

Trade Secret Protection in China

Ruixue Ran
Covington & Burling LLP
9/25/2018

COVINGTON

BEIJING BRUSSELS DUBAI FRANKFURT JOHANNESBURG LONDON LOS ANGELES
NEW YORK SAN FRANCISCO SEOUL SHANGHAI SILICON VALLEY WASHINGTON

www.cov.com

TODAY'S OUTLINE

- Introduction
- IP v. contract claims in China
- Multi-jurisdiction protection
- Risk mitigation



Part I

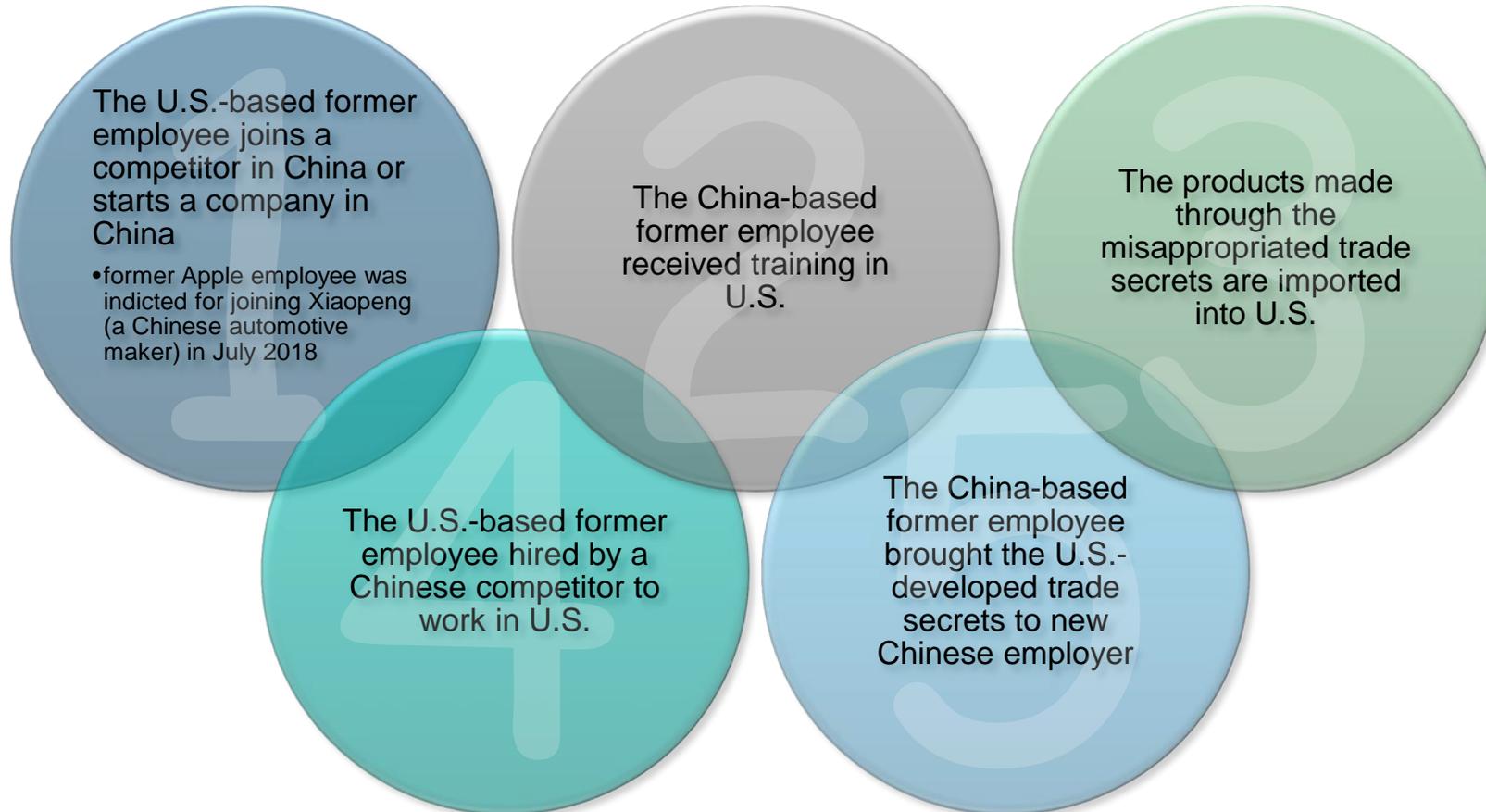
INTRODUCTION

Common Scenarios of Trade Secret Misappropriation



Trade Secret Misappropriation		
<p>Join a competitor</p> <ul style="list-style-type: none">• Sometimes using a labor dispatch arrangement to cover up	<p>Start a new company competing with the former employer</p>	<p>Your partner, e.g. joint venture partner, reseller or supplier, becomes a competitor</p>

Potential Cross-border Elements





Part II

IP V. CONTRACT CLAIMS IN CHINA

Enforcement in China

IP claims

- Administrative enforcement
- Civil action
- Criminal proceeding

Contractual claims

- Breach of confidentiality
- Breach of non-compete(if applicable)
- Normally through labor arbitration and subsequent appellate proceedings before the civil courts

Legal Framework Protecting Trade Secrets in China

China does NOT have a unified trade secrets law, but a number of laws and regulations governing civil, criminal and administrative enforcement options:

Primary statute protecting trade secrets: Anti-Unfair Competition Law (2017)--
“Trade secret” defined:

- “Technical information” or “business information”
- which is unknown to the public
- have commercial value
- for which the rights holder has adopted secret-protection measures

Other statutes setting forth additional legal standards:

- Labor Law and Labor Contract Law
- Company Law
- Contract Law
- Criminal Law

Chinese Authorities Concerning Trade Secrets Protection



The court system: the Supreme People's Court ("SPC") and local courts.

- Civil and criminal litigation

The public prosecutor system: the Supreme People's Procuratorate ("SPP") and its local counterparts

- Criminal trade secret misappropriation investigation and prosecution

Chinese Authorities Concerning Trade Secrets Protection

Local Public Security Bureaus ("PSBs")

- Criminal investigation of trade secrets misappropriation.

The State Administration for Market Regulation ("SAMR", formally known as "SAIC")

- Local AICs also have authority to investigate allegations of trade secret misappropriation.

- Criminal investigation of trade secrets misappropriation.

("PSBs")

Local Public Security Bureaus

- Local AICs also have authority to investigate allegations of trade secret misappropriation.

known as "SAIC")

Regulation ("SAMR", formally

State Administration for Market

Chinese Authorities Concerning Trade Secrets Protection

China's trade secrets framework offers **THREE** ENFORCEMENT OPTIONS:



Administrative enforcement:

Seek administrative relief through the local AIC

Civil litigation:

Bring a civil suit in the appropriate court

Criminal investigation and prosecution:

Ask local prosecutors to bring criminal charges

IP Claims in China: Administrative Enforcement



SAMR and local counterparts (AICs) as the “market regulator”

Main enforcer of “Anti-Unfair Competition Law”

Pros:

- Authority vs. speed: AIC proceedings can progress to conclusion within 90 days, and thus are speedier routes to relief, including injunctions.
- AICs may impose fines from RMB 100,000 to 3,000,000

Cons:

- Limited authority to collect evidence, as compared to PSB
- AICs often decline to take cases involving complicated technical issues, which may also take longer than the prescribed 90-day period.

Courts with civil and criminal jurisdiction tend to be more powerful than AICs and often the more appropriate fora in which to pursue relief.

IP Claims in China: Civil Litigation

**Bring a civil litigation
for trade secret
misappropriation in
court...**

Pros:

- Civil courts can order damages.
- the cap for the statutory damages increased from RMB 1 million to 3 million since this January.
- Civil courts may issue permanent and preliminary injunctions.
- Civil and criminal cases may be pursued concurrently, or civil cases may be initiated after seeking AIC and/or criminal investigations.

Cons:

- No U.S.-style discovery: essentially leaving the plaintiff to assemble evidence through private resources
- Burden of proof in civil court quite high
- Judicial appraisal is normally necessary, which would delay the action.

IP Claims in China: Civil Litigation

Burden of proof in civil trade secret cases:

The plaintiff is required to prove, with legally obtained, documentary evidence, that

- it possessed a trade secret conforming to the statutory requirements;
- the other party's information is identical or substantially identical to the trade secret, and
- the other party has adopted unfair methods.

IP Claims in China: Civil Litigation

Compare with U.S. rule

The test under Chinese law is **similar** to the “substantial similarity, plus access, without legitimate sources” rule used in U.S. trade secrets litigation when there is a lack of direct evidence of misappropriation



IP Claims in China: Criminal Prosecution

Complainants may seek criminal charges if the trade secret misappropriation causes “serious” or “particularly serious” economic losses



Pros:

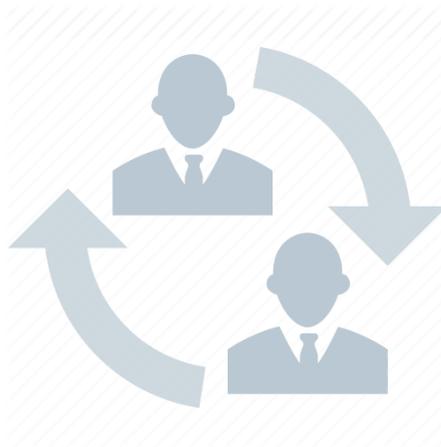
- Law enforcement can get fast and better access to information (confessions, cooperating witnesses, etc.; PSBs have greater power to collect evidence than AICs)
- Tougher deterrence and punishment: criminal cases can lead to sentences of up to 7 years’ imprisonment and fines
 - faster-moving criminal case can have implications for civil case
 - can enhance perception of legitimacy of civil case
 - signals to third parties a willingness to seek criminal prosecution
- Complainant involvement: Complainant can continue to work with the PSB during the investigation. Complainant involvement is particularly helpful for the PSB’s submission of documentary evidence to the appropriate judicial appraisal institution; assistance with the submitted evidence is critical to the complainant’s success.

Cons:

- Difficult to persuade the PSB to build the case, and the bar is quite high
 - to provide prima facie evidence proving losses incurred are higher than RMB 500,000
 - to provide prima facie evidence the information taken is a “trade secret”
- Current employees may have second thoughts toward such action against the former employees.

IP Claims in China: Interplay between Different Available Options

Practitioners and general counsels must consider and understand the interplay between the different available enforcement procedures



The most challenging aspect of trade secret cases frequently lies in evidence collection.

For example, civil plaintiffs usually complain of their inability to obtain evidence of trade secret misappropriation, especially relating to misappropriated manufacturing processes believed to be used in competitors' factories.

One strategy for addressing this challenge: parallel proceedings.

To pursue an AIC proceeding or criminal investigation before filing the civil action, as these proceedings may result in admissible evidence for use in the civil trial.



Contractual Claims in China

Breach of confidentiality

- relief largely depending on the terms of NDA
- normally including damages and specific performance

Breach of non-compete

- relief largely depending on the non-compete terms
- normally including damages and specific performance (if the term of non-compete has not expired)



Contractual Claims in China

Forum

- normally firstly resorting to labor arbitration committee
- first-instance court
- appellate court

Tencent v. Xu Zhenhua

- the Shanghai First Intermediate People's Court awards Tencent RMB 19.8 million in August 2018 for Xu's breach of non-compete.

IP Claims v. Contract Claims

Normally cannot be brought simultaneously in a civil case, mainly due to labor arbitration is preemptively required for the action against a former employee

It would be easier for the plaintiff to establish violation of non-compete

IP claims are generally more powerful than contractual claims, and are normally preferred approaches

criminal/administrative authorities involvement can have more deterring effects

current employer can also be a target and can be named as a defendant

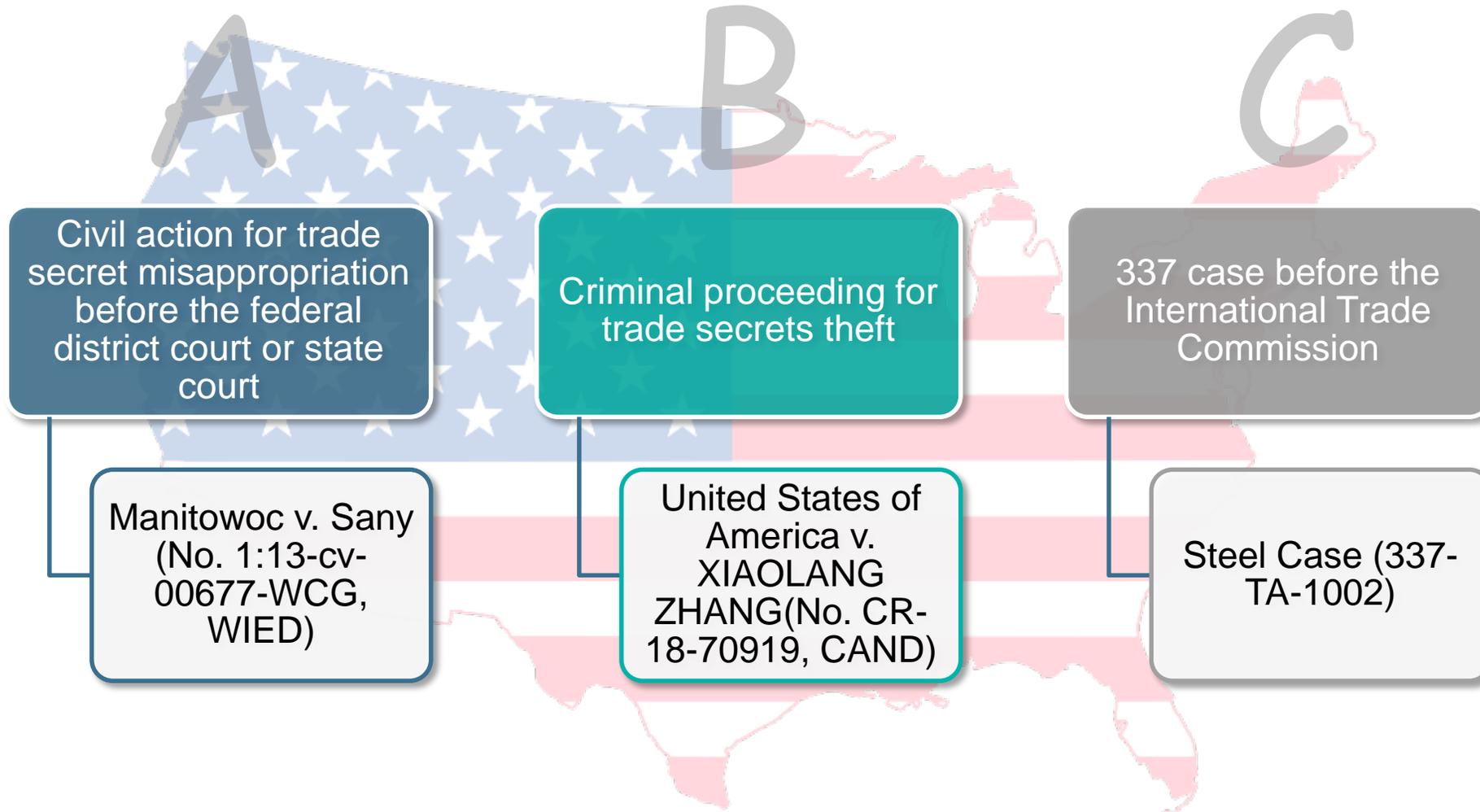
remedies can be more powerful

- injunctive relief: drive the competing products out of the market
- damages: the current employer are usually more resourceful than the former employee

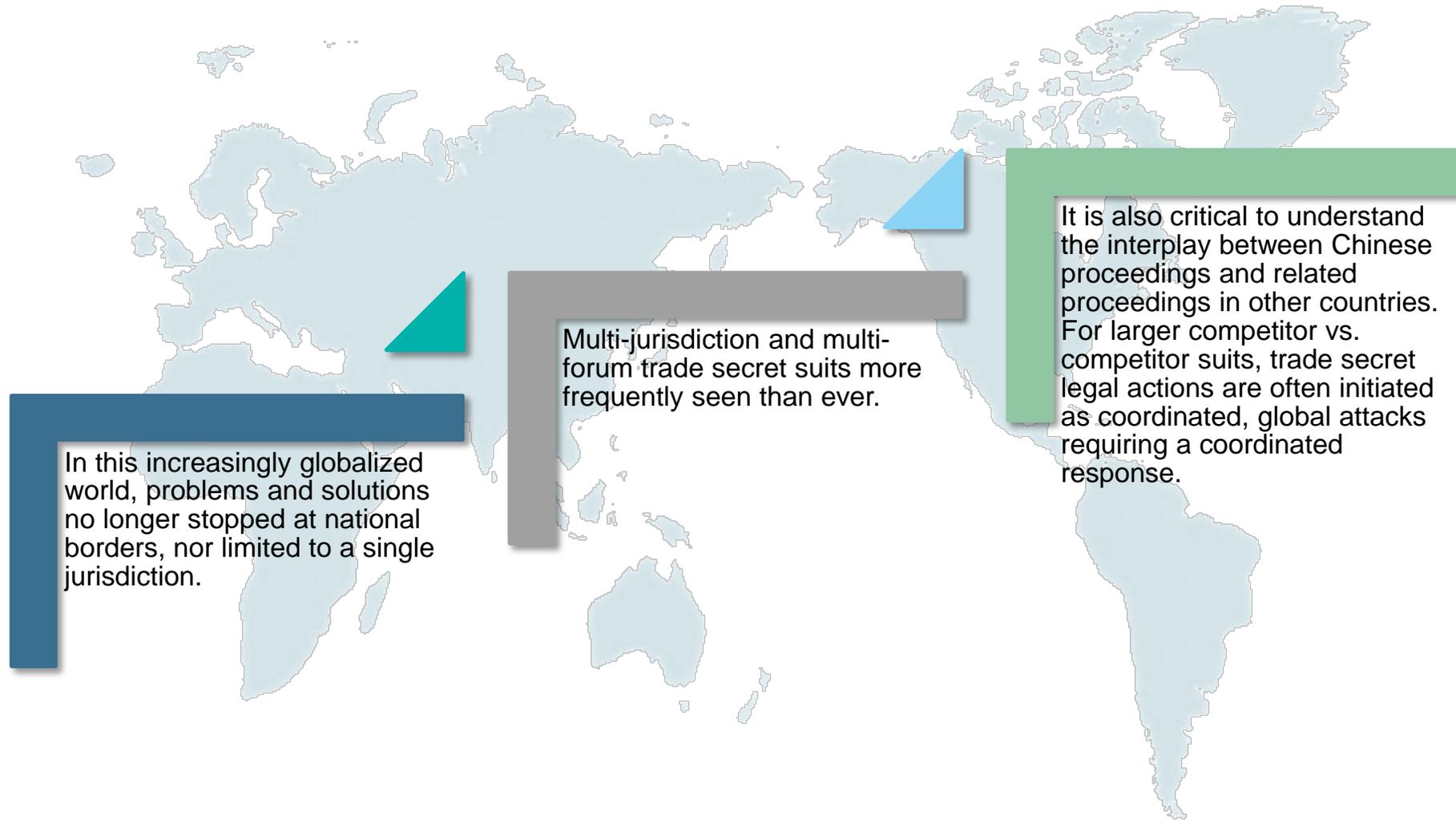
Part III

MULTI-JURISDICTION PROTECTION

Enforcement-U.S.



Trade Secret Enforcement Options: Multi-jurisdiction and Multi-forum Suits



Trade Secret Enforcement Options: Multi-jurisdiction and Multi-forum Suits

Challenges of parallel proceedings across the globe

Different legal standards or despite similar legal standards, different applications

Difficulties of evidence collection and admission into evidence

Applicable law for the conducts at issue - the act of "misappropriation" usually takes place in a jurisdiction other than the place of suit

Local protectionism

Jurisdictional challenge

Conflicting goals and procedures of parallel proceedings

Trade Secret Enforcement Options: Multi-jurisdiction and Multi-forum Suits

Example: The Sino Legend (Rubber Resins) related litigation

SI Group contacted the Shanghai PSB to initiate a **criminal investigation** against the former employee. The PSB eventually terminated its investigation for “lack of evidence.”

As a result of PSB’s decision to terminate the criminal investigation, SI Group filed **two civil actions** against Sino Legend and the former employee before the Shanghai Court.

SI Group re-filed these cases.

Sino Legend counter sued SI Group for trade secret misappropriation in Shanghai.

SI Group, Inc. of Schenectady, New York filed a complaint at the **ITC and sought permanent exclusion orders** and cease and desist order pursuant to Section 337. The complaint alleges that the Sino Legend entities in China unlawfully import into the U.S. certain rubber resins made using misappropriated SI Group trade secrets obtained from a former employee of SI Group.

November 26, 2008

Early February 2010

March 24, 2011

January 2012

May 21, 2012



Part IV

RISK MITIGATION: A COMPREHENSIVE APPROACH

TRADE SECRET MATRIX

Define	Mitigate Trade Secret Risk		Prepare for Incidents	*	Incident Response	
trade secrets and other confidential information	Limit Access	Verify Compliance	identify team & resources <ul style="list-style-type: none"> management legal, IT, HR, PR, security, etc. functions forensics gov't contacts investor relations PR 	BREACH OR SUSPECTED BREACH	implement plan	
	secure networks, devices, data, documents, locations, and other property	security audits and other monitoring			secure critical information to mitigate loss/preserve evidence	
protections afforded by law or contract	policies & procedures <ul style="list-style-type: none"> IT security privacy HR risk managers Procurement 	hire/exit procedures <ul style="list-style-type: none"> interviews end access retrieve devices agreements 	check & secure insurance coverage		critical decisions <ul style="list-style-type: none"> investigate hold back comp and benefits file civil litigation engage law enforcement <ul style="list-style-type: none"> — investigation — prosecution — intelligence sharing engage diplomatic and trade officials notify insurers disclose <ul style="list-style-type: none"> — shareholders — customers — other companies 	
	Training	business changes				develop incident response plan
	agreements <ul style="list-style-type: none"> vendors/ contractors employment executive benefit plans Acquisitions 	<ul style="list-style-type: none"> M&A due diligence integration procedures flip side on dispositions joint ventures 				consider best practices-related communications; brokered by government

Preventive Steps for Protecting Trade Secrets in China

1

Establish a system for managing confidential information in and provided to Chinese subsidiaries and joint ventures

- Exercise care when sharing trade secrets with employees, subsidiaries, joint ventures, vendors, suppliers, or other third parties
- A signed confidentiality agreement in advance
- An acknowledgement of receipt of confidential information that identifies in detail the disclosed confidential information
- A summary description is not likely to provide sufficient protection

Preventive Steps for Protecting Trade Secrets in China

2

Include trade secret-related rules and protections in all contracts

- Companies doing business in China or with Chinese entities or employees should negotiate and set forth trade secret-related rules and protections in their contracting practices and procedures
- Decide and specify in advance on issues such as who owns trade secrets at the time of contracting, and who will own trade secrets in the event either party undertakes additional research and development following the date the contract is executed
- Confidentiality agreements of unlimited duration OK

Preventive Steps for Protecting Trade Secrets in China

3

Establish trade secret-related rules and protections in the company's employment management

- Employment agreements may incorporate non-compete provisions of limited duration binding the employee during and after the employment term.
- The scope of the non-compete must be reasonable, for example, in terms of the applicable business scope, the geographic region and duration (usually up to two years).
- Reasonable monthly compensation agreed upon in advance and paid.
- Companies should also take protective measures to ensure that their employees maintain confidentiality.
- Companies should conduct exit interviews with all departing employees to flag potential issues as early as possible.

Exit Review and Return of Company IP

Conduct exit review

- Know where the employee goes
- Remind the obligations of non-compete and confidentiality
- Remind return of IP
 - Any compensation for the IP developed?
 - Remuneration for the service invention per the Patent Law?

Collect and store the devices and the documents

- record for chain of custody

NOT THE END

IF YOU HAVE ANY QUESTION...

Ruixue Ran

Covington & Burling LLP
2301 Tower C Yintai Centre, 2 Jianguomenwai Avenue
Chaoyang District, Beijing 100022
T +86 10 5910 0511 | rran@cov.com