, information “unknown to the public” refers to the relevant information which is unknown to and is difficult to obtain by the “relevant person in the relevant field.”<sup>29</sup> Specifically, the following information is considered NOT “unknown to the public”:

- (1) Information that is common sense or trade practice for people in the relevant field;
- (2) Information that only involves simple combination of dimensions, structures, materials and parts of products, and can be directly acquired through observation of products by the relevant public after the products enter into the market;
- (3) Information that has been publicly disclosed in a publication or other mass media;
- (4) Information that has been publicized through open conferences or exhibitions;
- (5) Information that can be acquired through other public channels;

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<sup>25</sup> Zui Gao Ren Min Fa Yuan Guan Yu Shen Li Bu Zheng Dang Jing Zheng Min Shi An Jian Ying Yong Fa Lv Ruo Gan Wen Ti De Jie Shi

(最高人民法院关于审理不正当竞争民事案件应用法律若干问题的解释) [Interpretation of Supreme People’s Court on Some Issues Concerning the Application of Law in the Trial of Civil Cases Involving Unfair Competition], Fashi 2/2007 (Sup. People’s Ct. 2007) (China) [hereinafter Interpretation].

<sup>26</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Sept. 2, 1993), art. 10 (China).

<sup>27</sup> See Interpretation, *supra* note 25, at arts. 9–11.

<sup>28</sup> See *id.* at arts. 12–14, 16–17.

<sup>29</sup> *Id.* at art. 9.

- (6) Information that can be easily acquired without substantial efforts and costs.<sup>30</sup>

### B. *Economic Value and Practical Utility*

¶45 According to the Interpretation, any information which has actual or potential commercial value and can bring competitive advantages to the owner shall be regarded as having “economic benefits and practical utility.”<sup>31</sup>

### C. *Confidentiality Measures*

¶46 The essential characteristic of a trade secret is confidentiality. A trade secret owner must take reasonable steps to maintain the confidential nature of the trade secret. As the Interpretation explains, if the owner adopts proper measures reasonable under the circumstances in order to prevent its disclosure or leakage, such measures shall be held as reasonable “confidentiality measures.”<sup>32</sup>

¶47 It further states that courts shall determine whether the owner has adopted confidentiality measures according to the following factors: features of the relevant information carrier, confidentiality desire by the owner, identifiability of the confidentiality measures, difficulty for others to obtain it by justifiable means, and other factors.<sup>33</sup>

¶48 The Interpretation provides additional guidance as to what may constitute sufficient confidentiality measures. The following is a non-exhaustive list:

- (1) Limiting access to classified information and disclosing it only on a need-to-know basis;
- (2) Locking up the carrier of classified information or adopting any other preventive measure;
- (3) Including a confidentiality notice on the carrier of classified information;
- (4) Adopting passwords or codes on classified information;
- (5) Executing a confidentiality agreement;
- (6) Limiting visitor access to classified machinery, factory, workshop or any other place, or imposing confidentiality obligations on visitors; and
- (7) Adopting any other proper measure for ensuring the confidentiality of information.<sup>34</sup>

Where the owner has actively sought to protect its trade secret, the question then becomes whether the protective measures are reasonable. There is no general rule as to what preventive measures are deemed reasonable. The question of whether the owner has taken “proper and reasonable steps” depends on the circumstances of each case,

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<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at art. 10.

<sup>32</sup> *Id.* at art. 11.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.*

considering the nature of the information sought to be protected, as well as the conduct of relevant parties.<sup>35</sup>

¶49 In sum, the owner of a trade secret must take reasonable measures to maintain its confidentiality in order to satisfy the statutory requirements of trade secrets. It is essential for the preventive measures to be reasonable under the circumstances.

#### *D. Independent Creation and Reverse Engineering*

¶50 According to the Interpretation, independent creation and reverse engineering are viable defenses to a claim of trade secret misappropriation.<sup>36</sup> In particular, “reverse engineering” refers to the process of acquiring relevant technical information through dismantling, mapping, analyzing, or any other technical means on the product obtained from public channels.<sup>37</sup> A party who acquires another’s trade secret by unjustified means cannot successfully assert a defense of reverse engineering.<sup>38</sup>

#### *E. Customer List*

¶51 Whether customer lists can constitute trade secrets was controversial in China. The Interpretation makes it clear that customer lists can be protected as trade secrets so long as they meet the statutory requirements.<sup>39</sup> Customer lists which may be considered as trade secrets refer to the name, address, contact information, business patterns, and business plans that have risen to the level of specific customer information. Compilations of the names of general customers or specific customers with a long-term business relationship, for instance, are different than what is known to the relevant public.<sup>40</sup> Of course, such compilations must not be publicly known to be considered as a trade secret.

¶52 Situations may arise where a customer relied upon a particular employee and conducted business with his employer. After this employee left his employer, if it can be established that the customer voluntarily followed the employee to his new employer, a court will find that no illegal means were employed, unless there is an agreement between the former employer and employee to the contrary.<sup>41</sup>

#### *F. Burden of Proof*

¶53 The burden of proof rests with the plaintiff who claims that a defendant has misappropriated its trade secret.<sup>42</sup> The plaintiff must prove that (1) its trade secret meets the statutory requirements, (2) what the defendant uses is similar or substantially similar to its trade secret, and (3) the defendant has used illegal means.<sup>43</sup>

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<sup>35</sup> *See id.*

<sup>36</sup> *Id.* at art. 12.

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *See id.* at art. 13.

<sup>40</sup> *Id.* at art. 13.

<sup>41</sup> *Id.*

<sup>42</sup> *Id.* at art. 14.

<sup>43</sup> *Id.*

### *G. Damages Determination*

¶54 The Interpretation recognizes three acceptable methods of ascertaining damages in trade secret misappropriation cases (similar to those used in patent infringement cases): (1) plaintiff's lost profits; (2) defendant's profits realized from the misappropriation; and (3) reasonable royalty.<sup>44</sup>

¶55 Where a defendant's actions have caused a trade secret to become known to the general public, the damages shall be determined according to the commercial value of the trade secret. The commercial value of a trade secret shall be determined with reference to its research and development costs, proceeds from practicing the trade secret, the tangible benefits, the length of time during which the trade secret confers competitive advantages to the plaintiff, etc.<sup>45</sup>

### *H. Injunctions*

¶56 Unlike a patent, trademark, or copyright, a trade secret is not a right granted by a government agency. Whether something constitutes a trade secret is almost always subject to disputes. As such, the likelihood of success on the merits is more difficult to prove for trade secret cases. Moreover, China has not adopted the inevitable disclosure doctrine.<sup>46</sup> Therefore, it is rather unusual to obtain a preliminary injunction for trade secret misappropriation. However, once the plaintiff prevails on a claim of trade secret misappropriation, courts are likely to grant a permanent injunction.<sup>47</sup> Generally, the length of a permanent injunction will not be extended to the time when the trade secret becomes known to the general public, if at all.<sup>48</sup> If the length of an injunction according to this rule is patently unreasonable under the circumstances, a court may limit the scope and length of the injunction, provided that the trade secret owner's competitive advantages are legally protected.<sup>49</sup> Consequently, IP owners are no longer entitled to an automatic permanent injunction after establishing infringement or misappropriation.

## V. ENFORCEMENT OF TRADE SECRETS RIGHTS

¶57 In cases of suspected trade secrets misappropriation, the owners can undertake administrative or judicial actions to enforce their trade secret rights. Judicial remedies include both civil litigation and criminal prosecution.

### *A. Administrative Action*

¶58 According to the Anti-Unfair Competition Law, for administrative enforcement of trade secret misappropriation, the offices of the Administration for Industry and

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<sup>44</sup> *Id.* at art. 17.

<sup>45</sup> *Id.*

<sup>46</sup> Some U.S. courts adopt the doctrine of inevitable disclosure, which allows for an injunction against competition, even in the absence of actual trade secret misappropriation, based on the presumption that the employee's new duties cannot be performed without disclosure of the old employer's trade secret. *See PepsiCo., Inc. v. Redmond*, 54 F.3d 1262 (7th Cir. 1995).

<sup>47</sup> *See* Interpretation, *supra* note 25, at art. 16.

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

Commerce (“AICs”) in China have the power to investigate trade secret misappropriation acts.<sup>50</sup> AICs have additional authority to order the return of drawings, blueprints, and other materials containing the trade secrets, and to order the destruction of the goods manufactured using the stolen trade secrets, if such goods would disclose the trade secrets to the public when made available.<sup>51</sup>

¶59 According to Article 25 of the Anti-Unfair Competition Law, after an investigation and determination of wrongdoing, AICs can order the wrongdoer to cease the misappropriating acts and impose a civil fine of at least RMB 10,000 but less than RMB 200,000.<sup>52</sup> However, the AICs do not have the power to award damages to an aggrieved owner of a trade secret.<sup>53</sup> If damages are sought, parties must turn to civil litigation.<sup>54</sup> All decisions of AICs may be appealed to the People’s Court.<sup>55</sup>

### B. Civil Court Action

¶60 An injured party can institute legal actions in a People’s Court to seek compensation for damages under the Anti-Unfair Competition Law.<sup>56</sup> Damages should be determined in accordance to the Interpretation.<sup>57</sup> In addition, expenses and fees arising from investigating and collecting evidence of the misappropriation also can be included in the claim for damages.<sup>58</sup> Injunctive relief is available as well.<sup>59</sup>

¶61 Because there is no U.S.-style discovery in China, plaintiffs must collect and submit their own evidence to meet their burden of proof regarding, *inter alia*, trade secret misappropriation and damages. Chinese courts rarely accept evidence unless in its original form; therefore, documentary evidence is practically the only form of evidence

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<sup>50</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 16 (China).

<sup>51</sup> Guo Jia Gong Shang Xing Zheng Guan Li Ju Guan Yu Jin Zhi Qin Fan Shang Ye Mi Mi Xing Wei De Ruo Gan Gui Ding (国家工商行政管理局关于禁止侵犯商业秘密行为的若干规定) [Several Provisions on Prohibiting Infringements upon Trade Secrets] (promulgated by the State Admin. for Indus. and Commerce of the P.R.C., 1998), art. 7 (China).

<sup>52</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 25 (China) (the current exchange rate between RMB and US dollar is 6.6 to 1).

<sup>53</sup> See Guo Jia Gong Shang Xing Zheng Guan Li Ju Guan Yu Jin Zhi Qin Fan Shang Ye Mi Mi Xing Wei De Ruo Gan Gui Ding (国家工商行政管理局关于禁止侵犯商业秘密行为的若干规定) [Several Provisions on Prohibiting Infringements upon Trade Secrets] (promulgated by the State Admin. for Indus. and Commerce of the P.R.C., 1998), art. 9 (China); see also, [http://beijing.usembassy-china.org.cn/ipr\\_tsuc.html](http://beijing.usembassy-china.org.cn/ipr_tsuc.html).

<sup>54</sup> See Guo Jia Gong Shang Xing Zheng Guan Li Ju Guan Yu Jin Zhi Qin Fan Shang Ye Mi Mi Xing Wei De Ruo Gan Gui Ding (国家工商行政管理局关于禁止侵犯商业秘密行为的若干规定) [Several Provisions on Prohibiting Infringements upon Trade Secrets] (promulgated by the State Admin. for Indus. and Commerce of the P.R.C., 1998), art. 9 (China); see also, [http://beijing.usembassy-china.org.cn/ipr\\_tsuc.html](http://beijing.usembassy-china.org.cn/ipr_tsuc.html) (“It should be noted that AICs do not have the ability to award compensation in unfair competition cases. If damages are sought, parties must turn to proceedings in the People’s Courts.”).

<sup>55</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 29 (China).

<sup>56</sup> *Id.* at art. 20.

<sup>57</sup> *Interpretation*, *supra* note 25, at art. 17.

<sup>58</sup> *Id.* at art. 21. It is rare that a court would award all costs and attorney fees in China.

<sup>59</sup> *Id.* at art. 16.

that carries significant weight in a Chinese court.<sup>60</sup> However, evidence obtained in violation of law is inadmissible in Chinese courts, and if admitted, it may constitute reversible error on appeal.<sup>61</sup> Subsequently, it is essential to have a proper and thorough evidence gathering strategy to overcome the challenging evidentiary hurdles for a potential plaintiff in a trade secret misappropriation case. In some cases, it is challenging to obtain documentary evidence to prove misappropriation. In others, it may be difficult to prove that the potential defendant had access to confidential information. As a practical result, though trade secrets can be protected by means similar to those used in the U.S., such as a confidentiality agreement, the mere existence of a confidentiality agreement may not be sufficient. It is advisable to have the recipient sign an acknowledgement of receiving access to the confidential information, in addition to executing a confidentiality agreement, prior to giving confidential information to a recipient.

¶62 An often used procedure to “discover” evidence of misappropriation is what is called “evidence preservation” provided under Article 74 of the Chinese Civil Procedure Law:

Under circumstances where there is a likelihood that evidence may be destroyed, lost, or difficult to obtain later, the parties in the proceedings may apply to the People’s Court for preservation of evidence. The People’s Court may also on its own initiative take measures to preserve such evidence.<sup>62</sup>

Accordingly, under the circumstances prescribed above, a party may seek *ex parte* a court order to preserve such evidence. The court may demand the requesting party to post a bond.<sup>63</sup> An evidence preservation order is typically enforced by the judges themselves. Such orders can be very effective, as the respondent generally will not be notified in advance and may be required to comply with the order by providing the relevant documentation and evidence on the spot. In the execution of the order, the court may question the respondent, order production of documents, take samples of the infringing product, conduct an inspection of the premises, and so on. Any evidence obtained from evidence preservation efforts that is verified by the court is admissible in subsequent court proceedings.<sup>64</sup> Therefore, evidence preservation has become a powerful tool in

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<sup>60</sup> See Zhong Hua Ren Min Gong He Guo Min Shi Su Song Fa (中华人民共和国民事诉讼法) [Civil Procedure Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 28, 2007, effective Oct. 28, 2007), art. 68 (China).

<sup>61</sup> See Zui Gao Ren Min Fa Yuan Guan Yu Min Shi Su Song Zheng Ju De Ruo Gan Gui Ding (最高人民法院关于民事诉讼证据的若干规定) [Provisions of the Supreme People’s Court on Evidence in Civil Procedures] (promulgated by the Jud. Comm. of Supreme People’s Court, Dec. 21, 2001, effective Apr. 1, 2002), at 68, Fashi 33/2001 (Sup. People’s Ct. 2001) (China).

<sup>62</sup> Zhong Hua Ren Min Gong He Guo Min Shi Su Song Fa (中华人民共和国民事诉讼法) [Civil Procedure Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 28, 2007, effective Oct. 28, 2007), art. 74 (China).

<sup>63</sup> See Zui Gao Ren Min Fa Yuan Guan Yu Min Shi Su Song Zheng Ju De Ruo Gan Gui Ding (最高人民法院关于民事诉讼证据的若干规定) [Some Provisions of the Supreme People’s Court on Evidence in Civil Procedures] (promulgated by the Jud. Comm. of Supreme People’s Court, Dec. 21, 2001, effective Apr. 1, 2002), at 23, Fashi 33/2001 (Sup. People’s Ct. 2001) (China).

<sup>64</sup> See Zhong Hua Ren Min Gong He Guo Min Shi Su Song Fa (中华人民共和国民事诉讼法) [Civil Procedure Law of the P.R.C.] (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 28, 2007, effective Oct. 28, 2007), art. 63 (China).

trade secret misappropriation cases in Chinese courts. To prevent its abuse, however, courts may require the movant present some preliminary evidence showing ongoing or imminent misappropriation before issuing such an order. According to the statistics released by the Supreme People's Court, Chinese courts granted 93.72% of the 1,312 motions for evidence preservation in IP-related cases from 2002 to 2009.<sup>65</sup>

### C. Criminal Court Action

¶63 Criminal prosecution should always be considered as an enforcement option when the trade secret owner has suffered “serious” or “exceptionally serious” losses, because police in China have the power to seize any relevant evidence, which can also be used in administrative or civil litigation.

¶64 Under Article 219 of the Criminal Law, whoever commits any of the following acts and thus causes “serious” or “exceptionally serious” losses to the trade secret owner shall bear criminal liabilities:

- (1) Acquiring a trade secret of another by theft, inducement, duress, or other illegal means;
- (2) Disclosing, using, or allowing others to use a trade secret of another acquired by the above illegal means;
- (3) Disclosing, using, or allowing others to use a trade secret in breach of an agreement or a confidentiality obligation imposed by a legal owner; or
- (4) Acquiring, using, or disclosing a trade secret by a third party, when he knew or should have known that the trade secret has been misappropriated in any of the aforementioned ways.<sup>66</sup>

In 2004 and 2007, the Supreme People's Court and Supreme People's Procuratorate issued judicial interpretations regarding intellectual property crimes.<sup>67</sup> Under the 2004 interpretation, the court can impose prison sentences of up to three years and fines for misappropriation of trade secrets, if the loss incurred is “serious,” which is defined as a loss of more than RMB 500,000.<sup>68</sup> In cases of “exceptionally serious” loss, which is

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<sup>65</sup> *China's Intellectual Property Protection in 2009*, STATE INTELLECTUAL PROPERTY OFFICE OF THE P.R.C. (Jun. 6, 2010, 4:17 PM), <http://www.nipso.cn/onews.asp?id=9599>.

<sup>66</sup> *Zhong Hua Ren Min Gong He Guo Xing Fa* (中华人民共和国刑法) [Criminal Law of the P.R.C.] (promulgated by the Nat'l People's Cong., Mar. 14, 1997, effective Oct. 1, 1997), art. 219 (China).

<sup>67</sup> *Zui Gao Ren Min Fa Yuan, Zui Gao Ren Min Jian Cha Yuan Guan Yu Ban Li Qin Fan Zhi Shi Chan Quan Xing Shi An Jian Ju Ti Ying Yong Fa Lv Ruo Gan Wen Ti De Jie Shi* (最高人民法院、最高人民检察院关于办理侵犯知识产权刑事案件具体应用法律若干问题的解释) [Interpretation of the Supreme People's Court & the Supreme People's Procuratorate Concerning Some Issues on the Specific Application of Law for Handling Criminal Cases of Infringement upon Intellectual Property Rights] (promulgated by the 10th Procuratorial Comm. of the Supreme People's Procuratorate, Dec. 8, 2004, effective Dec. 22, 2004) *Fashi* 19/2004 (China) [hereinafter 2004 Interpretation]; *Zui Gao Ren Min Fa Yuan, Zui Gao Ren Min Jian Cha Yuan Guan Yu Ban Li Qin Fan Zhi Shi Chan Quan Xing Shi An Jian Ju Ti Ying Yong Fa Lv Ruo Gan Wen Ti De Jie Shi* (最高人民法院、最高人民检察院关于办理侵犯知识产权刑事案件具体应用法律若干问题的解释) [Interpretation II of the Supreme People's Court & the Supreme People's Procuratorate of the Issues Concerning the Specific Application of Law in Handling Criminal Cases of Infringement of Intellectual Property Rights] (promulgated by the 10th Procuratorial Comm. of the Supreme People's Procuratorate, April 5, 2007, effective April 5, 2007) *Fashi* 6/2007 (China) [hereinafter 2007 Interpretation].

<sup>68</sup> 2004 Interpretation, *supra* note 67, at art. 7.



defined as a loss of more than RMB 2,500,000, the defendant can be imprisoned for three to seven years in addition to being fined.<sup>69</sup> Pursuant to the 2007 interpretation, entities can be convicted and sentenced using the same guideline set forth in the 2004 interpretation for individuals.<sup>70</sup> Under Chinese criminal law, fines shall be imposed on an entity if it commits a crime, and the persons who are directly in charge of the entity and the persons who are directly responsible for the crime shall suffer the relevant criminal liabilities.<sup>71</sup>

¶165 Generally speaking, criminal prosecution is very effective in trade secret misappropriation cases, but it is not always easy to get police interested in run-of-the-mill trade secret cases. In the authors' experiences, the police are more interested in high profile cases. Consequently, the authors advise that one should try to "package" the case as "high profile" to enhance the chance of criminal prosecution. It also is important to build good relationships with the local community, including the local police, before any misappropriation happens.

## VI. PREVENTATIVE MEASURES FOR TRADE SECRET PROTECTION

¶166 Enforcement of trade secret rights after misappropriation has occurred is difficult and expensive in China, especially with the high evidentiary burden to prove trade secret misappropriation. Therefore, prevention is the best protection when it comes to trade secrets. Furthermore, because one of the key elements for a protectable trade secret is that the trade secret owner has taken measures to keep the trade secret confidential, it is important to establish and enforce a company-wide confidentiality policy. A lot has been written on best practices in establishing a confidentiality and trade secret policy and creating a corporate culture for such protection. The following is considered the minimum necessary to protect one's trade secrets in China.

### A. *Establishing Confidentiality Policy*

¶167 If a company has a dynamic process for development of trade secrets, it is essential to establish a trade secret audit program and implement a regular policy to maintain the confidentiality of the trade secrets at issue. The necessary steps of any effective confidentiality policy should include, among other things, at least the following:

- (1) Identifying what information the company deems confidential and how its employees should handle such information.
- (2) Clearly spelling out the consequences of any unauthorized, improper use, or disclosure of confidential information.
- (3) Clearly stating that improper use or disclosures can and will be grounds for employment termination or even criminal prosecution.

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<sup>69</sup> *Id.*

<sup>70</sup> 2007 Interpretation, *supra* note 67, at art. 6.

<sup>71</sup> Zhong Hua Ren Min Gong He Guo Xing Fa (中华人民共和国刑法) [Criminal Law of the P.R.C.] (promulgated by the Nat'l People's Cong., Mar, 14, 1997, effective Oct. 1, 1997), art. 31(China).

*B. Enforcing Confidentiality Policy*

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The following are the recommended practices on how to enforce a company confidentiality policy and effectively protect a company's trade secrets:

- (1) Require all key personnel who have knowledge of trade secrets to sign confidentiality agreements. In addition, the company should have a formal policy regarding the ownership of any intellectual property created by the employee during his employment, such as assigning all IP rights, including trade secret rights, to the company.
- (2) Conduct regular training on the company's confidentiality policy.
- (3) Verify that all employees have received a copy of the confidentiality policy in their employee handbook and have signed a statement acknowledging that they have read, understood and will comply with the policy as a condition of their employment.
- (4) Keep confidential information in restricted areas and in clearly marked binders or storage media. Items should be marked as Classified, Restricted, Confidential, Do Not Disclose, Do Not Copy Property of [the company], or other appropriate methods particular to the company's business.
- (5) Implement the following practices: restricting access to confidential information and disclosing it only on a need-to-know basis; adopting a locking system on the confidential information, such as a check-in and check-out system; and adopting passwords on confidential information.
- (6) Impose confidentiality requirements on visitors to the company's factories and premises.
- (7) To the extent possible, require all employees to sign a written acknowledgement prior to receiving any company information. If not, a subsequent written acknowledgement must be obtained. For a consultant, subcontractor, or any other third party, a written acknowledgement must be obtained in advance.
- (8) Conduct exit interviews of departing employees to ensure that they are not taking to their new jobs any information that the company would not want to disclose to a competitor. This also serves to remind all key employees that their obligation not to disclose trade secrets extends beyond their employment with the company. Departing employees must also provide written acknowledgment that they had access to certain confidential information and attach a list of such information. It is advisable to have departing employees return all electronic storage devices, such as USB drives, upon resignation.
- (9) Terminate electronic access for departing employees immediately prior to termination. In the alternative, closely monitor electronic access in accordance with company computer policies, because one of the most common avenues for loss of trade secrets is disclosure through electronic means. It is also advisable for the company to have computer policies in place that permit monitoring of electronic transmissions, such as regular imaging of employee's computer, in a manner that would alert the company

- if confidential files are being transmitted outside the company without company's consent.
- (10) To the extent possible, keep the key computers bearing confidential information off the network.
  - (11) To the extent possible, limit unauthorized downloading and/or installation of software that is not work-related.
  - (12) To the extent possible, but without invading personal privacy, monitor employee web surfing and email communication both in and out of the company computers.
  - (13) Ask contractors and employees to provide written undertakings not to compete with your business after they leave.
  - (14) Obtain reference and background checks on all managers, key employees, and persons who will have regular access to any confidential information.
  - (15) Build and maintain good relationships with the local police and Chinese government agencies, such as the State Administration for Industry and Commerce.

Although these measures may not completely prevent a company's trade secret from unwanted disclosure, they are necessary steps to prove that the trade secret owner has taken adequate measures to protect the confidentiality of the trade secret at issue, which is essential if the owner wants to effectively pursue any type of enforcement action against misappropriation.

¶169 As discussed above, for third-party liability to attach, the new employer must know or should have known that its new employee had access to trade secrets and may be about to breach a confidentiality obligation.<sup>72</sup> Notice may be constructive or actual. Constructive notice arises when the new employer should reasonably know that his new employee may be acting improperly.<sup>73</sup> However, reliance on constructive notice is fraught with difficulties. Therefore, it is highly recommended that actual notice be sent every time a departing employee with knowledge of confidential information leaves and joins a competitor.

¶170 Accordingly, if an employee has departed the company by reason of resignation or termination and has taken employment with a competitor, the first step for the company to take is to give immediate notice to the new employer of the employee's continued obligation to not disclose the company's trade secrets. This can be accomplished by sending a registered letter to the new employer indicating that the new employee has knowledge of the company's trade secrets. The letter should include an explanation of the legal basis for the employee's confidentiality obligation (for example, a non-disclosure agreement). If this is done, the trade secret owner may have a cause of action against the new employer should the employee disclose the trade secret to his new employer. The notice may prompt the new employer to take steps to ensure that its new employees will not use prior employers' trade secrets. Of course, the letter must be

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<sup>72</sup> See *supra* text accompanying note 17.

<sup>73</sup> Zhong Hua Ren Min Gong He Guo Fan Bu Zheng Dang Jing Zheng Fa (中华人民共和国反不正当竞争法) [Anti-Unfair Competition Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 10 (China).

carefully drafted so that it would not become a basis for a claim of defamation or unfair competition.

## VII. CONTRACTUAL PROTECTION OF TRADE SECRETS

¶71 Chinese law permits companies to contractually protect their trade secrets. Due to the high evidentiary burden in China, written agreements are vital in protecting trade secrets and confidential information.

### A. Confidentiality Agreement

¶72 Both the Labor Law and Labor Contract Law provide that the employers and employees may enter into confidentiality agreements regarding the employer's trade secrets.<sup>74</sup>

¶73 Article 92 of the Contract Law provides that after the termination of the rights and obligations under a contract, the parties shall observe the principles of honesty and good faith and perform the obligations of notification, cooperation, confidentiality, etc., in accordance with customary business practice.<sup>75</sup> However, what constitutes "customary business practice" in China is unclear.

¶74 Article 26 of the Regulations on Technology Import and Export further stipulates that the assignor/licensor and the assignee/licensee of a technology import contract are obligated to keep non-public technology confidential pursuant to the confidentiality scope and duration as prescribed in the contract.<sup>76</sup> Moreover, during the confidentiality period, if the confidential technology is made known to the public by a person who is not under the confidentiality obligation, the confidentiality obligation shall immediately terminate.<sup>77</sup>

¶75 Chinese law does not prescribe any fixed term during which an employee must keep the trade secret confidential, but a court may prolong the obligation until the general public is aware of the trade secret.<sup>78</sup> Therefore, employers should consider specifying a reasonable time limit for maintaining confidentiality obligations post-termination in all IP agreements, consultant agreements, and service agreements that the companies may have with its employees, contractors, and subcontractors, etc. Another option is to specify that the post-termination obligation continues so long as the trade secrets remain secret. Whenever possible, confidentiality agreements should clearly identify the information that the employer deems as confidential.

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<sup>74</sup> See Zhong Hua Ren Min Gong He Guo Lao Dong Fa (中华人民共和国劳动法) [Labor Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995), art. 22 (China). See also Zhong Hua Ren Min Gong He Guo Lao Dong He Tong Fa (中华人民共和国劳动合同法) [Labor Contract Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2007, effective Jan. 1, 2008), art. 23 (China).

<sup>75</sup> See Zhong Hua Ren Min Gong He Guo He Tong Fa (中华人民共和国合同法) [Contract Law of the P.R.C.] (promulgated by the Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), art. 92 (China).

<sup>76</sup> Zhong Hua Ren Min Gong He Guo Ji Shu Jin Chu Kou He Tong Deng Ji Guan Li Ban Fa (中华人民共和国技术进出口合同登记管理办法) [Measures for the Administration of Registration of Technology Import and Export Contracts of the P.R.C.] (promulgated by the Ministry of Foreign Trade and Economic Cooperation, Dec. 30, 2001, effective Jan. 1, 2002), art. 26 (China).

<sup>77</sup> *Id.*

<sup>78</sup> See Interpretation, *supra* note 25, art. 16.

### B. Non-Compete Agreement

¶76 Non-competes are now routinely used in China. Generally speaking, non-competes are invalid without additional compensation. Continued employment has not been held to be adequate consideration for a valid non-competes clause. The 2007 Labor Contract Law has detailed prescriptions on the non-competes obligations.

¶77 Article 23 of the Labor Contract Law provides that for an employee with confidentiality obligations, the employer and the employee may add non-competes clauses in an employment contract or confidentiality agreement.<sup>79</sup> The employer and employee may further agree that upon the dissolution or termination of the employment contract, the employee shall be paid monthly monetary compensation during the non-competes period.<sup>80</sup> Upon violation of the non-competes clause, the employee shall pay the penalties for breach of contract as stipulated in the contract.<sup>81</sup>

¶78 Article 24 of the Labor Contract Law specifies that non-competes obligations are limited to senior managers, senior technical personnel, and other personnel with confidential obligations.<sup>82</sup> The scope, region, and duration of the non-competes obligations should be stipulated by the employer and employee, provided that they do not violate any laws or regulations.<sup>83</sup> Upon dissolution or termination of the employment contract, the duration of the non-competes obligations shall not exceed two years.<sup>84</sup>

¶79 The amount of additional compensation can be mutually agreed upon by the parties, unless specified by local rules or regulations. However, the agreed additional compensation must be reasonable for the obligated employee. According to the Supreme People's Court Opinions on Several Issues Regarding the Implementation of the National Intellectual Property Strategy, courts are required to properly strike the balance between protection of trade secrets and freedom of employment. In particular, the courts are concerned about the relationship between non-competition and the flow of talents, so as to protect employees' legitimate rights and interests.<sup>85</sup> It is likely that in litigation involving non-competes clauses between an employee and its employer, a court may tip the balance in favor of the employee if the court considers the compensation insufficient. Also, not everyone is subject to non-competes obligations. As discussed above, they are limited to senior managers, senior technical personnel and other personnel with confidential obligations.<sup>86</sup>

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<sup>79</sup> Zhong Hua Ren Min Gong He Guo Lao Dong He Tong Fa (中华人民共和国劳动合同法) [Labor Contract Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2007, effective Jan. 1, 2008), art. 23 (China).

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> *Id.* at art. 24.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> Zui Gao Ren Min Fa Yuan Guan Yu Che Di Shi Shi Guo Jia Zhi Shi Chan Quan Zhan Lve Ruo Gan Wen Ti De Yi Jian (最高人民法院关于贯彻实施国家知识产权战略若干问题的意见) [Opinions of the Supreme People's Court on Several Issues Regarding the Implementation of the National Intellectual Property Strategy] Fafa 16/2009, art. 12 (Sup. People's Ct. 2009) (China).

<sup>86</sup> Zhong Hua Ren Min Gong He Guo Lao Dong He Tong Fa (中华人民共和国劳动合同法) [Labor Contract Law of the P.R.C.] (promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2007, effective Jan. 1, 2008), art. 24 (China).

## VIII. PROTECTING TRADE SECRETS IN LICENSING TRANSACTIONS &amp; JOINT VENTURES

¶80 When conducting IP licensing or forming joint ventures in China, it is essential to have a proper game plan to ensure that valuable trade secrets are not lost. Failing that, these trade secrets could end up in the hands of potential competitors both in the Chinese market and in major markets outside of China. Therefore, it is essential for companies to ask some critical questions. For example, how much of the global revenues are at risk by transferring the trade secret? How vulnerable is the trade secret to duplication? How much would it hurt the company if the competitor acquired the trade secret? The rule of thumb should be that if one cannot afford to lose the trade secrets, one should not transfer them to China.

¶81 **License Transactions.** Should a foreign company decide to license its trade secrets to a Chinese company, the licensor company should consider the following recommendations:

- (1) **License Agreement:** Draft a written licensing contract with sufficient clauses to protect the licensor's rights to the maximum extent permitted under Chinese law. In addition to the normal provisions on the definition of confidentiality information, consider adding clauses relating to the obligations of the licensee, time period, termination of contract, dispute resolution, injunctive relief, bond for breach, right to audit for compliance, indemnity, and improvements.<sup>87</sup> Specify that upon the termination or expiration of the license agreement, the licensee has no right to continue to use the licensed technologies, that the licensee has no right to market or sell any product made by or from the licensed technologies, and that the licensee must return all technical information to the licensor.
- (2) **Confidentiality Agreement:** Consider signing confidential agreements directly with the licensee's employees. Specify that the confidentiality obligation survives the termination of the license agreement. Preferably, a specific time period should be stated. Or state that the post-termination confidentiality obligation continues so long as the confidential information remains as trade secrets.
- (3) **Preventive Measures:** Require the licensee to set up policies to identify relevant personnel that have access to the underlying trade secret and inform them of their confidentiality obligations.

**Joint Ventures.** From an IP protection perspective, a wholly owned subsidiary is the preferred corporate form, a joint venture ("JV") in certain circumstances is the only vehicle to do business in China. Licensing trade secrets to a JV is somewhat better than directly licensing to a Chinese company, because a JV can give trade secret owners more leverage to enforce its rights if the JV is properly set up. For example, the following is a recommended practice for trade secret owners to maximize the protection of trade secrets licensed to a JV.

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<sup>87</sup> Under Chinese law, the licensor cannot contractually obligate the licensee to assign the ownership rights in any improvement without paying the licensee adequate consideration.

- (1) **License Agreement and JV Formation Agreement:** In the JV Formation Agreement, specify that all decisions relating to intellectual property matters are to be decided by a majority vote, not a unanimous vote, of the board of directors. Avoid using the term “technology transfer;” rather, call it “technology license.” In the license agreement, specify that the license to use the trade secrets terminates upon the termination or expiration of the license agreement (which normally terminates upon the dissolution of the JV), that there is neither a right to continued use nor a right to market or sell products made by or from trade secrets, and that the JV must return all technical information to the licensor. In a JV formation agreement and license agreement, specify that the licensor company should have audit rights after termination or expiration of these agreements to ensure that no misappropriation of trade secrets occurs, and provide that injunctive relief is the agreed remedy for misappropriation of trade secrets.
- (2) **Confidentiality Agreement and Non-compete Agreement:** Have each person who has knowledge or access to trade secrets sign a confidentiality agreement and a non-compete agreement. If possible, execute the above agreement by all three parties: the licensor company, the licensee partner, and the employee.<sup>88</sup> When a third-party, such as a contractor or consultant is involved, require the third-party to sign a confidentiality agreement and a non-compete agreement.
- (3) **Preventive Measures:** Important trade secrets should be accessed by a limited number of people on a need-to know basis. Maintain a list of people who have knowledge or access to trade secrets. Moreover, a written confirmation of the knowledge or access to trade secrets should be obtained from each such person. If a third party will have access to confidential information, a written acknowledgement must be obtained in advance.

## IX. RECENT TRADE SECRET CASES IN CHINA

### A. *Civil Cases*

¶82 The following recent trade secret misappropriation cases illustrate how Chinese courts adjudicate trade secret misappropriation cases.

¶83 **Siwei v. Avery Dennison.**<sup>89</sup> In the *Siwei* case, the Chinese Supreme Court clarified what activities constitute trade secret misappropriation in applying the first-to-accept rule for jurisdiction determination.

¶84 On April 8, 2004, Siwei Industrial (Shenzhen) Co., Ltd. and Siwei Enterprise Co., Ltd. (collectively as “Siwei”) sued Avery Dennison Corp., Avery Dennison (Guangzhou) Co., Ltd., Avery Dennison (Kunshan) Co., Ltd., Avery Dennison (China) Co., Ltd. (collectively as “Avery Dennison”), Nanhai City Lishui Yili Printing (“Lishui Yili”) and

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<sup>88</sup> The reason for this three way agreement is to give the licensor company the standing to sue after a JV is dissolved.

<sup>89</sup> *Siwei Indus. (Shenzhen) Co., Ltd. v. Avery Dennison Corp.*, Minsanzhongzi No. 10/2007 (Sup. People’s Ct. 2009) (China) (explaining that under the first-to-accept rule, if there are two lawsuits involving essentially the same legal issues and underlying facts, the later-filed case must be consolidated with the first case to avoid inconsistent adjudication).

Foshan City Huanshi District Dongsheng Fenjiang Printing Sales Department (“Dongsheng Fenjiang”) in the Guangdong Foshan Intermediate People’s Court for trade secret misappropriation, alleging damages of RMB 60,000,000 (“the Guangdong lawsuit”).<sup>90</sup> On May 17, 2004 and November 29, 2004, Siwei twice amended its pleadings to increase the damage amount to RMB 150,000,000. Due to the jurisdictional limit of the court, the Guangdong Foshan Intermediate People’s Court moved the case to the Guangdong Higher People’s Court.<sup>91</sup> On June 6, 2005, Siwei submitted its civil complaint to the Guangdong Higher People’s Court again. In addition, on October 13, 2004, Avery Dennison sued Siwei in the Jiangsu Higher People’s Court for trade secret misappropriation (“the Jiangsu lawsuit”). However, the Jiangsu Higher People’s Court transferred the Jiangsu lawsuit to the Guangdong Higher People’s Court and consolidated it with the Guangdong lawsuit based on the first-to-accept rule.<sup>92</sup> Avery Dennison objected raising a jurisdictional issue in the Guangdong Higher People’s Court. The objection was overruled; therefore, Avery Dennison appealed to the Supreme People’s Court.<sup>93</sup>

¶85 The Supreme People’s Court held that both the Guangdong and Jiangsu lawsuits should be transferred to the Jiangsu Higher People’s Court and consolidated into one legal proceeding.<sup>94</sup> In arriving at this conclusion, the Court first discussed the issue of what activities constituted trade secret misappropriation. According to the Court, Article 10 of the Anti-Unfair Competition Law prescribes specific forms of wrongdoer liability and third-party liability for trade secret misappropriation, which does not include selling infringing products made from misappropriated trade secrets.<sup>95</sup> The Court clarified that trade secret misappropriation ends after the infringing products are made and that it does not extend to the sales activities of such products. Therefore, the sales activities by Lishui Yili and Dongsheng Fenjiang, in and of themselves, did not constitute acts of trade secret misappropriation, and thus the Guangdong Foshan Intermediate People’s Court did not have original jurisdiction over the case.<sup>96</sup> Moreover, the Guangdong Higher People’s Court could not relate its acceptance date back to the original acceptance date by the Guangdong Foshan Intermediate People’s Court.<sup>97</sup> As a result, the Guangdong lawsuit should be considered to be accepted on June 6, 2005, while the Jiangsu lawsuit was accepted on October 13, 2004. Based on the first-to-accept rule, the Court held that the Jiangsu Higher People’s Court had jurisdiction over the case.

¶86 **GE v. Jiuxiang.**<sup>98</sup> The *GE* case is an example where a foreign plaintiff prevailed as the trade secret owner against its former employee for misappropriation. In this case,

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> While the Supreme Court stated that the mere selling of products made from misappropriated trade secrets is not an act of misappropriation within the scope of Article 10 of Anti Unfair Competition Law, it is not clear if it is a broad statement of China’s trade secret misappropriation law or it should be limited to jurisdictional determination.

<sup>97</sup> *Siwei Indus. (Shenzhen) Co., Ltd. v. Avery Dennison Corp.*, Minsanzhongzi No. 10/2007 (Sup. People’s Ct. 2009) (China).

<sup>98</sup> *Gen. Elec. Co. v. Xi’an Jiuxiang Elec. Tech. Co.*, Ximinsichu No. 26/2007 (Xi’an Interm. People’s Ct. Aug. 13, 2007) (China).



General Electric Company, General Electric (China) Co., Ltd., General Electric Medical Systems Trade Development (Shanghai) Co., Ltd. (collectively as “GE”) sued Xi’an Jiuxiang Electronic Technology Co., Ltd. (“Jiuxiang Co.”) and its president Xiaohui Wang (“Wang”) for trade secret misappropriation in the Xi’an Intermediate People’s Court.<sup>99</sup> Wang was a former employee of GE China and one of the key engineers in charge of the service and maintenance of GE’s CT machines. While employed with GE, Wang attended GE’s internal training sessions and had access to the classified “Red Service Disc” and other training materials.<sup>100</sup> In 2002, Wang resigned from GE and founded Jiuxiang Co., which provided maintenance services for medical equipment, such as, GE CT machines. Wang and Jiuxiang offered four training workshops on CT machine maintenance and circulated GE’s “Red Service Disc” and training materials to their trainees.<sup>101</sup>

¶87 A key issue in this case was whether the asserted technical information, contained in the Red Service Disc and Advanced Maintenance Manual, constituted trade secrets. The Court held that the technical information at issue was a trade secret, because it met every element of what constitutes a trade secret.<sup>102</sup> First, it was unknown to the public. Citing the Interpretation, the Court held that information “unknown to the public” referred to information that could not be acquired from public channels and was 1) unknown to and 2) difficult to be obtained by the relevant person in the relevant field.<sup>103</sup> According to the Court, the Red Service Disc and Advanced Maintenance Manual resulted from GE’s own efforts in designing, manufacturing, and maintaining its GE CT machines.<sup>104</sup> Therefore, the Disc and Manual were unknown and difficult to be obtained by the relevant person in the relevant field, and considered unknown to the public. Second, it had economic benefits and practical utility. The Court concluded that both GE and Jiuxiang Co. acquired economic benefits and practical utility from utilizing the asserted information.<sup>105</sup> Third, the legal owner undertook confidentiality measures. The Court decided that GE undertook adequate confidentiality measures by entering into a labor contract with confidentiality obligations with Wang, marking Classified and Confidential on the asserted Red Service Disc and Advanced Maintenance Manual, and restricting such information to a limited scope.<sup>106</sup>

¶88 Furthermore, the Court held that Wang is liable for trade secret misappropriation by disclosing, using, and allowing others to use the asserted trade secret in breach of its confidential obligations to GE imposed by the labor contract.<sup>107</sup> The Court further found that Jiuxiang Co. was liable as a third-party by using and disclosing trade secrets that he knew to have been misappropriated. Both defendants were jointly liable for RMB 500,000 for trade secret misappropriation.<sup>108</sup> The defendants were also enjoined from

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<sup>99</sup> *Id.*

<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

<sup>108</sup> *Id.*

any further misappropriation activities until the asserted trade secrets become generally known to the public.<sup>109</sup>

### B. Criminal Cases

¶89 A significant number of people have been imprisoned for trade secret misappropriation in China, as illustrated by the following case.

¶90 **Hubei v. Xing.**<sup>110</sup> Xing was arrested and tried for the crime of trade secret misappropriation.<sup>111</sup> During Xing's former employment with Kingdream Public Limited Company ("Kingdream"), she was a senior engineer and had access to confidential technical information of the company.<sup>112</sup> Xing later resigned from Kingdream and became the head of the Technology Department of Tianjin Lilin Bit Co., Ltd. ("Tianjin Lilin"). The Court concluded that the technical information at issue constituted trade secrets, because, among other things, Kingdream undertook sufficient confidentiality measures by using confidentiality agreements, confidentiality policies, and employee handbooks.<sup>113</sup> Furthermore, Xing acquired and used the trade secret in breach of her confidentiality obligations to Kingdream. Consequently, Tianjin LiLin produced and sold competing products made by using the trade secrets acquired by Xing from Kingdream. The misappropriation directly caused Kingdream economic losses of more than RMB 10,000,000.<sup>114</sup> The appellate court affirmed the trial court's finding that Xing violated her confidentiality obligations and was guilty of trade secret misappropriation.<sup>115</sup> Due to the "exceptionally serious" loss, Xing's six-year-sentence with a RMB 50,000 fine was held reasonable and affirmed by the appellate court.<sup>116</sup>

## X. FINAL THOUGHTS

¶91 China has been viewed by many as a country lacking a strong intellectual property protection system. Previously, some multinational companies assumed that China did not protect IP and ignored the procurement of IP in China. Even though the tides there are changing, some companies continue to operate under such assumption and have not developed an effective IP strategy for China.

¶92 Over the last decade, China has taken significant steps to create an IP protection environment that encourages innovation. In fact, IP has become such an important issue for China's transition to an innovation-based economy that the State Council of China issued the Outline of the National Intellectual Property Strategy in June 2008.<sup>117</sup> In promulgating the national IP strategy, China seeks to transform itself into a country with

<sup>109</sup> *Id.*

<sup>110</sup> Hubei Zhanjiang People's Procuratorate v. Xing Fafen, Hanxingzhongzi No. 9/2008 (Hubei Hanjiang Interm. People's Ct. May 20, 2008) (China).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> Guo Wu Yuan Guan Yu Yin Fa Guo Jia Zhi Shi Chan Quan Zhan Lve Gang Yao De Tong Zhi (国务院关于印发国家知识产权战略纲要的通知) [Notice of the State Council on Issuing the Outline of the National Intellectual Property Strategy] Guofa 18/2008 (St. Council 2008) (China).

a higher level of intellectual property rights, creation, utilization, protection, and administration by 2020.<sup>118</sup> Therefore, a new IP protection paradigm is emerging in China. Multinational companies should now assume that China protects IP and aggressively build an IP portfolio there. Moreover, they should implement effective and comprehensive IP strategies in China, which should include rigorous trade secret protection.

¶93

As discussed above, there are many successful stories of trade secret enforcement in China. To be successful, implementation of a heightened trade secret policy for China is essential. The best practices for the U.S. should be implemented in China. But more is required. For example, written acknowledgment must be obtained when a trade secret or confidential information is passed onto a recipient. Three-way confidentiality agreements must be signed, when trade secrets are passed onto a JV. If all the recommendations discussed in this article are followed, a trade secret owner should be able to minimize the risks of misappropriation and enhance the chance of enforcing its trade secret rights in China.

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<sup>118</sup> *Id.*

