Protecting and Enforcing Trade Secrets in China

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Shortly after the start of the 2014 Chinese New Year, China’s State Administration for Industry and Commerce (SAIC) announced the opening of a discussion regarding a revision to the 1993 Anti-Unfair Competition Law (AUCL). Since the AUCL includes provisions governing trade secret misappropriation, the up-coming revision may potentially bring important changes to the current regulatory and statutory channels for the protection of trade secrets. While the legislative effort for such revision, the exact changes to AUCL and the legal ramifications of the revision are yet to be seen, we at the BRIC Wall thought it would be helpful to review the currently available measures for protecting and enforcing trade secrets in China.

China’s Legal Framework for Trade Secrets

Unlike many other countries, such as the United States, Russia and South Korea, China lacks a national, unified trade secrets law. Instead, China protects trade secrets through a series of laws and regulations. The most important of these is the AUCL; however, other aspects of trade secret protection are included in Contract Law, Labor Contract Law, Company Law, Labor Law and Criminal Law, as well as several different regulations (such as the 1998 Provision Regarding the Prohibition of Trade Secret Infringement) and judicial documents (such as the 2007 Interpretation on Certain Issues Related to the Application of Law in Trials of Civil Cases Involving Unfair Competition).

Article 10 of the AUCL defines trade secrets as “technical and business information that is unknown to the public, which can bring economic value to the rights holder that has applicability, and for which the rights holder takes measures to protect their confidentiality.” The AUCL defines illegal behaviors related to trade secrets as including the direct acquisition of trade secrets via theft, inducement, coercion or other illegal means or the use of illegally obtained trade secrets. Also covered is the use or sharing of trade secrets by third parties who are not authorized by the owner for such use or sharing.

Options for Enforcing Trade Secrets in China

Companies have three enforcement options available in China. These are: administrative, criminal and civil enforcement.

Administrative enforcement - This type of enforcement is conducted by the local Administration for Industry and Commerce (AIC) offices, which are responsible under the AUCL to pursue trade secret misappropriation as well as other anti-competitive behavior. If an AIC finds misappropriation of trade secrets, it has the authority to order one or more remedies such as the destruction of products manufactured using the stolen trade secrets, return of the trade secrets to the owner and imposition of fines. Under AUCL, the fine ranges between RMB 10,000 to 200,000 (US$ 1,600 to 33,000). The fine may be higher in some provinces or cities; for example, the Enterprise Technology Secrets Protection Regulations in the Shenzhen Special Economic Zone (generally considered an advanced area for industrial and economic development) stipulate that the fine may be RMB 500,000 to 1000000 (US$ 82,000 to 160,000) if it is found that the misappropriating party obtained the trade secret through illegal means and disclosed, used or transferred the trade secret to others. To get an AIC to start such administrative enforcement, a trade secret owner must file a complaint with the local AIC office (or, in some places, the department of Market Supervision Administration Bureau), together with sufficient evidence to substantiate a claim of trade secret misappropriation. In practice, to initiate an administrative enforcement action, a trade secret owner has to convince AIC officials that a case of trade secret misappropriation may exist. Otherwise, AIC
administrative proceedings may not be transparent, and is limited to a specific geographic jurisdiction, which can be further complicated by local protectionism. Additionally, the damage suffered by an injured party is not likely to compensate that party for its complete economic loss. Therefore, administration enforcement is generally not suitable or the best option in cases involving complex, large scale trade secret misappropriation cases. Specifically, the proceeding can be dealt with locally, as AIC offices can be found in each province in China. Additionally, the enforcement process can be carried out without legal representation by a lawyer. In addition to a fine, the trade secret owner may also obtain an injunction to prevent future trade secret misappropriation. In fact, the AIC exhibits a great impact on almost every aspect of local business through the many important regulations it administrates (such as advertising, consumer rights, labor, enterprise registration, and trademark protection). Moreover, the AIC has an Anti-monopoly and Anti-unfair Competition Enforcement Bureau, whose mission includes investigation into unfair competition practices (including the misappropriation of trade secrets). Thereupon, the importance of local AICs in protecting against trade secret misappropriation cannot be ignored.

However, administrative enforcement does have some disadvantages. Specifically, the amount of the fine is generally small and really does not function as a meaningful deterrent. Moreover, the enforcement process may not be transparent, and is limited to a specific geographic jurisdiction, which can be further complicated by local protectionism. Additionally, the damage suffered by an injured party is not likely to compensate that party for its complete economic loss. Therefore, administration enforcement is generally not suitable or the best option in cases involving complex, large scale trade secret misappropriation cases. Specifically, the proceeding can be dealt with locally, as AIC offices can be found in each province in China. Additionally, the enforcement process can be carried out without legal representation by a lawyer. In addition to a fine, the trade secret owner may also obtain an injunction to prevent future trade secret misappropriation. In fact, the AIC exhibits a great impact on almost every aspect of local business through the many important regulations it administrates (such as advertising, consumer rights, labor, enterprise registration, and trademark protection). Moreover, the AIC has an Anti-monopoly and Anti-unfair Competition Enforcement Bureau, whose mission includes investigation into unfair competition practices (including the misappropriation of trade secrets). Thereupon, the importance of local AICs in protecting against trade secret misappropriation cannot be ignored.

Criminal enforcement – In practice, a criminal enforcement proceeding can be brought when a plaintiff demonstrates that the loss due to trade secret misappropriation has reached the level of RMB 500,000 (US$ 82,000) or more. If the loss is “serious” (namely, if more than RMB 500,000 is involved) or “exceptionally serious” (namely, if more than RMB 2,500,000, or US$ 410,000 is involved), imprisonment of less than three years (for “serious” cases) or three to seven years (for “exceptionally serious”) can be imposed against a party found to have misappropriated a plaintiff's trade secrets. In some instances, a fine may be also imposed together with imprisonment. Procedurally, a criminal case may be started using one of three approaches:

1. Public prosecution: Public prosecution occurs when a trade secret owner reports the misappropriation to the Public Security Bureau (PSB) which conducts a criminal investigation. Upon completion of the investigation, the People’s Procuratorate (PP) files for prosecution of the case with the Basic People’s Court (Basic Court). The Basic Court accepts criminal cases as a first instance courts.

2. When a trade secret misappropriation case is transferred from an administrative agency: During administrative enforcement of a trade secret misappropriation case, if the AIC believes or suspects that a crime has been committed (such as when the trade secret misappropriation causes a loss of more than RMB 500000 or causes the trade secret owner to go bankrupt), the administrative agency (such as the local AIC office) is required to transfer the case to a judicial agency (such as the People’s Procuratorate) for criminal prosecution.

3. Private prosecution: A trade secret owner may file a criminal complaint directly with the court if the trade secret misappropriation does not gravely harm the social order and state interest. According to Article 5 of the 2007 Interpretation (II) of the Supreme People’s Court and the Supreme People’s Procuratorate on Certain Issues Concerning the Specific Application of Law in Hearing Criminal Cases of Intellectual Property Rights Infringement, the People’s Court accepts an intellectual property right (IPR) criminal case filed directly by a victim when the victim produces evidence proving its case. IPR criminal cases that gravely harm the social order and state interest are publicly prosecuted by the PP.

The possibility of imprisonment resulting from trade secret misappropriation has a great deterrent effect in China. Thereupon, criminal prosecution is an effective and useful option for plaintiffs in trade secret misappropriation cases. Another advantage of criminal enforcement is that the PSB can be used to facilitate evidence collection from a party suspected of trade secret misappropriation. In contrast, in a civil enforcement proceeding, the trade secret owner is on its own to collect evidence against the party suspected of the misappropriation, and typically, the PSB is not involved.

While evidentiary standards have been lowered as a result of recent judicial interpretations, resource issues (such as the difficulties associated with the collection of evidence) may still make criminal enforcement proceedings difficult to pursue. Moreover, the police may be reluctant to become involved in a trade secret misappropriation case when the value of the case is deemed to be “small” compared to other “high-profile” cases (namely, those trade secret misappropriation cases which have a high value, attract wide public attention or may cause a negative social impact). Another disadvantage of a criminal enforcement proceeding is that the trade secret owner cannot control the progress of the investigation and prosecution and must rely on the PSB and PP. The PSB and PP are not likely to notify or update a trade secret owner of the progress of a criminal enforcement proceeding. Additionally, difficulties may exist in situations where administrative proceedings are
referred for criminal enforcement. Presently, the transfer of administrative enforcement proceedings from the administrative department to the judicial department is governed by administrative regulations, rather than by the law. The administrative regulations only provide guidelines of how to transfer a case to the judicial department but provide no information regarding the consequences of not transferring these cases.

**Civil enforcement** – Civil enforcement is the most viable and commonly used option in China for trade secret protection. A civil action is filed with the Intermediate Court. The Intermediate Court is more specialized in intellectual property right enforcement than the Basic Courts. In a civil enforcement proceeding, a plaintiff must provide evidence demonstrating that:

1. Its trade secret(s) meets the statutory requirements (namely, it is unknown to the public, has an economic benefit and practical utility and the owner has taken reasonable confidentiality measures);

2. What the infringer (namely, the party that has misappropriated the trade secret) is using is similar or substantially similar to the plaintiff’s trade secret; and

3. The infringer obtained the trade secret through illegal means.

The method of calculating the damages in a civil enforcement proceeding is similar to the method used for calculating damages in a patent infringement action. Specifically, damages can be calculated based on lost profits, defendant’s profits or a reasonable royalty attributed to the misappropriated trade secret. Additionally, a permanent injunction is also available as a civil remedy.

A major disadvantage of a civil enforcement proceeding is the relatively high cost associated with such a proceeding. In addition, the damages awarded are often low and difficult to collect. Moreover, there is a lack of independence of the judiciary in many jurisdictions. Furthermore, because China has no procedure for conducting discovery like in the U.S., the burden of gathering evidence rests solely on the plaintiff. Additionally, courts largely rely on documentary evidence, thus any evidence obtained in violation of law will not be accepted. Therefore, plaintiffs face a rather high evidentiary burden.

Nonetheless, compared to the administrative and criminal enforcement proceedings, civil enforcement proceedings offer a more effective and practical option for plaintiffs to protect their trade secrets. While administrative enforcement proceedings are fast and inexpensive, an AIC’s decision is not final and can be appealed to the courts. When a party found to have misappropriated a trade secret appeals an AIC’s decision to the court, it becomes very difficult for the AIC to stop the infringer or to compensate a trade secret owner for its loss through this mechanism.

Also, although initiation of a criminal case can facilitate the process of collecting evidence through the use of the PSB, plaintiffs should also consider filing a separate civil enforcement proceeding along with a criminal enforcement proceeding (which a trade secret owner cannot control) to pursue civil liability and damages. The filing of a civil enforcement proceeding is particularly useful when a trade secret case is of less interest to the police.

**Trade Secret Cases in China**

To date, the number trade secret misappropriation cases in China remains relatively small, compared to the number of litigations pursued for other intellectual property (IP) rights. According to the High Court of Shanghai city (one of the most economically invigorating cities in China), trade secret cases accounted for less than 2% of all IP cases during the period of 2009-2011. Among the 2% trade secret cases, less than 30% of the cases went to trial and resulted in a court decision. Moreover, trade secret infringement was found in less than 50% of decided cases. According to an AIC report, the AIC handled 540,000 cases under the AUCL during the past 20 years (namely, since the AUCL became effective). Of these, only 900 were trade secret cases.

Additionally, local AICs, IP officials and judges typically have very limited experience and knowledge in handling trade secret cases. In fact, most trade secret cases are decided in favor of the defendant (thus resulting in failure for the plaintiff). The main reason for the failure of trade secret owners to prevail in these cases (whether in a civil enforcement proceeding or in a criminal enforcement proceeding aided by the PSB) likely resides in the difficulty plaintiffs have in collecting evidence to prove that: (1) the trade secret meets the statutory requirements (namely, it is unknown to the public, has an economic benefit and practical utility and the owner has taken reasonable confidentiality measures); (2) what the infringer is using is similar or substantially similar to the plaintiff’s trade secret; and (3) the infringer obtained the trade secret through illegal means.

**Best Practices for Maintaining and Protecting Trade Secrets in China**

Companies should consider instituting one or more of the below best practices for maintaining and protecting
trade secrets in China.

1. Identify the information considered to be a trade secret as well as the appropriate amount and type of protection needed for each trade secret.

2. Institute the necessary measures to limit access to the trade secret information. The steps taken should include the necessary physical and digital controls (such as requiring visitors to sign in before entering company premises, password and limited access protection to various computer data and files, etc.).

3. Institute human resource policies to protect trade secrets through the use of employment agreements, conducting ongoing internal training on trade secret and confidentiality obligations and establishing exit interview procedures to remind employees leaving the company of their trade secret and confidentiality obligations.

4. Use nondisclosure and confidentiality agreements when working with third parties.

5. Work with Chinese regulators when requested to submit confidential information to limit the amount of confidential information that needs to be submitted.

6. When working with Chinese companies, a foreign company should require effective implementation of the above confidentiality measures by the Chinese partner company in order to protect the foreign company’s trade secrets.

This post was written by Lisa Mueller, Wei Yan and Ivan Shen of Shen Li and Partners.

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