

## Protecting trade secrets in China

As China's market grows and workforce mobility increases, trade secret theft has become a genuine concern. The risk is especially high in technology-heavy industries where poor maintenance of trade secrets may result in serious financial repercussions or loss of competitive edge.

Although China has developed laws to protect the rights of trade secret owners, enforcement can be tricky and the damages awarded can be inadequate. Prevention is, therefore, still the best way to protect trade secrets in China. This briefing aims to give an insight into how companies may formulate an effective IP strategy to address the practical challenges of trade secret protection in China.

### Applicable Chinese Laws

The legal framework for the protection of trade secrets in China is set forth in the *Anti-Unfair Competition Law (ACUL)* promulgated on 2 September 1993. Article 10 of the ACUL defines trade secret as "technical information and operational information which is not known to the public, capable of bringing economic benefits to the rights owner, has practical applicability and which the rights owner has undertaken measures to keep secret." Article 10 of the ACUL further prescribes trade secret misappropriation as:

- acquiring trade secret of another by theft, inducement, duress or other illegal means;
- disclosing, using or allowing others to use trade secret of another acquired by the above illegal means; or
- disclosing, using or allowing others to use trade secret in breach of an agreement or a confidentiality obligation imposed by the rights owner."

In addition, Article 10 of the ACUL imposes the same liability on a third party who knowingly or should have known that trade secrets it obtains, uses or discloses have been misappropriated by any of the above means.

On 12 January 2007, the Supreme People's Court issued an *Interpretation on Some Issues Concerning the Application of Law in the Trial of Civil Cases Involving Unfair Competition (2007 Interpretation)* to clarify issues relating to unfair competition claims. The 2007 Interpretation considers "information which is not known to the public" to be those that is unknown and difficult to obtain by the relevant person in the relevant field. The 2007 Interpretation expressly rejects the following information as being "unknown to the public":

- (1) information that is common sense or industry practice as known by the relevant person in the relevant technical or economic field;
- (2) information that only involves the simple combination of dimensions, structures, materials and components of products, and can be directly obtained by observing the products by the relevant public after the products enter into the market;

### Key Issues

Applicable Chinese Laws	1
Enforcement of Trade Secret Rights	2
Preventive Measures for Trade Secret Protection	3
Recent Cases	4
Conclusion	5

If you would like to know more about the subjects covered in this publication, please contact:

**Hong Kong**  
[Ling Ho](#)+852 2826 3479

**Shanghai**  
[Ann Chen](#)+86 21 2320 7212

If you would like to know more about our China publications, please contact:

[Chlorophyll Yip](#) +852 2826 3426

Clifford Chance, 28th Floor, Jardine House,  
One Connaught Place, Hong Kong SAR  
[www.cliffordchance.com](http://www.cliffordchance.com)

- (3) information that has been publicly disclosed in a publication or other mass media;
- (4) information that has been publicized by open conferences or exhibits;
- (5) information that can be obtained through other public channels; and
- (6) information that can be easily obtained for free.

According to the 2007 Interpretation, any information which has actual or potential commercial value and can bring competitive advantages to the rights owner shall be regarded as having "economic benefits and practical utility." The 2007 Interpretation also provides the following examples to be what might constitute adequate confidentiality measures under normal circumstances:

- (1) limiting access scope of the classified information and disclosing it only on a need-to-know basis;
- (2) locking up the carrier of the classified information;
- (3) labelling a confidentiality sign on the carrier of the classified information;
- (4) adopting passwords or codes on the classified information;
- (5) executing a confidentiality agreement;
- (6) limiting visitor access to the classified machinery, factory, workshop or any other place, or imposing confidentiality obligations on visitors; and
- (7) adopting other reasonable measures to ensure the confidentiality of the information.

### Enforcement of Trade Secret Rights

To enforce its trade secret rights, an owner can pursue either administrative or judicial actions. The offices of the Administration for Industry and Commerce (**AICs**) are responsible for administrative enforcement of trade secret misappropriation. AICs have authority to investigate and determine misappropriating acts, impose a fine of between RMB 10,000 and 200,000, and order the return of items that contain or expose the trade secret. However, unlike the Chinese courts, AICs do not have the authority to award damages and injunctions.

According to the 2007 Interpretation, the plaintiff carries the burden of proof in a trade secret misappropriation action. Specifically, the plaintiff must show admissible evidence in a Chinese court that the trade secret

- is not publicly known;
- has economic benefits and practical utility;
- was protected by adequate confidentiality measures; and
- has been misappropriated.

The Chinese legal system does not have a formal discovery procedure, and Chinese courts rarely accept non-documentary evidence. It is therefore essential for the trade secret rights owner to have an evidence gathering strategy. For example, a plaintiff can present preliminary evidence of ongoing or imminent misappropriation and request for evidence preservation under Article 74 of the Civil Procedure Law.

Once a plaintiff successfully proves his case, he can claim damages based on his lost profits, the defendant's profits realized from the misappropriation or reasonable royalty. However, preliminary injunctions are almost impossible to obtain in China and permanent injunctions might be granted only for a limited scope and period of time. In situations where the infringing action causes trade secret to be known to the general public, damages will be determined on the basis of the commercial value of the trade secret, which in turn is based on the cost of research and development of the trade secret, proceeds from practising the trade secret, the tangible benefits and duration in which the trade secret confers competitive advantages.

A plaintiff should consider criminal prosecution when he suffers "serious" or "exceptionally serious" losses. On 8 December 2004, the Supreme People's Court and Supreme People's Procuratorate issued an *Interpretation on Some Issues Concerning the Application of Law in the Trial of Criminal Cases Involving Infringement of Intellectual Property Rights (2004 Interpretation)*. According to the 2004 Interpretation, a person who causes a trade secret owner to lose more than RMB 500,000 commits a "serious" offence and may be fined and/or imprisoned for up to three years. One who causes a trade secret owner to lose more than RMB 2,500,000 commits an "extremely serious" offence and may be fined and imprisoned for three to seven years. Criminal prosecution can be quite effective in China. The Public Security Bureau also has the power to seize relevant evidence for use in administrative or judicial actions.

### Preventive Measures for Trade Secret Protection

A company may easily lose its competitive edge if its trade secrets are not well maintained. Any subsequent enforcement or remedial action might come in too late or ineffective to rectify the situation. As a result, prevention remains the best means of trade secret protection. In fact, a trade secret owner must prove that it has adequately protected its trade secret with confidentiality measures in a trade secret misappropriation action in China. Hence, it is important for companies to establish and implement effective confidentiality policies, which may be formulated along the lines below.

#### (1) Identify and Safekeep Your Trade Secrets

To begin, a company should evaluate whether its commercial activities involve the use or development of any trade secrets. If so, the company should identify information which it considers confidential and set out written procedures for recording and handling such information. For example, the company should keep and regularly update a list of all confidential information. The carriers containing confidential information should be labelled with one or more words/phrases such as "Confidential," "Classified," "Restricted," "Do Not Disclose," and "Do Not Copy Property of [the company]." The carriers should also be kept in a restricted area that is locked and/or has secured access. When stored in electronic format, the confidential information must be encrypted and/or be subject to restrictive access.

#### (2) Document All Transfer and Receipt of Trade Secrets

The company should provide confidential information to authorized personnel on a need-to-know basis only. Each and every transfer and acceptance of confidential information should be documented, at least, with the following information:

- (i) the identity, carrier type and number of copies of the confidential information that has been released;
- (ii) the person authorizing the release of the confidential information;
- (iii) the person receiving the confidential information;
- (iv) the time of release of the confidential information;
- (v) the intended use of the confidential information; and
- (vi) the time of return of all copies of the confidential information.

Where practicable, the carriers containing the confidential information should be unique such that unauthorized copies can be easily differentiated. For instance, the confidential information can be provided on specialty or anti-photocopying paper or diskettes.

#### (3) Draft PRC-Law Compliant Employee Manual and Labour Contract

It is imperative that a company has a formal written policy regarding the maintenance and disclosure of confidential information. The employee manual should at least:

- (i) identify information which the company considers confidential;
- (ii) describe procedures for handling confidential information, including access, use or disclosure, and creation or destruction of copies;
- (iii) set forth the employees' duty of confidentiality and the conditions for non-competition;
- (iv) emphasize that employees should not use any confidential information from a prior employment; and

- (v) state that unauthorized or improper use or disclosure of confidential information may be grounds for termination of employment, administrative and/or civil action, and/or criminal prosecution.

The manual should also provide computer use rights and restrictions. The company should provide each employee with a copy of the manual. More importantly, the company should require each employee to sign a statement acknowledging that he has read, understood and will comply with the confidentiality policy as a condition of his employment.

Likewise, the labour contract should contain confidentiality and non-compete clauses, as well as the employee's assignment of all IP rights, including trade secret rights, to the company. Both the *PRC Labour Law* and *PRC Labour Contract Law* provide that the employers and employees may enter into confidentiality and non-competition agreements regarding the employer's trade secret. Non-competition agreements should be limited to employees with confidential obligations and should be reasonable in duration (e.g. two years) and geographic scope. It is worth noting that non-competition agreements are invalid under PRC law if no additional compensation is promised to the obligor.

Apart from executing the non-competition agreements, companies should also ask employees to initial next to each provision in the agreement. Companies should bear in mind that the employee manual and labour contract are general in nature, and therefore, an employee's actual access to confidential information should be granted only after the execution of a confidentiality agreement and in accordance with the release procedures described above.

#### (4) Create Protective Environment of Trade Secrets

In addition, companies should conduct employee training on the company's confidentiality policy and any changes thereof on a regular basis. The company should also appoint persons responsible for monitoring, updating and enforcing the company's confidentiality policy, and make this person available for questions or comments by other employees. The company should obtain reference and background checks on employees who have regular access to confidential information.

Information may be stolen in transit or from unattended computers. Thus, the company should ensure that all office computers, travelling laptops and blackberry are password-protected and have automatic lock screen. The companies should also monitor web-surfing and email communications, as well as limit the downloading and/or installation of non-work-related software. In addition, companies should have security systems installed on its premises and shredding/storage policies on documents.

#### (5) Restrict Visitor Access to Company Information

There may be visitors (including secondees) from other institutions in the company's premise from time to time. It is therefore important for the company to restrict information access. In particular, the company should limit visitor access to the company's computer network and physical facilities, as well as impose confidentiality and non-competition obligations on them.

### Recent Cases

In April 2011, a Chinese engineer was sentenced by the U.S. District Court for the Eastern District of Michigan to 70 months' imprisonment and a fine of \$12,500 for stealing trade secrets from Ford Motor Co. The engineer was arrested when he returned to the U.S. from another subsequent employment in China. If the engineer never entered U.S. territory, Ford could have actually considered bringing a similar action in China under the PRC Anti-Unfair Competition Law.

In an action taken in China in 2007, General Electric (China) Co., Ltd. (GE (China)) and GE Medical Systems Trade and Development (Shanghai) Co., Ltd. sued an ex-employee in the Intermediate People's Court of Xi'an for misappropriating trade secrets and copyright infringement. Upon discovering that the ex-employee offered training courses using GE's trade secrets, GE (China) first filed a complaint with the Hangzhou AIC. The AIC inspection resulted in the seizure of a large amount of training materials, including text and image materials bearing GE's internal logo and copyright, evidence which GE (China) (later joined by its parent GE (US)) then used in the suit against the ex-employee. The court found the trade secrets and copyright to be valid and infringed, and ordered an injunction and compensatory damages in the amount of RMB 900,000 (out of which RMB 500,000 was for trade secrets misappropriation and RMB 400,000 for copyright infringement). The court ruled in favour of GE because the evidence produced by GE was sufficient to establish that the disputed information was technical information developed by GE, of great economic value to GE, subject to GE's confidentiality measures, and could not be obtained through public channels.

### Conclusion

For years, many have questioned China's ability and willingness to protect intellectual property rights. As China transforms itself from a manufacturing powerhouse to an innovation-based economy, it has made substantial effort to strengthen its IP protection regime. Multinational companies must therefore formulate an IP strategy in China that builds in methods of trade secret protection discussed above. By doing so, the companies should be able to minimize the risks of misappropriation and enhance the chance of enforcing its trade secret rights in China.

---

This briefing is designed to provide a general commentary on aspects of the subject matter covered. It does not purport to be comprehensive and it does not constitute legal advice. We expressly disclaim any liability in respect of the consequences resulting from acting or refraining from acting on the basis of any matter contained in this publication. All rights are reserved.

The above is based on our experience as international counsel representing clients in their business activities in China. As is the case for all international law firms licensed in China, we are authorized to provide information concerning the effect of the Chinese legal environment, however, we are not permitted to engage in Chinese legal affairs in the capacity of a domestic law firm. Should the services of such a firm be required, we would be glad to recommend one.

[www.cliffordchance.com](http://www.cliffordchance.com)