

Newsletter No 107 (EN)

Protection of Trade Secrets in China

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1. Introduction

With the economic boom of Mainland China and the continuously growing volume of foreign direct investment, the question of how to protect trade secrets and pursue the liabilities of the infringers has become increasingly serious for foreign enterprises and foreign invested enterprises. This especially includes those doing successfully business since their entry into Chinese market. Those yet to enter the market will certainly benefit from understanding this issue and establishing sound mechanisms to tackle this problem. This Newsletter is an attempt to discuss some critical legal aspects of trade secret protection by analysing a representative case which has been included into the case database of the PRC People's Supreme Court.

2. Facts of the Case

YSJ Co., Ltd. (hereinafter referred to as “**YSJ**”) is a company engaged in providing enterprise consultancy services in the field of finance and management. Zhao was one of the founders as well as a director of YSJ. The company relies on its internal Management System (in this case called a DN 88 Management System) to manage and maintain a large amount of confidential client data and other business information, the access to which is restricted and requires authorisation within the company. As one of the senior management personnel, Zhao had been granted access to the internal DN 88 Management System.

Later on, Zhao chose to leave the company stating emigration as reason. However, in fact, Zhao never emigrated after leaving YSJ. Instead, he set up JSB Co., Ltd. (herein-

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after referred to as “**JSB**”) carrying on business which is completely identical to that of YSJ.

While competing with YSJ, Zhao and JSB presented the clients of YSJ to be those of their own and exaggerated the reputation and quality of services of JSB, based on which and slightly lower service prices, JSB managed to poach customers from YSJ. In order to protect its interest, YSJ sued Zhao and JSB at the Shanghai No. 1 Intermediary Court for infringement of trade secrets.

3. What qualifies a client list as trade secret?

During the proceedings, the intense debate between the plaintiff and the defendants was based on the question whether the customer list constituted a trade secret of YSJ.

A trade secret is defined by the PRC Anti-Unfair Competition Law (effective as of 1 December 1993) to have the following three features:

- It is not known to the public
- It is practically useful and may bring business profit to its owner
- Its owner has taken appropriate measures to keep it confidential

Business information shall simultaneously meet the aforesaid three conditions to be qualified as trade secret.

In the present case, since JSB was engaged in virtually identical business activities as those of YSJ, the court thus recognized that the relevant client information may generate business profit. During the court hearing, YSJ submitted invoices, payment receipts and relevant client information to prove that seven clients, who had been listed on the website of JSB as its clients, in fact were originally the clients of YSJ.

Furthermore, YSJ proved that it had taken a series of necessary measures including restricting authorization of access to the Management System, establishing internal confi-

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dentiality rules, incorporating confidentiality obligations into the labour contract with Zhao etc. to secure the confidentiality of the client information. Based on these evidences, the court concluded that YSJ had taken appropriate measures to protect its client information.

The defence side argued as its primary objection the fact that the related client information had also been publicised on the website of YSJ whereby it had become known to the public and thus was no longer confidential. The court eventually overruled the objection on the following ground:

Despite the fact that the related client names have been publicized on the website of YSJ, such names are merely abbreviations and did not reveal any core information such as contact methods, terms and conditions, transaction habits and intentions. Consequently, it cannot be proven that the related client information was already known to the public before being used by JSB.

This was the first case in which a court in Shanghai clearly recognized and supported the protection of client information as a trade secret. It can be practically concluded that client information which qualifies as trade secret cannot be a simple client list and must be specific and differentiated to such an extent that they cannot be easily acquired or accessed by the public. It was precisely because the client information in the present case fulfils this condition that it eventually qualified as trade secret.

4. Establishment of trade secret infringement and onus probandi

In judicial practice, the rule of “access and similarity” broadly applies in determining the *onus probandi* in trade secret infringement cases. According to this principle, given that certain information qualifies as a trade secret, if there is evidence proving that the alleged infringer was ever granted access to such information and the alleged infringer has disclosed or used information which is materially similar to the trade secret, the court will usually conclude there is an infringement, unless the alleged infringer can prove that he has obtained such information from a legal source.

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Two important principles underlie the rule of “access and similarity”: Firstly, the plaintiff only needs to assume the *onus probandi* gradually and accordingly; he is not required to completely disclose the trade secret and may gradually disclose the relevant parts of the concerned trade secret in response to the arguments of the defendant. Secondly, the *onus probandi* will shift to the defendant to prove the contrary under certain circumstances such as in cases of poached employees or manufacturing identical products. These principles were also applied by the court in the present case.

Therefore, YSJ was able to focus on evidences which could prove “access and similarity”. YSJ provided the court with the login interface of Zhao and the operational instruction of the subsequent interfaces after login, which proved that the access to the Management System was restricted and entailed authorization and as a partner Zhao was granted such access. This fact was reinforced by the evidence where Zhao approved internal employment and work data in his capacity as partner of the company. Furthermore, these pieces of evidences proved that important client information could be accessed via this system.

YSJ demonstrated that they used to provide finance consultancy services to a number of multinational companies since 2005. Other evidence proved that the same companies were listed on the website of JSB as customers of JSB. They had even been included into the service proposals made by JSB to its potential customers. The business relationship between JSB and the concerned customers of YSJ was thus established by the court.

Based on the above, the court found that Zhao was able to access the trade secret of YSJ and the business of JSB established by Zhao was materially similar to that of YSJ. It was eventually stated in the court verdict that the two defendants had been found liable for infringing the trade secret of YSJ and were ordered to jointly cease any infringement and compensate YSJ for its corresponding economic loss.

5. Conclusion

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While establishing a sound mechanism to protect their trade secrets, it is imperative for companies to take into account the features of trade secrets and the main principles and rules a court usually applies in infringement cases.

Similar to any type of civil proceedings, trade secret infringement cases can only be won with strong factual evidence and persuasive legal arguments. It is nevertheless more difficult to collect evidence and even organize a cohesive and well-built evidence chain in trade secret infringement cases than in most of other civil infringements cases.

Moreover, and with regard to compensation, due to the highly variable profitability of different industries and the lack of consistent practice, Chinese courts appear to be relatively more flexible and unpredictable in determining the amount of compensation it will grant and appear more susceptible to the quality of the evidences and arguments of both sides.