

Protecting Your Trade Secrets in China

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Nearly all businesses in all industries and sectors possess trade secrets. Trade secrets are a valuable and highly useful form of intellectual property right. It is strongly recommended that you take the adequate steps to protect them because trade secrets can ensure your business advantage over competitors and by being able to prove that you made the effort to keep it secret, you have an option of enforcing your rights against those who misappropriate your trade secrets.

Unlike some other forms of IP rights such as patents and copyrights that have a finite term, trade secrets can theoretically enjoy an infinite term of protection so long as the trade secret remains just that - a secret. The main difference between protecting something by patent or as a trade secret is that, while technical information is publicly disclosed in patents, it is kept away from the public eye in trade secrets. A trade secret can last forever as long as the confidentiality measures that protect it continue to work. An invention patent typically expires after 20 years.

Perhaps the most classic example of a trade secret is the recipe or formulation for Coca-Cola. This has been closely

guarded for decades by The Coca-Cola Company, and nobody has been able to figure it out. Had the formulation been patented when it was first invented, it would have entered the public domain as soon as the patent expired.

On the other hand, legal protection of trade secrets is easily lost. Once the information becomes public information, it no longer enjoys any legal protection. As a result, prevention is the golden rule when it comes to protecting your trade secrets because once your secret is out, there is usually very little that you can do about it. China, like most other countries, provides a legal framework for the protection for trade secrets, and the law provides for remedies in the event that your trade secrets are unlawfully disclosed.

You can use the following steps to protect your trade secrets in China.

Step 1: Know Your Secrets

You can only protect trade secrets when you know you have them. But what exactly can be a trade secret? The universe of what can be a trade secret is vast, but there are certain requirements.

Funded by:



Simply calling something a secret is not enough. In China, by definition, a trade secret is any non-public information with actual or potential commercial value and that is guarded by confidentiality measures. Thus, in order for the information to be a trade secret, it must a) be non-public - it must not be known by the general public or by your competitors; (b) have actual or potential commercial value - it must give the owner a competitive advantage or be capable of generating economic benefit; and (c) guarded by confidentiality measures - the owner must take reasonable measures to protect the confidentiality of the information. All three elements are essential pieces of the puzzle.

If you are still unsure whether you have trade secrets, a good rule of thumb is to consider whether the information is something your competitors would want to know or that would give them a commercial advantage. Your trade secrets may include:

- (c) the status of products or services under development, expected product release dates, and details of how they function and their technical features, for example, new design features, a new interface, device functions, or how a new software program works, etc.;
- (d) valuable business information such as customer lists, cost and price information, suppliers and contractors, contract terms, marketing strategy and plans, etc.; or
- (e) any other information with potential commercial value such as your preferences with regard to customers or suppliers, rankings of quality of suppliers or creditworthiness of customers, etc.

If you have not already done so, it is important to catalogue what trade secrets you may have, rank the trade secrets in terms of importance and value, and to remember to periodically update your catalogue as your business grows.

Step 2: Keep It Secret, Keep It Safe

It is important to remember that once trade secrets become publicly known, they can no longer be protected as trade secrets. Ways in which a trade secret can be disclosed would include publication, disclosure of technical information by your engineer during a seminar, disclosure of information or documents during negotiations and other business dealings with third parties without a non-disclosure agreement, conversations, accidental disclosure by misdirected E-mails or other correspondence, etc.

Trade secrets differ from jewellery or other valuables in that they are not always in a tangible form, but as with anything of value, it is important to keep trade secrets secret and safe. Trade secrets may be stored in printed documents, CDs or DVDs, computer files and hard drives, USB drives, or even in your head. As it is not always practical or possible to keep trade secrets locked away, keeping trade secrets safe involves using a combination of physical, technical,



- (a) expressions of ideas that give your business a competitive advantage, for example, a new type of product, an innovative business model, or a new online concept, etc.;
- (b) know-how such as manufacturing or design techniques, skills, formulations, work-flow processes, quality control methods, knowledge, etc. relevant to the development, testing, and manufacture of your products, including also "negative know-how" or information learned during research and development on what not to do or what does not work;

and contractual barriers and implementing a trade secrets protection policy. Although some businesses go to great lengths to protect their trade secrets, any business can and should take simple, sensible precautions.

Physical barriers may include simply marking documents "CONFIDENTIAL", keeping sensitive documents in a safe, undisclosed location, and locking files away after business hours. In addition, access to areas where sensitive business documents are stored should be restricted to certain employees. Limit access and copying rights to the personnel who actually need it. All visitors should be logged, required to sign a non-disclosure agreement before being granted access to sensitive areas of your premises, and should not be left unattended.

Technical barriers require the use of information technology (IT) to protect trade secrets stored in electronic files on your computers or data servers. The basic rule in IT security is that the more valuable the information, the harder, more expensive, and more difficult it is to protect. Consulting an IT security specialist can help you to design a cost-effective IT security system. However, even simple, inexpensive means of IT security measures can be used such as employing the proper use of passwords, commercially available encryption, and logging features. In addition, it is important to have a written technology policy in place and to ensure that your employees abide by the technology policy. For example, as it is extremely easy for your employees to E-mail sensitive documents to third parties or to transfer files using USB memory cards or CD/DVDs, you might want to consider restricting the ability of your employees to use USB memory cards and burn CD/DVDs. Your employees in China should be given a copy of your technology policy written in both English and Chinese (possibly as an appendix to their employment contract) and be required to sign an agreement stating they received and understand the policy.

Contractual barriers generally involve the use of non-disclosure or confidentiality agreements. In fact, such agreements are generally considered as one of the best ways to protect your trade secrets.

You should require every existing employee and all new employees to sign an employment contract with non-disclosure or confidentiality provisions. For your employees in China, the contract should be in both English and Chinese to prevent an employee from claiming he or she did not understand the confidentiality obligations. Such agreements should also be entered into with suppliers, subcontractors and business partners who are given any level of access to your trade secrets.

Be sure to document the trade secrets protection measures you take and make sure your trade secrets protection policy is written down. It is also essential to maintain sufficient records of the flow of information in and out of your company, including keeping records of meetings, discussions, E-mails, written correspondence, and the transfer of electronic files so that you can conduct an investigation and have evidence in case you suspect your trade secrets have been misappropriated.

Finally, be vigilant in protecting your trade secrets and implementing your trade secrets protection policy. Businesses usually lose their trade secrets because they are too relaxed about keeping the information inside the company. Make sure your management is informed. Trade secrets are a double-edged sword. Your staff and workers must be told not only to protect your trade secrets but also not to obtain or utilise the trade secrets of others. Designating a person to be in charge of ensuring compliance with your trade secrets protection policy may be a useful option to consider.

Step 3: Don't Forget Your Employees

Most theft of trade secrets cases involve current or former employees, disgruntled or otherwise. It is simply the most common way trade secrets literally walk out the door. A typical theft of trade secrets case generally involves an employee leaving the company for a competitor and the company discovering shortly after that its competitor is selling a product that looks suspiciously familiar.

The best way to avoid such a situation is to have an employment agreement with non-disclosure

provisions. In addition, you should periodically and politely remind your employees about their confidentiality obligations. For employees who are leaving the company, be sure to hold exit-interviews, have them return documents, materials, computers, and files, and bring the non-disclosure agreement to their and their future employer's attention. For new employees, you should ask them whether they have a non-disclosure agreement with their former employer and to take appropriate steps to make sure you do not misappropriate their former employer's trade secrets. For an important or senior-level employee who is intimately knowledgeable about your business, you may want to consider also having a non-compete agreement, but make sure that it is of a reasonable duration and otherwise complies with China's Labour Contract Law.

Trade secrets may also be inadvertently disclosed by employees. For example, an overzealous engineer may give away too much technical information when giving a presentation at a conference. It is important to recognise that people simply love to talk, especially people like many engineers and designers who are passionate about their work. Also, in particular for China, your employees in China may not have the same understanding of IP rights and proprietary information or expectations about protecting such information as you do. These concepts are all relatively new after all. For example, your employees may not immediately understand that a project proposal or marketing proposal may contain valuable sensitive information. It is important that you periodically remind your employees what kind of information is proprietary, how it should be kept confidential, and what your expectations are.

Step 4: Dealing with Third Parties

Another common way trade secrets are disclosed is during business dealings or negotiations with third parties, whether it be potential partners, suppliers, contractors, licensees, or customers. Your trade secrets protection policy should address the protocol to be followed when dealing with third parties.

Generally, you should insist that both parties sign a mutual non-disclosure agreement before any discussions begin or documents are transferred. After the negotiations have reached a certain stage, both parties should enter into a Memorandum of Understanding (MOU) outlining the structure of the deal, what information will be shared, and the respective non-disclosure obligations of both parties. Finally, once an agreement has been reached, the final agreement should identify who owns what information, what information was exchanged, and the respective non-disclosure obligations of both parties. Explaining that it is your policy to have a non-disclosure agreement in place before negotiations begin is a good way to demonstrate your professionalism and respect for your counterparts' intellectual property rights. Having a non-disclosure agreement already drafted also helps to minimise the issue so that you can move forward with your negotiations.

Many foreign-invested small and medium-sized enterprises operating in China find it difficult to insist on a pre-negotiation non-disclosure agreement when dealing with Chinese parties. Chinese parties often claim that such requests are "hostile" or "unnecessary", and a handshake between friends should be enough. This together with the unpalatable prospect of losing a potential business opportunity because of what appears to be a rather minor issue, particularly for a small start-up business, often leads many small and medium-sized enterprises to move forward with negotiations without a non-disclosure agreement in place. However, this may prove costly when the other party starts using the information to compete against you. When confronted with such a scenario, it is important to know before you enter negotiations how far you are willing to skirt protections of your trade secrets and when to walk away. Try to develop the relationship and get to know who you are dealing with to see if they respect your IP rights. The party that refuses a reasonable request for a mutual non-disclosure agreement is also the party that is most likely to misappropriate your trade secrets and use them to compete against you. Finally, being business savvy can go a long way to protecting your trade secrets in such a situation. For example, if the

Chinese party in such negotiations requests to see your designs, you can request that they view them at your business premises or send them only rough sketches which just give a general idea but which are not detailed enough to be reduced to practice.

Even after an agreement is signed, it is important to make sure you continue to monitor your partners, suppliers or licensees to make sure they are complying with your trade secrets protection policy. You may wish to negotiate the right to make unannounced visits and to conduct periodic audits in your agreement.

Step 5: What to Do When Your Secret is Out

The key to protecting your trade secrets is prevention. China provides for administrative, civil and criminal protection for trade secrets, but by the time you have to consider legal action through any one of these channels, your trade secret and commercial advantage may already have flown away.

If you find that your trade secrets may have been

stolen, the first step is to conduct an internal investigation and to preserve as much evidence as possible, including preserving documents and E-mails. If necessary, it may be necessary to engage the services of an external investigator to investigate a particular employee or competitor. Once you have gathered all the information, you together with your lawyer can decide on the best course of action.

Litigation is the primary means by which you can pursue a remedy for the misappropriation of your trade secrets in China. If you are successful, the court can require the infringer to pay you damages and order the infringer to stop using the trade secret. In order to be successful in a theft of trade secrets case, you need to prove with sufficient evidence that a) you have and own the trade secret in question, including that it is tangible, has commercial value, and you have taken measures to protect it; b) that the defendant possesses information that is identical or substantially identical to your trade secret; and c) that the defendant used improper means to obtain it. The court will place a heavy burden on you to prove these



three elements with direct evidence. It is important to know beforehand that evidence in a Chinese litigation is almost exclusively in the form of documents and a court will usually not permit witnesses to testify on whether the trade secret exists or that the trade secret was stolen. There is no formal discovery procedure where you can compel the defendant to produce evidence in its possession. Although you can request the court to go to the defendant's business premises to preserve evidence, there is no guarantee that the court will find the evidence you need and might believe exists. Because of these reasons, it can be very difficult for you to prove trade secret infringement in China unless you have all the evidence already in your possession. Therefore, it is very important to have a sufficient record and proper documentation.

In addition to litigation through the court system, unlike in many other countries, China provides for administrative enforcement in trade secret cases. Instead of a court, an application is made to the local Administration for Industry and Commerce (AIC), a Chinese agency charged with administering various aspects of the operations of local businesses, which is empowered to carry out the enforcement action. It is possible to stop the sale of products manufactured using your trade secret and to obtain administrative penalties against the infringer ranging from RMB 10,000 to RMB 100,000. However, in practice, it can be difficult to get the AIC to accept your case, particularly if complex technology is involved. The administrative channel may be appropriate for simpler cases involving non-technological trade secrets that are easy to explain to the officials concerned.

Theft of trade secrets is also a crime in China where the loss to the injured party is significant, which involves a loss of more than RMB 500,000. Infringers may be fined and/or imprisoned for up to three years, or in very serious cases, such as those involving a loss of more than RMB 2.5 million, for up to seven years. If you believe the theft of your trade secrets constitutes a crime, you can also inform the local Public Security Bureau who can then decide whether or not to conduct a criminal investigation.

Take-Away Messages

- Prevention is the key to protection. More often than not, once a trade secret is disclosed, the damage is already done and it is often very difficult to recover its value, even if you succeed in litigation.
- Establish an internal management system for trade secrets. Training and clear written guidelines are essential. As your employees in China may not have the same understanding of proprietary information and intellectual property rights as you might have, it is important to educate them on what can or cannot be disclosed. Adopt appropriate measures to mark and store confidential documents whether such documents are in electronic or paper format.
- Require all employees to sign an employment agreement with strict confidentiality provisions. To win a theft of trade secrets claim in China, you must show that the information stolen is (1) not publicly known, (2) has commercial value, and (3) that you took measures to keep it secret. When a current or former employee steals your trade secrets, having an employment agreement with confidentiality provisions is essential to show that you took measures to keep it secret.



Trade Secrets Checklist

- Identify and catalogue your trade secrets
- Use a combination of physical, technical and contractual barriers
- Document trade secret protection measures you take, in case of a dispute later on
- Implement a trade secret protection policy within your company, making sure your employees understand your expectations
- Consider non-disclosure agreements before entering negotiations with third parties

SME Case Study

Background

A Chinese-foreign joint venture company ("Company A") was engaged in the development and sale of integrated circuit cards ("IC cards"). While still employed by Company A, an employee contacted a rival IC card manufacturer ("Company B") and helped it to establish a competing IC card manufacturing operation. Several months later, the employee quit. Almost immediately after the employee's departure, Company A discovered that Company B was selling an identical IC card system using nearly identical technology.

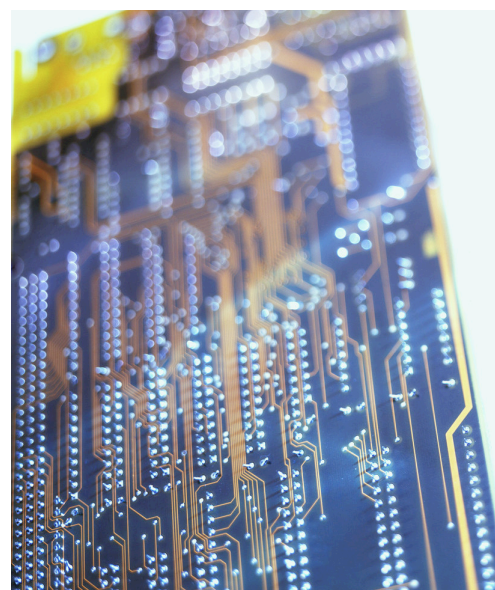
Actions Taken

Company A requested the court to preserve evidence from Company B's business premises and obtained the two computers containing Company A's software, Company A's design diagrams, customer lists, marketing materials, technical documents, and note from the employee containing technical specifications for modifying Company B's IC card software.

Company A then sued Company B and the former employee and provided evidence, such as Company A's employment contract including a confidentiality clause and agreement that IC card technologies developed by employees belong to the employer signed by the employee, striking similarities between the IC card systems, and a statement from a customer of Company A stating that the employee had copied Company A software from the IC card system that he had purchased.

Outcome

The People's Court determined that the Company A's IC card technology was a trade secret because the technical information disclosed had commercial value and the employment contract with confidentiality provisions demonstrated Company A's efforts to keep the information a secret. The court also found that the employee had disclosed the information without permission because the employee was simultaneously employed by both companies for a period of time, the Company B's product was almost identical to Company A's product, and Company A software and designs were found in the Company B's computers. The court awarded damages of RMB 136,450 (approximately EUR 14,800) to Company A.



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