

# Roadmap

## for Intellectual Property Protection in China

### Trade Secrets Protection in China

Suggested for use by companies,  
particularly new entrants to the  
Chinese marketplace

Prepared February 2011

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# Overview

## Importance of trade secret protection in China

In today's increasingly technology driven and knowledge oriented business environment, confidential information of commercial value is a key drive to business success. Businesses need to protect their trade secret to maintain their competitive edge: once a trade secret is disclosed, its commercial value is often lost. With the ongoing globalisation and digitisation of society, safeguarding trade secrets has become a more significant challenge for many businesses.

Companies doing business in China should be particularly aware of the importance of protecting their trade secrets, given that intellectual property violations, including trade secret misappropriation, are more prevalent in China compared to developed nations. Trade secret as well as other forms of intellectual property is a relatively new concept in China. It should be noted that in China, the market economy, which necessitates a legal system that protects economic rights, only started development 30 years ago when China entered the period of "reform and opening". Before that, private enterprises generally did not exist in China as virtually all companies were state-owned, and therefore Chinese companies at that time shared all types of information with each other freely.

As such, although a legal framework for trade secret protection has been established in China, it is relatively new and violations are generally more prevalent than in developed countries. For instance, if a company which is a part of a company group receives a trade secret, and its parent company or sister company finds this trade secret useful, the chance that this Chinese company may be pressured to unlawfully disclose this trade secret to its affiliates may be greater than if the company is a European company.

Also, compared with Europe, the practices of Chinese courts, administrative agencies, or other organs of the Chinese legal system could be problematic for a company trying to enforce its rights to intellectual property including trade secrets. For example, in civil litigation, Chinese courts tend to place a heavy burden on the plaintiff to prove a case of trade secret misappropriation, but do not provide an effective process (such as a formal discovery procedure in common

law jurisdictions such as the UK) for the plaintiff to obtain evidence. This can make it difficult for parties who suffered a loss of trade secret to try to mitigate their losses or seek retribution in China.

This Roadmap considers how trade secrets are protected in China and what measures businesses should take themselves to protect them.

## Distinction between patents and trade secrets

Trade secrets are often associated with the protection of new technology, and new technology is often protected by patents. However, the nature of trade secrets and patents are quite different as discussed below.

- a) Trade secrets include all types of information, not just information relating to technology. For example, a business contact list may be the subject of trade secret protection, but not patent protection.
- b) For a technology to be patentable, it must be novel (new), non-obvious (inventive), and have utility. There is no novelty or inventiveness requirement for trade secrets. In general, any non-public information that a party has taken reasonable measures to keep secret is a trade secret assuming that it has practical applicability. Regarding technical information, for example, any technical know-how can be protected as trade secrets even if the technical know-how cannot be patented due to, e.g., lack of inventiveness.
- c) Patent protection requires registration of a patent right with the relevant authority (e.g., the State Intellectual Property Office in China if a Chinese patent is to be registered). Trade secret protection does not require such registration.
- d) Patent rights are protected for a limited period of time. In China, the term of protection for invention patents is 20 years, and the term of protection for utility model patent and design patents is 10 years, both starting from the date of filing of the patent application. A trade secret has an unlimited term of protection as long as it remains a secret.

e) Patent holders can exclude anyone from practicing the patented invention. A trade secret holder has no protection against persons who independently obtained the information through legitimate means (e.g., through one's own research and development, or through reverse engineering).

**f) To seek patent protection, a company needs to disclose the invention to the public. In contrast, trade secrets are protected by keeping them as secrets.**

The last distinction discussed above is important for an owner of a new invention because it means that the owner needs to choose whether to apply for a patent or to keep the invention as a secret. The owner cannot have it both ways. Although trade secrets have an unlimited term of protection as discussed above, in practice, seeking patent protection is often the right choice because an invention kept as a trade secret becomes worthless once someone else recreates the invention and applies for a patent, or if the secret is otherwise disclosed to the public.

In relatively few situations, an owner of a patentable invention may choose to protect the invention as a trade secret for the following reasons:

- a) It considers that the likelihood of someone else recreating the invention is relatively small, and
- b) It considers that patent protection for the invention is weak in the jurisdiction(s) of interest (e.g., countries where it expect to sell its products).

In particular, if the jurisdiction of interest is China, reason b) above can be valid for certain types of inventions. For example, suppose a company developed a new process for manufacturing a known product which is relatively complex, and assume the main market of the product is China. If the company applies for a patent, and another company starts to use the patented process in China, it may be very difficult for the first company to collect enough evidence to prove and win a patent infringement case against the second company. If this is the case, and if the likelihood of someone else recreating the invention is small, the company may consider protecting the new process as a trade secret.

## Legal framework governing the protection of trade secrets

The current legal and regulatory framework in China governing the protection of trade secrets is mainly made up by the following laws, regulations, and Supreme People's Court judicial interpretations:

- **The PRC Anti-Unfair Competition Law<sup>1</sup>** (the "AUCL") - Article 10 provides a definition of a trade secret and lists the types of acts which constitute a violation of a trade secret. Articles 20 and 25 of the AUCL provide the legal basis of a civil action and an administrative action for trade secret violation;
- **The PRC Criminal Law<sup>2</sup> and related judicial interpretations<sup>3</sup>** - Under Article 219, anyone who violates a trade secret and thereby causes great losses to the right holder is guilty of a criminal offence;
- **The PRC Contract Law<sup>4</sup>** - Article 43 of PRC Contract Law provides that parties to a negotiation have duty to protect trade secrets obtained through the negotiation whether or not a contract is signed. In breach, the other party may bring a case of trade secret violation;
- **Supreme People's Court Interpretation on Some Issues Concerning the Application of Law in the Trial of Civil Cases Involving Unfair Competition<sup>5</sup>** (the "SPC Interpretation") - Articles 9-17 are provisions to be observed by the courts when hearing civil cases involving trade secrets;

1 Promulgated by the NPC Standing Committee on 2 September 1993 and effective as of 1 December 1993

2 Promulgated by the NPC on 14 March 1997 and effective as of 1 October 1997

3 Related regulations include Explanations by the Supreme People's Court and Supreme People's Procuratorate on Several Issues regarding the Applicable Law in Handling Criminal Intellectual Property Cases, effective as of 22 December 2004, and Regulations on Claim Standards for Economic Crime Cases issued by the Supreme People's Procuratorate and the Public Security Bureau, effective as of 18 April, 2001

4 Promulgated by the NPC on 15 March 1999 and effective as of 1 October 1999

5 Promulgated by the Supreme People's Court, effective as of 1 February 2007

- **Several Provisions regarding the Prohibition of Trade Secret Violations<sup>6</sup>** issued by the State Administration of Industry and Commerce (the “SAIC Provisions”) - The provisions provide regulations to be observed by the relevant Administration for Industry & Commerce (the “AIC”) in handling administrative actions involving trade secret violation.

Based on the above, trade secrets are protected in the following ways:

- Administrative actions:** A party that suffered a loss of trade secret may work with the AIC to bring an administrative action against the infringer.
- Civil actions:** A party may also bring a civil action against the infringer.
- Criminal actions:** The Public Security Bureau (the “PSB”) (i.e., the Chinese police) may investigate, and the People’s Procuratorate (the “PP”) may prosecute a crime involving trade secrets. In the alternative, such a crime may also be privately prosecuted, meaning that the owner of the trade secret may directly initiate a criminal case in a People’s Court against a defendant without involving the PSB and the PP.

It should be noted that China is also a party to a number of international treaties relating to intellectual property protection, mainly the Paris Convention and the TRIPS Agreement. The Paris Convention and the TRIPS Agreement have certain provisions relating to the protection of trade secrets. Therefore, these treaty provisions can in theory be applied by Chinese courts when handling trade secret cases. However, Chinese courts rarely cite these treaties in handling trade secret cases, because it is not entirely clear whether international treaties can be applied in China directly, and because useful treaty provisions relating to trade secret protection can in general be found in the Chinese statutes and Supreme People’s Court judicial interpretations, and therefore, there is no need to cite the text of the treaties.

As a civil law country, China does not have a system of case law. Prior decisions by the same court or a higher court do not legally bind the judges. Hence, the above mentioned statutes and judicial interpretations constitute the body of trade secret law in China. Important cases, especially cases from the Supreme People’s Court, may have persuasive power and may be used to argue a point, but there is no guarantee that they will be strictly followed. Judicial interpretations or opinions issued by the Supreme People’s Court and regulations issued by an administrative agency, on the other hand, are formal sources of law in China.

In China, judicial interpretations are not limited to interpreting provisions of the law, they often include detailed provisions as guidance on handling a case. In this sense they are similar to legislation and are used as legislation by the courts. Apart from the Supreme People’s Court, other courts, especially the Higher People’s Courts also issued judicial interpretations or opinions, which are considered as binding in the jurisdiction where they are located. For example, the Jiangsu Higher People’s Court issued in 2004 an Opinion on Issues relating to the Trial of Trade Secret Cases, and the Beijing Higher People’s Court issued in 1998 Answer to Several Questions relating to the Trial of Anti-unfair Competition Cases (Trial Version) which included provisions on trade secrets. These judicial interpretations or opinions are binding in Jiangsu and Beijing respectively.

Regulations issued by administrative agencies in China usually serve as guidance for the administrative agencies to apply the laws. In particular, the SAIC Provisions are used by the Chinese Administration of Industry and Commerce (“AIC”) to handle trade secret administration actions. Such regulations are often referenced by the People’s Courts.

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<sup>6</sup> Revised by the State Administration for Industry & Commerce on 3 December 1998 and effective as of the same date

# Protection of trade secrets

## What is a trade secret in China?

Pursuant to Article 10 of the AUCL, a trade secret is technical information and operational information:

- I. which is not known to the public;
- II. capable of bringing economic benefits to the right holder and has practical applicability; and
- III. the right holder has taken measures to keep it confidential.

Article 2 of the SAIC Provisions and Article 219 of the PRC Criminal Law also provides the same definition of trade secret. Therefore, for the purposes of administrative actions, civil actions, and criminal actions, the definition of trade secret is generally the same.

Articles 9-13 of the SPC Interpretation and Article 2 of the SAIC Provisions further clarify what constitutes a trade secret as discussed below.

### I. Not publicly known

Firstly, to qualify as a trade secret, the information may not be known to the public. Article 9 of the SPC Interpretation in particular states that this criterion is met if the information is not commonly known or easily accessible to relevant people in the field of the information. Information shall be considered publicly known, if it:

- a) is the general knowledge of the people in its technical or economic field or the practice of the industry;
- b) only concerns details such as the dimensions, structures, materials and the simple assembly of the components of goods, and can be directly obtained by observing the goods;
- c) has been publicly disclosed in publications and other media, in public seminars and exhibitions, or can be obtained through other public channels;
- d) is easy to obtain without having to pay a certain cost.

### II. Economic benefits and practical applicability

According to Article 10 of the SPC Interpretation, information can bring economic benefits and has practical applicability, if it has actual or potential commercial value, and can bring competitive advantages for the right holder.

### III. Confidentiality measures

According to Article 11 of the SPC Interpretation, if a party takes measures to protect information that is reasonable in view of the commercial value of the information, the "confidentiality measures" requirement is satisfied. A People Court should determine whether "confidentiality measures" has been taken based upon the following factors:

- a) Characteristic of the media that contain the relevant information
- b) Information owner's intention to protect the information
- c) Whether the protection measures can be clearly recognised
- d) Whether it would be easy for others to obtain the information from a public source

Examples of measures that qualify as reasonable measures to keep the information confidential are also provided in Article 11 of the SPC Interpretation, including:

- a) restricting access to the information and only allowing access by people who need access to the information;
- b) using preventive measures on the information media such as locks;
- c) marking the information as confidential;
- d) using passwords or encryption on the information being protected
- e) using confidentiality agreements
- f) limiting visitor access to places such as factory rooms or machine rooms where information can be obtained or requiring visitors to maintain confidentiality.

Apart from the SPC Interpretation, the Beijing Higher People's Court also provides some guidance on what amounts to "reasonable measures taken to maintain the confidentiality" in paragraph 12 of the Answer to Several Questions relating to the Trial of Anti-unfair Competition Cases (Trial Version). It states that the right holder must have adopted both external and internal measures to protect the information and be clear about the scope of protected information. The measures must be reasonable and appropriate, but do not need to be absolutely safe. As discussed above, this judicial interpretation is only binding on courts in Beijing, but it can have persuasive power on other courts as well.

It follows from the above that a broad variety of information may qualify as a trade secret in China. Examples of information that can be a trade secret are: customer lists; customer information; customer preferences; supplier lists; pricing information; marketing/product strategies; internal cost information; production processes; formulae and recipes; unpatentable or unpatented technology/processes.

### **Reverse engineering**

Article 12 of the SPC Interpretation states that obtaining information through reverse engineering or through one's own research and development efforts does not constitute trade secret infringement. Here, "reverse engineering" refers to obtaining information through technical means by taking apart, measuring, and/or analysing a product that is obtained through a public channel.

## **What acts constitute trade secret infringement in China?**

In China, acts of trade secret infringement are specified by the AUCL, PRC Criminal Law and PRC Contract Law.

### **The AUCL**

The AUCL form the main legal basis for bringing a civil action or an administrative action against a trade secret infringer. Article 10 of the AUCL sets out the following acts which constitute trade secret infringement in China:

- a) obtaining trade secrets from the right holder by stealing, luring, resorting to coercion or other illegitimate means;
- b) disclosing, using or allowing others to use trade secrets of the right holder obtained by the means mentioned in the preceding section; or
- c) disclosing, using or allowing others to use trade secrets obtained in breach of an agreement or disregarding the requirement of the right holder to preserve the trade secrets.

Further, if a third party obtains, uses or discloses the trade secrets of others when he has or should have knowledge of the illegal acts mentioned in above, he shall be deemed to have infringed on the trade secrets of others.

Article 3 of the SAIC Provisions and Article 219 of the PRC Criminal Law also provides generally the same definition of trade secret infringement. Therefore, for the purposes of administrative actions, civil actions, and criminal actions, the definition of trade secret infringement is generally the same.

This definition of trade secret infringement is generally in line with laws of other nations, including that of Member States of the European Union (EU).

### **The Criminal Law**

According to Article 219 of the PRC Criminal Law, anyone who violates a trade secret and thereby causes significant losses to the right holder commits a criminal offence, which is punishable by incarceration of up to 7 years and/or fines. The acts which constitute a violation of a trade secret under



PRC Criminal Law are identical to those under the AUCL.

According to Article 170 of the PRC Criminal Procedure Law and related judicial interpretation<sup>7</sup>, a criminal case involving intellectual property infringement (which includes trade secret violations) may proceed in the following two ways:

- a) Public prosecution: the crime is investigated by the Public Security Bureau ("PSB") (e.g., the Chinese police) and is prosecuted by the People's Procuratorate ("PP").
- b) Private prosecution: the injured party may bring a lawsuit against the infringer directly in the People's Court, in which case the PSB and the PP will not be involved in the case.

### **The Contract Law**

The PRC Contract Law may provide an alternative redress in case of trade secret violation. Article 43 states that parties to a contract shall not disclose or improperly make use of the trade secrets obtained during the course of negotiation. Such obligation exists regardless of whether the negotiations result in a contract between the parties. Article 60 and Article 92 impose an implied duty of confidentiality on the parties during and after the contractual period respectively. The extent of the duty depends on the nature of the contract and the parties' previous course of dealing. In view of these provisions, breach of contract may also be successfully claimed in case of trade secret violation.

## **Proving trade secret infringement is more difficult in China than in developed countries such as European Union members.**

As mentioned above, the definition of trade secrets and acts of trade secret infringement are generally in line with developed nations such as members of the EU. This may give readers an impression that the law of trade secrets in China is more or less the same as in the EU, and therefore trade secret owners receive the same level of protection in China as in the EU. However, this is not the case. As mentioned in Section 1, it can be more difficult for trade secret owners, especially foreign companies, to enforce their rights, due to problems relating to political influences, local protectionism, and state-owned enterprises. In addition, proving trade secret infringement in China is generally more difficult than in Europe as discussed below.

### **Chinese procedural law and court practices make evidence collection and recognition difficult**

To understand why proving trade secret misappropriation is more difficult in China, one has to first understand the way Chinese courts work with evidence.

First, it should be noted that Chinese courts in general rely primarily, and often exclusively, on documentary evidence. Witness testimonies, including expert opinions, are often given little evidentiary weight. Obviously, this makes it difficult for a plaintiff whose case needs to be proved by witnesses or experts. In trade secret cases, Chinese courts usually do not permit expert witnesses to testify on whether a trade secret exists, or has been misappropriated.

Second, Chinese courts do not provide an effective mechanism for parties in a litigation to obtain evidence from each other. Unlike common law jurisdictions, China does not have a formal discovery procedure. Therefore, parties to litigation do not automatically provide to each other documents in their possession that are relevant to the case. In practice, parties usually refuse to provide any documents that are unfavorable to them with impunity, unless the other party requesting a document can show to the court that the other party is in possession of the document. A party may ask the court to collect evidence by applying for an Evidence

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<sup>7</sup> See, e.g., Supreme People's Court Interpretations relating to Several Issues regarding the Enforcement of the PRC Criminal Procedure Law, Article 1.

Preservation Order. However, courts often do not effectively execute such Evidence Preservation Orders, and usually do not allow the applicant to accompany the judges who execute such Orders when the other side objects.

As discussed below, these factors generally make it difficult in China for the plaintiff to prove trade secret infringement.

## Requirements for proving trade secret misappropriation

Plaintiffs in a trade secret misappropriation case in Chinese courts must first prove the following three elements (SPC Interpretation, Article 14):

- a) Existence and ownership of trade secrets. Plaintiff must present evidence on the following:
  1. Specific content of the secret and the medium that carries the secret
  2. Commercial value of the secret
  3. Protective measures taken by the owner of the secret
- b) Defendant possesses information that is identical or substantially identical to the trade secret; and
- c) Defendant used improper means to obtain the trade secret.

Some Chinese judges take the view that the burden of proof may shift regarding element (c) above - that defendant used improper means to obtain the trade secret. For example, Judge Wang Yongchang from the IP Civil Division of the SPC, speaking at a May 2007 conference to lower judges, expressed the view that:

“the burden should shift back and forth as parties provide counter evidence, and theft of trade secret can be inferred in civil cases if the plaintiff presents evidence showing that the defendant has come into contact with the secret, possess information similar to the secret, and there are no legitimate methods to obtain the secret.”

Other judges consider that there should be no burden shifting. For example, Jiang ZhiPei, former Chief Justice of IP

Civil Division of the Supreme People’s Court, in a July 2006 article stated that:

“there is no legal basis for the reversing of the burden of proof in trade secret infringement litigations; and there is also not sufficient ground to include such duties in future legislations. The plaintiff should bear a bigger burden than the defendant: the plaintiff has not only to prove that it is entitled to the rights, but also to prove that the defendant has obtained or used the business secrets of the plaintiff through illegitimate means.”

## Proving trade secret misappropriation is generally more difficult in China

Chinese courts place a heavy burden on the plaintiff to provide direct evidence of trade secret misappropriation. As discussed above, for instance, the plaintiff is required to show that the defendant possesses information that is identical or substantially identical to the trade secret owned by the plaintiff, and that the defendant used improper means to obtain the trade secret. Although some judges may allow a certain degree of burden shifting with respect to the latter element, not all judges do.

The nature of trade secret cases is that various evidence for proving these elements are often in possession of the defendant (e.g., evidence that defendant possesses the trade secret, and used improper means to obtain the trade secret). However, as discussed previously, Chinese courts do not provide an effective mechanism for the plaintiff to obtain evidence from the defendant. Without being able to obtain evidence from the defendant, the plaintiff may have to rely on witness testimonies and/or expert opinions (e.g., that defendant must possess the trade secret because defendant’s products incorporate the trade secret). However, Chinese courts generally do not give such evidence much weight, making it difficult for the plaintiff to prove its case.

Because it can be more challenging to enforce one’s rights to trade secrets in China than in more developed countries such as members of the EU, we recommend owners of trade secrets take special care in China to reduce the risk of the exposure of trade secrets, which will be discussed in more detail below.

## What measures should be taken by businesses to protect their trade secrets?

### Employees

In any company it is inevitable for certain employees to have access to or become knowledgeable of trade secrets. Considering this, current employees and former employees pose a significant risk of exposure of trade secrets. The subsequent paragraphs will consider what measures can be taken to prevent this risk from materialising.

### Educate employees on issues related to information security

The first essential step is to nourish a business culture that supports and emphasises the importance of information security. This requires at least the formulation and implementation of an information security policy and ongoing education of employees in this regard. For employees to observe information security guidelines, they must be aware of the importance of doing so.

Educating employees in China is particularly important. Many Chinese companies, especially in the past, often do not have a good system of information security in place, and often do not provide adequate training to their employees regarding trade secret protection. As a result, employees that have a previous background in such Chinese companies often do not have the adequate level of awareness on information security. Hence, companies doing business in China should make it a priority to educate its employees to make sure that the protocols for protecting information are strictly followed.

### Mark documents and restrict access

An information security policy should include a system to classify and identify confidential information. Documents that are deemed confidential should be marked as such. This practice alerts employees that they should keep the information confidential. In case of a breach, this practice helps the company to show to the court that it has taken adequate measures to keep the trade secret confidential, which is a required element for establishing a case of trade secret misappropriation as discussed above.

Such a classification system can also be used to control and restrict the access to confidential information to those who need to have access to the information. Modern technology allows an employee to copy hundreds of important documents onto a USB disk within seconds, which can then be taken out of the company. A carefully designed system of access control can effectively limit an employee's ability to obtain protected information and move it out of the company.

Access control is not the only approach to prevent information leakage. Some companies, for example, disable the USB port (or other Input/Output ports) on company computers, so that employees, even if they have access to a certain document, cannot copy the document onto their own disks. Other companies employ technology that encrypts documents, and the encrypted documents can only be decrypted and viewed on a company computer, so that it is useless to copy the (encrypted) documents and take them outside of the company.

### Confidentiality and Non-Disclosure agreements

Employers should also have their employees or contractors sign agreements relating to the duty of confidentiality and non-disclosure. The agreement should make clear that all information that the employee may come into contact within the company (including information generated by the employee himself) belong to the company, and the employee has a duty not to disclose it or cause it to be disclosed to any third party. Without such a written agreement where employee's duties are explicitly set out, the employer may be unable to enforce its rights in Chinese courts even though the employer may consider such duties are naturally implied by the employment relationship.

For key employees, such a confidentiality agreement can be accompanied by a non-compete agreement to reduce the risk that these employees would later use trade secrets learned from the employer to compete with the employer. If an employer wishes to use this approach, it should be noted the non-compete agreement should be drafted in accordance with Chinese law. For instance, the PRC Labour Contract Law provides that an obligation not to compete cannot exceed two years, and that the person bearing the obligation has right to compensation during the non-compete period.

## Promoting employee loyalty

It is fair to say that in China, employees are the biggest threats to trade secrets. In many cases, trade secrets are violated when an employee sells the trade secret to a competitor, or brings the trade secret to a new employer which is often a competitor. Hence, companies with low employee loyalty and high employee turnover experience a higher risk of trade secret infringement.

## Monitoring employee activities

Employers may also consider using reasonable measures to monitor employee activities. For example, a company's computer system may be configured to alert a designated person when an employee copies from the computer system a large amount of information to an external storage device, or tries to access information that he has not been given access to.

## Business partners

In China, another situation where trade secrets are sometimes violated is when a company works with business partners or potential business partners. We discuss the various scenarios below.

## Contract negotiations

In negotiations, confidential information is often passed to the other side. As discussed above, the PRC Contract Law imposes an implied duty of confidentiality on the parties, and provides that parties in a contract negotiation shall not disclose or improperly make use of the trade secrets obtained during the course of negotiation, whether or not a contract is eventually made. Despite this, it is still advisable for negotiating parties to sign non-disclosure agreements so that the duty to maintain confidentiality is made clear.

If possible, the non-disclosure agreement should preferably also describe briefly the trade secret that is being disclosed to the other side, so that the other side will not be able to later deny that they ever received the trade secret, or argue

that they do not know that the information they received is confidential. Please recall that Chinese courts place a heavy emphasis on documentary evidence, and often give little evidentiary weight to witness testimonies, especially if the witness is an interested party. Therefore, without a written acknowledgement of receipt of the trade secret from the other side, the owner of the trade secret will likely have a hard time proving that the other side to the negotiation actually received the trade secret.

## Licence agreements

Needless to say, if a party intends to license its trade secrets (e.g., technology know-how) to another party in China, it should specify in the license agreement that the other party has a duty to keep the trade secrets confidential. Otherwise, the trade secret owner would not have a cause to sue the other party if the trade secrets are later disclosed by that other party. The license agreement may specify that the duty to maintain confidentiality continues after the termination of the contract.

## Weight the risk

Given that the licensee has agreed to maintain confidentiality, the owner of the trade secret should still carefully weight the risk that the licensee would later disclose the trade secret to another party, especially to an affiliated party. Chinese company groups often do not strictly restrict the passing of information within the group. To reduce the risk that the licensee will pass the trade secret to an affiliate, the license agreement should clearly prohibit the disclosure of the trade secrets to affiliated companies, so that the licensee will be alerted to this issue.

However, even if the licensee is aware that it cannot disclose the trade secret to its affiliates, it may still later be pressured to disclose the trade secret by the affiliates if these affiliates find the trade secret useful. In consideration of this risk, the licensor may, for example, consider licensing the trade secret to the whole company group for an increased fee.

## Liquidated damages

In a contract, a liquidated damages clause is a provision

that specifies a certain amount to be paid from one party to the other party in case of breach. A liquidated damages clause can be particularly useful in license agreements involving trade secrets, because damages caused by a violation of trade secrets are often difficult to calculate. This is particularly true in China. First, Chinese courts usually put a heavy burden on the plaintiff to prove the amount of damages caused by infringement of intellectual property (or economic benefits received by the infringer due to infringement). When this amount cannot be clearly proven, the court will likely order statutory damages, which tend to be too low. Second, unlike some other jurisdictions where liquidated damages are discouraged by the courts, Chinese courts favour the use of liquidated damages because it eases the courts' work.

### **Require licensee to provide adequate measures to protect licensed trade secrets**

Because companies in China may not have adequate measures in place to protect trade secrets, the licensor may also consider requiring the licensee to adopt certain measures to prevent leakage of the trade secret (e.g., measures aimed at preventing leakage by the licensee's employees).

### **OEM manufacturing**

One common situation where a party licenses its trade secrets to a company in China is that the licensor asks the licensee to OEM manufacture products for it. In this situation, in addition to the concern that the OEM manufacturer may disclose the trade secrets to another party, the licensee is also often concerned that the OEM manufacturer, once obtaining the trade secret (e.g., manufacturing know-how), would use the trade secret to compete with the licensor. For example, the OEM manufacturer may start to produce a similar product under its own trademark, and offer the product to the licensor's customers. To reduce this risk, the licensor may add to the license agreement that the licensee must not manufacture the same product or a similar product for any purpose other than for delivery to the licensor.

### **Joint ventures and other subsidiaries**

When a foreign company create a subsidiary company (e.g., a joint venture, or a wholly owned subsidiary) in China, trade secrets are often passed between the parent and subsidiary. In this situation, employees of the parent company and the subsidiary may sometimes forget that they are working for separate legal entities, and start to share information without considering confidentiality issues. This creates a risk that trade secrets that are not meant to be disclosed are sent to the other side, or that employees who have received certain information may not realise that they are required to keep the information confidential. This problem may be particularly serious in joint ventures, as parent companies may not have managerial control of the joint ventures in China.

Therefore, companies should educate and provide guidelines to employees regarding the passing of information with affiliated companies. When trade secrets are to be shared, it is preferable that both parties sign a specific agreement for each information sharing event.

### **Industrial espionage**

A company may also lose its trade secrets because of industrial espionage. This is true in China as well as in other nations. For example, competitors of a company may hire "investigators" to gather information on the company, and the "investigators" may in turn go through the garbage of the company to look for relevant documents, contact employees or former employees of the company with pretexts, or even pay bribes to obtain confidential information. Although industrial espionage is likely not a wide spread problem in China, it has certainly been reported many times in the past and companies doing business in China should be aware of this risk and take measures to protect against it.

# Remedies against misappropriation/violation of trade secrets

As discussed above, in China, the holder of trade secret can seek legal redress for trade secret infringement by initiating (or having Chinese government bodies initiate):

- a) an administrative action,
- b) a civil action in a Chinese court, or
- c) a criminal action.

For the above three different types of actions, the definition of trade secret and trade secret infringement are generally the same. All three types of actions are explained in more detail in the subsequent paragraphs.

## Protection through administrative procedure

According to the AUCL, Article 25, in cases of trade secret infringement, relevant Chinese administrative agencies have power to impose penalties and to order the infringer to stop illegal activities. Therefore, owners of trade secrets may work with relevant administrative agencies to initiate administrative actions against the infringers.

### Advantages and disadvantages

An administrative action is not always a viable option for victims of trade secret infringement. We list the inadequacies/disadvantages of administrative actions below:

- a) Administrative agencies have discretion over whether to take a trade secret infringement case. In general, administrative agencies are only willing to act in simple cases requiring a straight forward application of the law. Given the complexity of many trade secret cases, administrative action may not be a viable option.
- b) The opposing party can always appeal the administrative decision to a People's Court if it is dissatisfied with the decision. Therefore, administrative actions involving trade secret infringement may end up in court anyways.

- c) In administrative actions a trade secret owner may not seek monetary damages from the opposing party. It may however seek injunctive relief.

Advantages of administrative actions include:

- a) An administrative action is quick and cost less.
- b) An administrative agency may take action with less evidence than what is required by a court, and may accept evidence that is not admissible in court.
- c) An administrative agency has the power to collect evidence, and therefore may help the trade secret owner obtain evidence that the trade secret owner cannot obtain by itself. This, however, requires a good working relationship with the administrative agency.

## Competent administrative authority

Under the AUCL, Chinese Administrations of Industry and Commerce ("AICs") have authority to investigate acts of unfair competition, which includes trade secret violations.

### How to initiate an administrative procedure?

To initiate an administrative action, the trade secret owner must report the trade secret violation to the AIC, and provide evidence of infringement.<sup>8</sup>

### What measures and decisions can be taken?

The AIC can investigate the acts of trade secret infringement. If trade secret infringement is found, it can:<sup>9</sup>

- a) order the infringer to cease the infringing act;
- b) impose a fine of any amount between RMB 10,000 and RMB 200,000;

<sup>8</sup> The SAIC Provisions, Article 5

<sup>9</sup> The SAIC Provisions, Article 7

- c) order the return of drawings, blueprints, and other materials containing the trade secrets; and
- d) order the destruction of the goods manufactured using the stolen trade secrets if such goods would disclose the secrets to the public when made available.

However, the AIC cannot order monetary damages to be paid to the trade secret owner.

### Judicial review of administrative decisions

Parties to an administrative action can appeal the decision to the People's Court. Decision of the People's Court can also be appealed to the higher court.

### Protection through civil procedure

Filing a civil action is the most common approach used by owners of trade secrets in trade secret misappropriation matters. Unlike administrative agencies, a People's Court does not have discretion over whether to take on a case when there is a defendant and the plaintiff stated a cause of action.

### How to initiate a civil action?

To initiate a civil action, the rights holder files a complaint and accompanying documents with a People's Court that has jurisdiction. The court sitting at the place of infringement, or the place where defendant is located, have jurisdiction over a trade secret case. The rights holder may also file other requests at, before, or after the time of filing the complaint such as:

- a) An application for an evidence preservation order;
- b) An application for an asset preservation order; and
- c) An application for a preliminary injunction.

We emphasise that when initiating a civil action, the plaintiff should have already gathered all the evidence it can possibly obtain. Unlike in more developed countries such as EU members, the plaintiff should not assume that it would be able to obtain evidence from the opposing party during

litigation. In fact, plaintiffs in a trade secret case in China often cannot obtain useful evidence in the possession of the defendant as discussed above.

### What civil remedies are available?

In trade secret cases, available civil remedies include:

- a) Monetary damages;
- b) Injunctive relief such as an order to cease the infringing acts;
- c) Pre-trial remedies, such as asset preservation order and preliminary injunction.

According to Article 17 of the SPC Interpretation, courts can determine the amount of damages in trade secret cases using the same methods of calculation adopted in patent infringement cases:<sup>10</sup>

- a) on the basis of the right holder's lost profits or the infringer's gains because of infringement;
- b) if the right holder's lost profits and the infringer's gains cannot be determined, the amount can be based on a reasonable license fee multiplied by a multiple between 1 and 3. I
- c) if both a) and b) above cannot be determined (e.g., the court cannot find a prior license fee arrangement as a reference, or if the prior license is obviously unreasonable), the court can order a statutory amount in the range of RMB 10,000 and RMB 1,000,000.

<sup>10</sup> See, Patent Law of the People's Republic of China, Article 65; Judicial Explanation of the Supreme People's Court Concerning Several Issues with the Applicable Law in Civil Patent Disputes (2001), Articles 20-22.

## Protection through criminal procedure

According to Article 219 of the PRC Criminal Law, a trade secret violation that causes significant losses to the right holder constitute a crime in China. The acts which constitute a violation of a trade secret under PRC Criminal Law are identical to those under the AUCL.

### How to initiate a criminal procedure?

In China, a criminal action of trade secret misappropriation can be initiated in the following two ways:

a) Public prosecution

After being informed of the alleged crime, the Public Security Bureau ("PSB") (e.g., the Chinese police) investigates the matter. The PSB, after collecting sufficient evidence, hands over the matter to the People's Procuratorate ("PP"), which in turn prosecutes the alleged crime in front of a Chinese court.

b) Private prosecution<sup>11</sup>

The injured party may bring a criminal lawsuit against the infringer directly in the People's Court, in which case the PSB and the PP will not be involved in the case.

### Advantages and disadvantages of private prosecution

The main advantage of privately prosecuting a trade secret crime is that the right holder has control of the prosecution, and hence can make sure that the infringer is diligently pursued. In contrast, in a public prosecution, the right holder has no control, and must rely on the PSB and the PP, which may not prosecute the crime diligently and usually do not disclose the progress made to the right holder. In China, PSBs and PPs often consider intellectual property infringement cases as low priority matters, and are generally not under pressure to solve such crimes.

However, if the PSB and the PP is determined to investigate and prosecute the crime, a public prosecution can be quite

advantageous to the right holder. This is because in China, PSBs have much greater power than private parties in terms of collecting evidence (e.g., obtaining evidence from the infringer), and PPs are usually taken much more seriously than private parties in Chinese courts. Compared with a public prosecution, the main disadvantage of a private prosecution is essentially a lack of power of the private party.

### What are the criminal penalties?

The criminal penalties largely depend on the amount of the damage caused:

a) if the damage is between RMB 500,000 and RMB 2,500,000, the penalty is up to three years imprisonment, and/or a fine;

b) if the damage is over RMB 2,500,000 (approximately USD 367,647), the penalty is imprisonment between three to seven years, and a fine;

c) if the infringer is an entity, the entity should receive a fine at a trebled rate, and the responsible individuals shall receive penalties separately.<sup>12</sup>

11 See, e.g., PRC Criminal Procedure Law, Article 170; Supreme People's Court Interpretations relating to Several Issues regarding the Enforcement of the PRC Criminal Procedure Law, Article 1.

12 Article 219 and 220 PRC Criminal Law, and Articles 7 and 15 Explanations by the Supreme People's Court and Supreme People's Procuratorate on Several Issues regarding the Applicable Law in Handling Criminal Intellectual Property Cases.



# China contact information

## **State Intellectual Property Office (SIPO)**

[www.sipo.gov.cn](http://www.sipo.gov.cn) (Chinese and English)

## **State Administration for Industry and Commerce (SAIC)**

[www.saic.gov.cn](http://www.saic.gov.cn) (Chinese and English)

## **China Trademark Office (CTMO)**

[www.ctmo.gov.cn](http://www.ctmo.gov.cn) or <http://sbj.saic.gov.cn/> (Chinese and English)

## **National Copyright Administration of China (NCAC)**

[www.ncac.gov.cn](http://www.ncac.gov.cn) (Chinese only)

## **General Administration of Customs of China (GACC)**

[www.customs.gov.cn](http://www.customs.gov.cn) (Chinese and English)

## **General Administration of Quality Supervision Inspection and Quarantine (AQSIQ)**

[www.aqsiq.gov.cn](http://www.aqsiq.gov.cn) (Chinese and English)

## **Ministry of Public Security (MPS)**

[www.mps.gov.cn](http://www.mps.gov.cn) (Chinese and English)

## **Supreme People's Court (SPC)**

[www.court.gov.cn](http://www.court.gov.cn) (Chinese and English)

## **China IP Judicial Protection, IPR tribunal**

[www.chinaiprlaw.cn](http://www.chinaiprlaw.cn) (Chinese and English)

## **Supreme People's Procuratorate (SPP)**

[www.spp.gov.cn](http://www.spp.gov.cn) (Chinese only)

## **Ministry of Commerce (MOFCOM)**

[www.mofcom.gov.cn](http://www.mofcom.gov.cn) (Chinese and English)

## **IP Protection in China**

[www.ipr.gov.cn](http://www.ipr.gov.cn) (Chinese and English)

## **Service Centres for IPR Protection, Reporting and Complaints**

<http://jbts.ipr.gov.cn/tousu/eHome.html> (English)

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**If you are a European SME or SME representative body, for further information contact the European Union's China IPR SME Helpdesk:**

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**中华人民共和国商务部**

**MINISTRY OF COMMERCE OF THE PEOPLE'S REPUBLIC OF CHINA**

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