

TRADE SECRETS IN CHINA¹

In recent years, China has made significant progress in building a comprehensive regulatory framework for the protection of intellectual property rights. Over the past thirty years, China has expanded its functions and powers in intellectual property protections through the implementation of new civil laws, regulations, and administrative, civil and criminal procedures. China has also enlarged the scope and increased the level of judicial power and review for intellectual property rights while working to enhance the effectiveness of implementing and enforcing safeguards now in place.

I. Legislative Efforts

Over the past two decades, the People's Republic of China ("PRC") has taken significant measures in protecting commercial trade secrets and governing trade secret lawsuits. In 1993, China enacted the Anti-Unfair Competition Law ("AUCL") which is the basis for trade secrets protection in China. The AUCL defines the meaning of a trade secret and further identifies with specificity different types of infringing acts. Over a decade later, in December 2006, the Supreme People's Court issued its first judicial interpretation on the AUCL. In issuing this interpretation, the Supreme People's Court sought to unify the judicial application of the AUCL across China. Effective as of February 1, 2007, the interpretation of the Supreme People's Court draws on the experience of the PRC courts (also referred to herein as "People's Courts") in dealing with unfair competition cases in the numerous cities and provinces of China. Since this time and in a continuing effort to strength protections in intellectual property rights of trade secrets in China, additional decisions have been promulgated by the Supreme People's Court.

As provided under Article 21 of the AUCL, a trade secret is defined as technical and operational information which: (a) is not known to the public; (b) is capable of bringing economic benefit to the owner; (c) has practical applicability, and (d) where the owner of the rights has taken measures to keep the information confidential. The AUCL governs business secrets. As discussed below, the PRC law on guarding State Secrets ("the State Secrets Law") governs State Secrets. State Secrets are not governed by AUCL. A State Secret means any matter which has a "bearing on State security and national interests and, as specified by legal procedure, are entrusted to a limited number of people for a given period of time."² Moreover, the unlawful misappropriation or possession of a State Secret is a criminal offense that carries

¹ This paper has been prepared by Xiaobing Feng, ExxonMobil (China) Investment Co., Ltd. & Carol M. Nielsen, Nielsen IP Law LLC for the AIPLA 2011 Spring Meeting, Friday May 13, 2011, Morning Track 2, *Beyond the Basics-Trade Secret Crimes, Damages and Protection in Asia*.

² Article 2, The Law of Safeguarding State Secrets of PRC, 2010.

heavy penalties including a maximum penalty of life imprisonment, 5 years deprivation of political rights, and/or 3 years public surveillance.

Business secrecy, as defined under the AUCL, means and includes both technical information and business information which is unknown by the public and creates business interests or profit for its owners, and, is also properly maintained by the owners.³ In accordance with Article 10 of AUCL, certain methods must not be used to infringe upon business secrecy. These methods are specifically set out as: (1) to steal, coerce, or use any other unfair method to obtain the other's business secrets; (2) to disclose, use or permit others to use the business secrets which were obtained by any of the methods set forth in the preceding sentence of this Article; and (3) to violate the contract or the requirement to publish, use or permit others to use the business secrets which were maintained as secrets by the legal owner of the business secrecy.⁴ Moreover, a third party who knows, or should know of illegal activities, and gains, uses or publishes the business secrecy is also infringing upon another's business secrecy.⁵

Notably, Chinese laws clearly recognize third-party liability for trade secret infringement. According to both AUCL Article 10 and PRC Criminal Law Article 210, one may not use any of the following means to infringe on the business secrets of others: (1) obtaining or acquiring trade secrets by theft, inducement, coercion or other illicit means; (2) disclosing, using, or allowing others to use trade secrets acquired by the above means; (3) disclosing, using, or allowing others to use trade secrets in breach of an agreement or a confidentiality obligation imposed by a legal owner; or (4) acquiring, using or disclosing trade secret when a third party knows or should have known that the trade secret has been misappropriated in any of the above ways.

Article 25 of the AUCL provides the legal basis for the relevant administrative authority to order an infringer to cease the illegal act(s) and to impose a fine. Under Article 25, the relevant administrative authority can order: (1) illegal activities to stop; (2) the return stolen materials and information; (3) the destruction of materials made with the trade secret; (4) confiscate the infringer's illegal income; (5) revoke the infringer's operating license, and (6) in certain circumstances may fine an infringer amounts between 10,000 and 200,000 RMB yuan (or about 1500 to 31,000 US dollars), if Article 10 is violated and the activity infringes upon a trade secret. Though the State Administration for Industry & Commerce ("SAIC") can order injunction, the injunction is generally useless once the trade secrets are disclosed to the general public. On the other hand, as discussed below, the State Administration for Industry & Commerce cannot award compensation to the owner of the trade secret. Hence, there is a

³ 3rd paragraph, Article 10, AUCL.

⁴ 1st paragraph, Article 10, AUCL.

⁵ 2nd paragraph, Article 10, AUCL.

concern by some lawyers and business people alike that the fines are not big enough to act as a deterrent.

The Supreme People's Court ("SPC") has interpreted certain the issues concerning the application of the AUCL in civil cases.⁶ Referred to as the "SPC Interpretation" of Articles 9 through 17, the Supreme People's Court has held that certain provisions of the AUCL should be followed with particularity by the People's Court in deciding trade secret cases. For example, under Paragraph 3 of Article 10 of AUCL, the Supreme People's Court has held that information is "capable of bringing about benefits" and "having practical applicability" when the information has actual or potential commercial value and can bring about a competitive advantage. To assess whether the required and necessary confidential measures have been implemented, the People's Court must then determine: (1) whether such measures have been adopted according to the features of the relevant information carrier; (2) the degree of confidentiality; and (3) the difficulty for others to obtain the information by justifiable means. Under Article 9, where the relevant information is unknown and difficult for relevant persons to obtain in the relevant field, the information shall be regarded as "unknown to the public" as prescribed in Paragraph 3 of Article 10 of AUCL.

Under the SPC Interpretation, confidential measures are considered to have been adopted if: (1) access to the classified information is limited to only a notification of the contents of such information; (2) the information was locked up or other preventive measure taken; (3) classified information was marked as confidential; (4) passwords or codes are used to access the information; (5) a confidentiality agreement was entered into; (6) visitors are limited to facilities; or (7) any other measure was adopted for the guarantee of confidentiality.

Furthermore, as mandated by the SPC Interpretation, information is considered to be known to the public if: (1) it is an industry practice in the relevant technical or economic field; (2) only involves the simple combination of dimensions, structures, materials and parts of products and can be directly obtained through the observation of products after the products enter into the market; (3) it has been publicly disclosed on any publication or any other mass medium; (4) it has been publicized through reports or exhibits; (5) it can be obtained through other public channels; or (6) if it can be easily obtained without price.

Moreover, under Article 12 of AUCL and the SPC Interpretation, mere independent development efforts or reverse engineering does not equate to an infringement of a business trade secret. Here, reverse engineering is relevant technical information obtained through dismantling, mapping or analyzing the products from public channels or technical means.

⁶ The Supreme People's Court is the equivalent in China to the Supreme Court in the United States.

On the other hand, under the SPC Interpretation of Article 13, lists of customers are among business secrets protected by AUCL including information such as the name, address, contact information, trading habits, trading intent and trading contents of customers. The specific customer information must be different from information available to the public, and include a listing of a large number of customers as well as the specific customers who have kept a long-term and stable trading relationship. When an employee leaves a company, provided it can be proven that the customer voluntarily chose to conduct further transactions with this employee or his new employer, then, unfair means have not been adopted by the employee or his new employer.

Furthermore, the 2008 Labor Contract Law of PRC (“LCL”) provides additional trade secrets protection to employers. Under the LCL, an employer and employee can agree to measures for the maintenance of the confidentiality of the employer’s trade secrets and intellectual property in the employment contract.⁷ The employer may specify in the employment contract of (or a confidentiality agreement with) the employee, the scope and term of confidentiality and non-competition together with monthly compensation for the non-competition period after termination of employment. A non-compete agreement can be applicable only to senior management personnel, senior technical personnel and other persons who have an obligation of confidentiality during the term of his or her employment. The scope, territory and term of a non-competition restriction must be agreed upon by the employer and the employee, and the provisions on such a restriction cannot violate laws or regulations.⁸

Notwithstanding a separate agreement, the 1st paragraph of Article 24, LCL prohibits a person from serving with a competitor that produces or deals in the same type of product or engages in the same type of business as his/her employer, or prohibits him/her from opening his/her own business to produce or deal in the same type of product or engage in the same type of business for a term not to exceed two years.⁹

The SPC Interpretation further requires under Article 14 that the party who claims another has misappropriated its business secret carries the burden of proving: (1) that its business secrets meet statutory requirements; (2) the information is similar or substantially similar to the business secret stolen, and (3) the other party has adopted the business secret by unfair means. Evidence for providing a business secret includes the carrier of the information, the specific contents, the commercial value of the secret and the confidentiality measures adopted. An exclusive licensee of the trade secret may bring the lawsuit whether or not the owner joins the

⁷ 1st paragraph, Article 23, LCL.

⁸ 1st paragraph, Article 24, LCL

⁹ 2nd paragraph Article 24, LCL

lawsuit. Furthermore, the non-exclusive licensee may also bring suit provided it lodges the lawsuit with the owner or if alone, upon written authorization from the owner. Notwithstanding, enforcement of trade secrets in China can be difficult because the Plaintiff must meet a high burden of proof and there is no discovery in China.

Once the People's Court adjudicates civil liability and orders an injunction, the injunction is generally extended to the time when this business secret has become known to the general public. Furthermore, if the time for stopping the infringement is then clearly improper, the tortfeasor may be enjoined from using the business secret within a certain term or scope so that the competitive advantage to the owner of this business secret is protected. In China, injunctions are the most feasible and best remedy for a trade secret owner. Preliminary injunctions are available if the trade secret owner can prove: (1) the information is a trade secret; (2) the defendant's acts are causing irreparable harm and (3) the plaintiff is likely to prevail on the merits of the case. As in the US, the plaintiff must post a bond.

Finally, under the SPC Interpretation of AUCL, the determination of damages may be governed by the same methods used to determine damages for patent infringement and/or the methods used to determine damages for infringement of registered trademarks. The damages for tort causes (not criminal) are generally determined according to the commercial value of the business secret, research and development costs, the proceeds from implementing the business secret, possible benefits and/or the time the competitive advantage was maintained. If damages to the trade secret owner are difficult to calculate or otherwise determine, the court can base the calculation on the profits realized by the infringing party as a result of the infringement. If infringement is found, the infringer is also liable for reasonable costs incurred by the trade secret owner to investigate the matter. Significant damage awards are rare.

II. Administrative and Criminal Procedures

There are specific administrative rules that govern how trade secret infringement lawsuits should be handled by the State Administration for Industry and Commerce in China. The State Administration for Industry and Commerce is an organization directly under the State Council. The State Council is the administrative authority (cabinet) of the Central People's Government and comprises about 50 members. The State Council directly oversees the various subordinate People's Governments in the provinces.

Several Provisions Regarding the Prohibition of Trade Secret Infringements (the "SAIC Provisions") were promulgated by Order No. 41 of the State Administration for Industry and Commerce on November 23, 1995, as later amended by Order No. 86 of the State Administration for Industry and Commerce on December 3, 1998. Under the SAIC Provisions, the term trade secret refers to practical information concerning technologies and business operations that are unknown to the public and able to bring economic benefit to the owner. To have a trade secret,

the owner must have taken the appropriate measures to keep the information confidential such as setting up a system of confidentiality within its business or adopting other reasonable measures. The term “unknown” as used in these provisions means that the information is not directly available through public channels. Furthermore, the information must be specific and definite and as noted above may include designs, formula, manufacturing techniques and methods, management secrets, customers, bidding and the like.

Article 3 of the SAIC Provisions specifically set out the activities amounting to infringement (misappropriation) of trade secrets which essentially mirrors the AUCL and include: (1) stealing, luring by promise, or coercing another to obtain trade secret information by improper means; (2) disclosing, using or allowing another to use a trade secret obtained improperly; (3) breaching a contract with the trade secret owner, or otherwise violating the trade secret owner’s requirements about disclosing the trade secret; and/or (4) allowing others to use a trade secret of which one has legitimate access.

Under Article 4 of the SAIC Provisions, infringement cases are handled by the State Administration for Industry and Commerce at or above the county level. Under Article 5, these rules mandate that the owner provide evidence to prove the existence of a trade secret and the infringement of it. The owner must prove that the information used by respondents is identical with or similar to its trade secret and that the respondent had access to the trade secret. Provided that the respondent cannot prove lawful acquisition or use of the trade secret, the industry and commerce organization shall determine infringement. If the infringer does not execute the punishment decision and continues his acts of infringement, then the infringer will have committed a new violation and will be given a heavier punishment. Article 10 of the SAIC Provisions specifically mandates that no state organization shall disclose or allow another person to use the trade secrets of another when he performs his official duties. Case handlers or other members of the SAIC shall keep trade secrets confidential when investigating unfair competition acts. Notwithstanding, many trade secret owners are hesitant to report bad acts to the police because there is a risk of further expose of the trade secret to the public during criminal prosecution.

The PRC Criminal Laws also make trade secret infringement a criminal offense. Specifically, Article 219 states that whoever acquires trade secrets via theft, lure by promise of gain or other improper means, and discloses, uses or allows others to use such commercial secrets via such acquisition, or in violation of an agreement with the rightful owner, having serious damage occur to the owner (over 500,000 Yuan – roughly 77,000 USD) shall be sentenced to not more than three years of imprisonment, criminal detention plus a fine. For damages that are exceptionally serious (no less than 2,500,000 Yuan – roughly 385,000 USD), there is an aggravation factor and the infringer could face up to seven years of imprisonment plus a fine. The amount of the fine can be up to five times the amount of the illegal income.

Finally, parties to a contract shall not disclose or otherwise improperly make use of trade secrets obtained during the course of negotiation, regardless of whether a contract is formed in the end. There is an implied duty of confidentiality imposed during and after the contractual period. The extent of this duty depends on the nature of the contract and the parties previous course of dealing.

III. State Trade Secrets

The PRC law on State secrets is somewhat unclear in scope and application. The PRC Law on Safeguarding State Secrets (“the State Secrets Law”) defines a State secret to be any matter which has a “bearing on State security and national interests and, as specified by legal procedure, are entrusted to a limited number of people for a given period of time.” Unlawful misappropriation and/or possession of a State Secret is a criminal offense which carries with it heavy penalties ranging from a maximum penalty of life imprisonment, 10 years imprisonment, 5 years deprivation of political rights, and/or 3 years public surveillance. The Ministry of State Security of China is responsible for the administration of State secrets. However, the classification of information as State secrets can occur at all levels of government including State Owned Enterprises (“SOEs”).

The State Secrets Law sets out seven types of secrets which can be State Secrets including: (1) major policy decisions on state affairs; (2) building of national defense and the activities of the armed forces; (3) diplomatic activities and activities related to foreign countries and commitments to foreign countries; (4) national economic and social development; (5) science and technology; (6) activities for safeguarding state security and the investigation of criminal offenses; and (7) other matters that are classified as state secrets by the state secret-guarding department. It is important to note that two types of protected information are “secrets in national economic and social development” and “secrets concerning science and technology,” each of which are readily capable of extending to the types of information usually passed between parties in commercial negotiations.

Therefore, state trade secrets should be approached with caution. This is particularly true when a company obtains documents from the Government or SOEs, particularly those documents which may touch upon PRC State economic and social development, science or technology or defense interests.

IV. The People’s Courts

The PRC Constitution specifically states that the: “Citizens of the People's Republic of China must abide by the constitution and the law, keep state secrets, protect public property and observe labour discipline and public order and respect social ethics.”¹⁰ Also, under the 1982

¹⁰ Constitution of the People’s Republic of China, Article 53, *emphasis added*.

PRC Constitution, both the Chinese Government (The State Council and all of its ministries and commissions) and the People's Courts report to the National People's Congress ("NPC"). The People's Courts in China are the judicial organs of the state. Generally, the impact of judicial decisions is more pronounced in the business sector.

China's legal system is a civil based system. Unlike the Federal and State court systems in the United States, the court system in China is centralized. China's constitution specifically refers to and establishes the Supreme People's Court. China's court system has four tiers. First, the Supreme People's Court resides in the top tier. In the next tier of the court system resides Higher People's Court at each province level. The Intermediate People's Court is the third tier of China's court system. Patent cases and certain trade secret lawsuit are heard by the Intermediate People's Court. In the fourth tier of the court system is the Primary People's Court. The People's Courts are established and funded by local government at various levels. Unlike other legal systems, interpretation of law is not a matter reserved solely for the judiciary. The National People's Congress has the authority to interpret law as well as the Supreme People's Court.

In recent years, the People's Courts have endeavored to build a stronger team of judges, selecting their more experienced judges to adjudicate intellectual property cases while bettering the overall capacity for providing judicial protection.¹¹ In the last 30 years, the People's Courts have expanded their function and power in intellectual property protections. For example, before 1990, lawsuits were primarily related to technology contracts. The People's Courts now handle cases involving all categories of intellectual property including, but not limited to, patents, trademarks, unfair competition & technology contracts. They have expanded their review to address the emerging issues such as copyright on the internet, computer software piracy, layout designs of integrated circuits, domain names, franchises and anti-monopoly. China's courts are becoming the primary means of intellectual property dispute resolution rather than other available administration means.

In terms of administrative adjudicative duties, since 1985, the People's Courts handle patent suits against the Patent Re-examination Board and are responsible for conducting judicial reviews of intellectual property administrative enforcement disputes and case over granting or validation of a patent or trademark. With the 1997 amendment of the Criminal Law, the judicial powers of the People's Courts are enhanced through the ability to impose severe punishment against serious violations of intellectual property rights such as counterfeit and piracy. On March 10, 2006, the Supreme People's Court launched a website "China IPR Judgments & Decisions" which is a centralized open library of judgments and decisions rendered by the

¹¹ Intellectual Property Protections by the Chinese Courts in 2009, The Supreme People's Court, the People's Republic of China, April 2010, Beijing and referred to herein as "the White Paper".

People's Courts of different levels. As reported by the White Paper, by the end of 2009, 34,263 IP-related written judgments and decisions in force were published on this website.

According to the White Paper and statistics provided therein dated October 2008, China's courts had established a total of 298 separate intellectual property divisions and 84 intellectual property panels in its civil divisions. As reported, there were 2126 specialized intellectual property judges among the general courts which include 31 High People's Courts, 409 Intermediate People's Courts and 3119 Primary People's Courts.

As further reported in the White Paper, the number of adjudicated IP-related civil cases has increased rapidly over the years. In 2009, 30,626 IP civil cases were admitted and 30,509 civil cases were closed. Of the newly admitted cases, there were 4,422 patent cases, an 8.54 percent increase from 2008; 6,906 trademark cases, a 10.8 percent increase; 15,302 copyright cases, a 39.73 percent increase and 1,282 unfair competition cases, an 8.19 percent increase.

In addition, through adjudicating administrative cases, the People's Courts have conducted judicial reviews of the government's conduct relating to intellectual property matters. In 2009, as reported, local courts nationwide admitted 2,072 IP administrative cases and closed 1,971 IP administrative cases, an increase of 92.92 percent and 90.99 percent respectively over the previous year. Of these cases and as reported, there were 688 new patent cases, 19.03 percent increase, 1,376 trademark cases, 184.3 percent increase, and 4 copyright cases, a decrease of 42.86 percent. The Supreme People's Court admitted 54 new cases and closed 56 cases.

Unfortunately, even with all of the judicial activity in China, the national and local components create a variety of different enforcement issues in cities and provinces. To add to this complexity, in China, enforcement of different intellectual property rights is handled by different agencies. For certain business and industry, infringement of intellectual property rights is concentrated in a few geographic locations. While for others, counterfeiting expands across the country. Therefore, the funding, training and procedures can vary widely and enforcement often depends on local officials. So, as discussed below, a one size fits all approach makes it challenging if not impossible to develop a consistent strategy for combating infringement.

Mirrored by this complexity, many companies question the viability of China's courts as an option for fighting over intellectual property rights. The USCBC states that last year, 43 percent of respondents said that China's Courts remain not a viable option. While 54 percent of the respondents said they are viable. Even when companies are successful, however, the fines and punishments seem to fall short of adequate disincentives to misappropriate trade secrets.

Finally, concerns over intellectual property issues vary and are typically based on the type of property right and the industry. According to the USCBC survey, the top concern of intellectual property owners in China are patent rights, rated the highest concern among 35 percent of the respondents. Trademark rights are the top concern for 22 percent of the

respondents. On the other hand, misappropriation of trade secrets was the top concern for only 15 percent of the respondents.

V. Recent Important Cases – State Secrets or Trade Secret

Noteworthy in recent cases and often a very difficult distinction is the difference between a trade secret and a state secret in the People’s Court. The definition of a state secret is somewhat ambiguous and much broader than a trade secret. As such, a State Trade Secret can include the commercial trade secrets of major State-Owned Enterprises (“SOEs”), such as CNPC, SINOPEC, etc. A state secret can also include even minor secrets. Moreover, the legal liability of dealing state secrets is much higher than the liability of dealing commercial trade secrets.

To decipher whether the information communicated is a state secret and how to handle it, a few simple questions should be asked. First, are you dealing with a State, Provincial or local Government? Are you working with a State-Owned Enterprise (“SOE”)? If you are not sure whether the entity is a state owned enterprise, inquire at the Supervision and Administration Commission of the State Counsel to confirm the status of the entity. Another question to ask is: does the information falls within one of the seven categories outlined above, or is it marked in such a way to indicate the information is a State Secret? If all of the answers to each of above questions appear to be in the negative, ask the relevant entity in writing whether or not they are providing State Secrets. If you are still in doubt, seek permission from the relevant branch of the Ministry of State Security of China prior to reviewing, copying or removing any documentation.

The definition of a state secret in China is broad and encompasses a wide variety of different types of information. Both Chinese citizens and foreigners can be prosecuted for theft of a state secret. For foreign multinational companies (“MNCs”) doing business in China, properly managing legal risk related to state secrets in China is very important. For example, a recent misappropriation of state secrets case involved a US citizen Feng Xue (“Mr. Xue”). Mr. Xue, a geologist, is currently serving an eight-year prison term in China. The People’s Court’s opinion has not been made available to the public by the court. However, based on information reported by the news media, Mr. Xue was charged with misappropriation of state secrets which included the geological conditions of onshore oil wells and database information giving the coordinates of an estimated 30,000 wells that were owned by a SOE, the China National Petroleum Corp.¹² Mr. Xue collected this information for his former employer, IHS Inc., a U.S. company. In his defense, Mr. Xue argued that the information was widely shared in the global energy industry and that he did not know that he was dealing with national secrets. Together with Mr. Xue, Li Yongbo, a Chinese national was convicted by the court for his role in the case. Mr. Li was accused of helping Mr. Xue procure for HIS the database of 32,115 oil wells and

¹² <http://www.global-military.com/tag/oil-wells-coordinates>.

prospecting sites mostly owned by PetroChina Co. He received an identical sentence to that of Mr. Xue.

Notwithstanding, the media coverage of the Feng Xue case, significantly more Chinese citizens are convicted for stealing state secrets than foreigners in China, though these cases are not always as newsworthy as the Feng Xue case. The Rio Tinto case is exemplary, and also a good example of the murky line of what may be considered a state secret or a trade secret by the People's Court. Originally charged for stealing state secrets, a charge that was ultimately dropped, Stern Hu, an Australian, together with three Chinese citizens, was sentenced to 7 to 14 years in prison in China for theft of commercial secrets. Mr. Hu's jail term (seven years for bribery and five for stealing business secrets) had been reduced to ten years because he had shown remorse.¹³ Indispensable to a lucrative contract negotiation, the trade secrets in this case involved pricing structure information useful for buying and selling iron ore. The information included profit margins on iron ore imported into China and information obtained from state-owned steel mills. As reported in the court's decision, the behavior of the defendants had a serious impact on the negotiations and damaged the competition benefits of Chinese state owned steel enterprises greatly for importing iron ore. Nevertheless, the state secret misappropriation charges were dropped. In short, even for the Chinese prosecutor, to distinguish between trade secret from state secret can be difficult too.

Stolen trade secrets taken from within the United States to China have also been successfully prosecuted. In 2010, a former Ford Motor Co. engineer, Xiang Dong Yu, plead guilty in the Eastern District of Michigan to fleeing to China with trade secrets valued as high as \$100 million. Under a plea agreement with the US Attorney's Office, Yu faces fines up to \$150,000 and 5 to 7 years of imprisonment in a US federal prison after such time he faces deportation.

Similarly, in April of 2011, a jury in the State of California awarded a verdict of 2.3 billion US dollars against a Chinese medical device company for stealing confidential technical information and exporting it to China to start up a competing company. Mr. Zou, a former employee of Pacesetter Inc., a division of St. Jude Medical Inc., downloaded highly confidential technical information from a company database in breach of his confidentiality agreement with the company and before leaving his position at Pacesetter. Mr. Zou's intent was to save hundreds of millions of dollars in research and development expenses and jump years ahead in marketing implantable devices to the estimated \$4.6 billion Chinese market for such devices. The \$2.3 billion verdict included \$947 million for past harm, \$868 million for future economic losses, and \$500 million in punitive damages. Plaintiff is currently seeking an additional \$1.9

¹³ <http://www.theaustralian.com.au/business/mining-energy/rio-tintos-stern-hu-jailed-10-years/story-e6frg9df-1225847088979>.

billion in other punitive damages. Interestingly, Plaintiff only sought \$1.2 billion originally. Experts testified at trial that it should have taken 1-2 years to develop the product specifications. The defendant completed them in about 5 weeks. Defendant represented himself and did not appear at the trial. With an element of cynicism, the jury foreman commented “Good luck collecting.”

The primary trade secret issue for foreign multi-national companies (“MNCs”) doing business in China has two flavors: a) protection of trade secrets as trade secret owner; and b) prevention of illegally obtaining a third party's trade secret. Most MNCs doing business in China clearly focused on protection of trade secrets as trade secret owner because the potential loss of commercially valuable trade secrets is high in China. Depending on the level of importance, different level of protection measures and best practices can be adopted. On the other hand, prevention of illegally obtaining a third party's trade secret can be a much big issue for MNCs doing business in China as the potential criminal liabilities are high and the hurdle for being criminally liable is low.

We believe that the trade secrets of MNCs in China are protectable. The risk is manageable if proper protocols in place. The listed best practices work well in China. Many times, the protection of trade secrets in China is actually better than many parts of the world. Indeed, many misappropriated trade secrets were stolen by former employees employed by MNCs' HQs outside of China. So, it is very important to understand for MNCs to focus employees on the both sides of the world.

The PRC law carries heavy punishment for trade secret misappropriation including criminally punishable up to 7 years (see Rio Tinto case). In general sense, the PRC legal system is to a great degree, employer friendly. The heavy punishment for trade secret misappropriation under the PRC law is a double edged sword, however. With many employees in China having less or almost no experience of intellectual property rights, to avoid being exposed with third party trade secrets is a difficult task for MNCs doing business in China. Sometimes, the legal risk of being sued for trade secret misappropriation is higher than the legal risk of trade secret loss in China.

VI. Additional Best Practices

The enforcement of intellectual property rights continues to rank among the top concerns for foreign and domestic companies doing business in China.¹⁴ In a recent survey by the US-China Business Council (“USCBC”), companies have expressed the wide reaching impact that reflect company fears about intellectual property protections in China. These concerns effect

¹⁴ See, 2011 Special 301 Review, Submission of the US-China Business Council, February 15, 2011, www.uschina.org.

what products are manufactured or co-manufactured and sold in China as well as whether key business activities such as research and development activities are conducted there. For US software, music and movie companies, intellectual property piracy remains a top issue for doing business in China and the protection of such intellectual property rights is fundamental. Despite this, however, one-third of the overall respondents indicated that China's record has no impact on its business.

Nonetheless, in addition to making improvements on the enforcement of intellectual property rights, the USCBC recommends that China take a number of additional to improve its enforcement environment. The USCBC has encouraged China to eliminate the value-based thresholds on counterfeit goods for criminal prosecution, and increase the effective penalty levels for infringement by imposing a statutory minimum and maximum on fines. China's thresholds have been the subject of recent discussions. While there have been efforts by the PRC to lower these thresholds, it is believed that the thresholds remain too high to bring a significant number of infringement cases to criminal courts and thus to discourage counterfeiting. Indeed, in a recent survey by the USCBC, over 60 percent of the respondents state that the threshold level has had an impact on its IP rights and protections.

The establishment of a permanent State Council led interagency group to focus on enforcement has also been suggested. Simplification of procedures has been further suggested by the USCBC to encourage the initiation of investigations by local public security bureaus. Clear guidance and increased communication is needed in China between the central and local-level government agencies. It has been recommended, therefore, that there be sharing of information between provincial and local intellectual property rights regulators including experiences and best practices to promote more consistent enforcement.

As a general matter, for protection of IP in China, certain practices are recommended. First, make your IP protection a responsibility of your entire management team, not merely for the lawyers to handle. Dedicate resources that match your IP protection goals. Also, focus your efforts on human resources such as background checks on key hires and implement a non-compete and non-disclosure policy among all employees. Share information on a need to know basis and educate your employees about the confidentiality requirements of your company. Track data flows and file transfers including flash disks, portable hard drives and the like. Monitor employee access to sensitive facilities and equipment. Conduct exit interviews and recover any and all sensitive materials. Remind your exiting employees of their obligations.

Secondly, control your production processes such as compartmentalize critical steps in the design for products that are covered by patents and require the use of trade secrets. No employee should have access to all information regarding the process. Keep your vital designs and latest generation technologies at home. Bring to China only information that is necessary.

Classify your information and identify what level of employee can access what type of information.

Third, carefully monitor your suppliers and distributors. Be selective of your partners and make sure that they can demonstrate an understanding of the value of intellectual property rights. Manage your suppliers through multiple employees and personnel to limit the ability of abuse by local businesses. Review information that is to be sent to third parties before its transmission. In all of your contracts and agreements, you should include intellectual property clauses.

Fourth, you should build relationships with China's government officials at multiple levels including courts and IP-related governmental agencies. This is particularly true for companies with IP exportations problems. In this case, record your IP with the General Administration of Customs in Beijing.

Fifth, register all IP in China and as early as possible. Even for copyright matters where registration is not necessary, registration provides useful evidence in court. Send your representatives to visit trade fairs and industry trade shows to look for counterfeiters. Review the distribution networks of your products at all levels and do so regularly. Monitor IP publications, particularly PRC Patent and Trademark gazettes and check the internet regularly.

Sixth, send cease and desist letters to infringers and pursue legal action against them through the official channels available in China. Local authorities can carry out raids and investigations if so ordered by the administration authorities. Indeed, these actions are easier and faster than civil or criminal suits and can be used to halt infringement. As a caution, however, companies should be prepared to undertake a significant preparatory investigation prior to requesting for administrative action.

Finally, work with IP service providers and engage industry associations such as USCBC to exchange your own best practices and for information sharing. Also, work with local and national media to address negative publicity that may accompany the outcome of an IP case against your company.

Although there are business and legal risks in China when bringing trade secrets into the country and when receiving third party information, these risks are manageable if proper mitigation measures and best practices are adopted and implemented with diligence. One of the most important and key factors is a good understanding of the commercial and regulatory landscape in China. It is important, if not essential, to one's business to establish an in-country legal department and/or identified trusted outside counsel. A well-educated workforce is the best

defense and protection for information to be used in China, as “China is too large to ignore” for new business opportunities.¹⁵

About the presenter: Xiaobing Feng is a licensed attorney admitted to practice in Texas and before the US Court of Appeals for the Federal Circuit and the Court of International Trade. Mr. Feng is in charge of the intellectual property group of ExxonMobil (China) Investment Co. in Shanghai, China. Mr. Feng has a PhD in Chemical Engineering from Yale University and his JD from the University of Houston.

¹⁵ Wall Street Journal Online, www.wsj.com, *In China, a Battle Over Tire Secrets, Suit by US Chemical Maker Points to Foreign Companies Fear of Having Their Products Copied by Local Rivals*, by James T. Areddy, May 5, 2011.