



Trade Secrets Protection in the Workplace in China

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As the scope of manufacturing and production in China increases in sophistication and technological advancement, companies are under greater pressure to protect their non-registerable intellectual property rights. The main category of non-registerable IP rights includes trade secrets. (Registerable IP rights include the more traditional trademarks, patents, and copyrights.) Trade secrets are defined under Chinese law as:

1. Technical and management information that is unknown to the public;
2. Can bring economic benefits and is of practical value, and
3. Which the rightful party has adopted measures to maintain its confidentiality.

Probably the most famous trade secret in the world is the exact formula for the manufacture of Coca-Cola. Other types of trade secrets include survey methods used by professional pollsters, recipes, a new invention for which a patent appli-

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cation has not yet been filed, marketing strategies, client lists, manufacturing techniques, and computer algorithms. Trade secret protection is entirely dependent on the individual company or person that has developed the secret or confidential trade process. The protection lasts for as long as the company continues to keep the information confidential. As illustrated by Coca-Cola, trade secret can last forever provided the proper safeguards have been established and are then well maintained. However, if the trade secret somehow becomes available to the public or becomes well known in its particular industry, then it loses all protection.

Trade Secrets Protection Under PRC Law

In China, there is protection against disclosure of a trade secret. Article 10 of the Anti-Unfair Competition Law, prohibits business operations from engaging in any of the following acts:

1. Obtaining the trade secrets of any rightful party by theft, inducement, duress, or other illegal means;
2. Disclosing, using or allowing others to use the trade secrets of any rightful party obtained by illegal means; or

3. Disclosing, using or allowing others to use trade secrets in breach of an agreement or the confidentiality requirements imposed by any rightful party.

There is also third-party liability. Third parties who obtain, use, or disclose business secrets that they knew or should have known to have been infringed by any of the methods in (1)-(3) above, will be deemed to have infringed the trade secrets of the rightful party.

Enforcement

In case of a suspected infringement of one's trade secrets, there are both judicial and administrative actions which can be undertaken to enforce one's rights.

The infringed party can institute proceedings in the People's Courts to seek compensation for damages under Article 20 of the Anti-Unfair Competition Law. In cases where damages cannot be reliably calculated, the amount of profits obtained by the infringing party can be used as the basis for the compensation claim. In addition, expenses and fees arising from investigating and obtaining evidence of the infringement can also be included in the claim for damages. Injunctive relief is also now available under recent amendments to the law.

For administrative enforcement for infringement of one's trade secret, the offices of the Administration for Industry and Commerce (AIC) above the county level will, after an investigation and determination of wrongdoing, order the infringer to cease its infringing acts and impose a civil fine of at least RMB10,000 but less than RMB200,000. If the infringer does not comply with the cessation order, a fine of more than twice and less than three times the amount of the value of goods sold will be imposed. All decisions of the Administration for Industry and Commerce may be appealed to the People's Courts.

Prevention of Trade Secrets Theft

It is always wise to try and prevent any infringement of your trade secrets rather than having to try and enforce them after infringement has occurred. As the definition of a trade secret states above, one of the main criteria for whether the trade secret is deemed a trade secret and should thus be afforded protection, is whether reasonable steps have been taken to ensure that the material is kept confidential. To achieve that goal, the following procedures are recommended:

- **Establish a confidentiality policy.** The necessary items of any effective policy include the following procedures:
 1. Define what information the company deems confidential and how your employees should handle such information.
 2. Clearly spell out the consequences of any unauthorized, improper use or disclosure of confidential information.
 3. Boldly announce that such use or disclosures can and may be grounds for employee termination.
- **Enforce the confidentiality policy**
 1. All key personnel should sign Non-Disclosure Agreements. In addition, the company should have a formal policy regarding the ownership of any intellectual property created by the employee during his/her employment.
 2. Conduct regular training on your company's confidentiality policy.
 3. Verify that each employee has received a copy of the confidentiality policy in their employee handbook and signs a statement acknowledging that they have read, understand and will comply with the policy as a condition of their employment.
 4. Keep confidential information in a restricted area and in clearly marked binders and/or storage media. Items should be marked as Classified, Restricted, Do Not Disclose, or Do Not Copy or in otherwise appropriate methods particular to your individual business.
 5. All employees must confirm with designated personnel prior to disclosing any company information, if the employee is unsure or unaware if the material in question is confidential.
 6. Conduct exit interviews of departing employees to ensure that they are not taking to their new job any information that you would not want to disclose to a competitor. This also serves to remind all key employees that their obligation to not disclose trade secrets extends beyond their employment with your company.

While these measures may not ensure that an employee will never steal, copy or disclose confidential information, they should be sufficient to establish that the material in question was deemed to be confidential and adequate measures had been established for its protection. That determination is essential if one is to effectively take any type of enforcement action against an infringer of one's trade secrets.

If an employee has departed your company by reason of resignation or termination and taken

employment with a competitor, then the first step to take is to give immediate notice to the new employer of the employee's continuing obligation to not disclose your trade secrets. This can be accomplished by sending a registered letter to the new employer, indicating that the new employee has knowledge of trade secrets, the general subject matter of the trade secrets, an explanation of the legal basis for the employee's obligation to maintain secrecy (for example, a Non-Disclosure Agreement), and that by virtue of the foregoing, 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.

For third party liability to arise, the new employer must know, or have reason to know, that its new employee had access to trade secrets and may be about to breach a confidential relationship. (See Third Party Liability above.)

Notice may be constructive or actual. Constructive notice arises where the new employer should reasonably know that his new employee may be acting improperly. (Some examples of anomalous behavior include: emails to employees of the former company, possession of confidential material, meeting with officials from competing companies or travel and or contact with persons in high risk areas.)

In most instances, for a case where the plaintiff must prove constructive notice, difficult issues of proof are determinative as to whether the new employer should have known or inferred that it was receiving trade secrets. Because of these evidentiary difficulties necessary to prove constructive notice, it is recommended to send actual notice if and when the former employer has reasonable grounds to believe that disclosure has occurred or may occur.

Recent Treatment Under the Law

Now that the general background has been provided, let me give some examples of recent cases in China where the courts and other authorities have examined the issue of trade secrets protection.

In a case decided last year by the Zhongyuan District People's Court in Zhengzhou City, Henan Province, a former employee of an electronics company was sentenced to eight years in prison and fined RMB70,000 (US\$8,500) for copying confidential information which he then provided to his new employer allowing them to produce a similar electronic device and compete against his former company. The Court found that his former

continued on page 18

Trade Secrets/China

China from page 17

company had suffered a demonstrable loss of more than RMB500,000 (US\$60,000).¹

The Nantong Intermediate People's Court issued a decision in a trade secrets case decided early last year. The Defendant was found guilty of unfair competition and fined RMB200,000 (US\$24,000).

The Defendant had been the sales manager for a local company based in Nantong that sold their products both domestically and for export. Mr. Z, the Defendant, in his role as sales manager, controlled the product price list, sales distribution channels and client list of the Plaintiff company. In 1999, while employed with the original company, Mr. Z, signed a Trade Secrets Protection Agreement. The next year, Mr. Z abruptly left the company and began working for another company

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in the same business and in the same capacity. The Court determined that Mr. Z's actions in disclosing his former company's trade secrets had caused them a great loss of sales and in the price for their exported goods.²

In a related case from Shanghai, two former employees of a Chinese-US joint venture stole confidential product formulas, client lists, and business secrets from the JV company and established their own company in direct competition with their former employer.

The Chinese-US JV had established its internal confidentiality system in late 1998, when both employees were with the company. In 2000, Mr. Y and Mr. Z, the former employees, left the JV and

established their own company in direct competition with the JV. They undercut the prices for their products to steal away the JV's customers. Three of the JV's main customers transferred their business to the new company after being contacted by Mr. Y, who had been the sales manager for the JV. The JV took their complaint to the Jiading District Public Security Bureau who arrested Mr. Y and Mr. Z after determining that the JV had suffered direct economic losses of more than RMB 1 million (US\$120,000) as a result of their actions.³

These are just a sampling of recent actions undertaken by the Chinese authorities to protect trade secrets for both domestic and foreign invested enterprises. One thing that does jump out from the cases excerpted above is that none of the hiring companies was found liable for third party trade secret infringement. That is an area where the Chinese courts are still relatively reluctant to impose sanctions. This may be a result of a desire to foster economic progress and to not unduly burden businesses with the requirements of fully vetting all of their newly hired personnel. However, the law will not realize its full utility until the hiring companies, that exploit workers to gain access to confidential secrets that belong to others, are also penalized for their actions. Simply punishing the individual employee for disclosure of trade secrets ignores the fact that the new company has also benefited from those disclosures and in many instances may have instigated the employee's hiring to gain that information. □

¹ Da He News, Aug. 6, 2002.

² Yangtze Evening News, April 30, 2002

³ Morning News, June 6, 2002

