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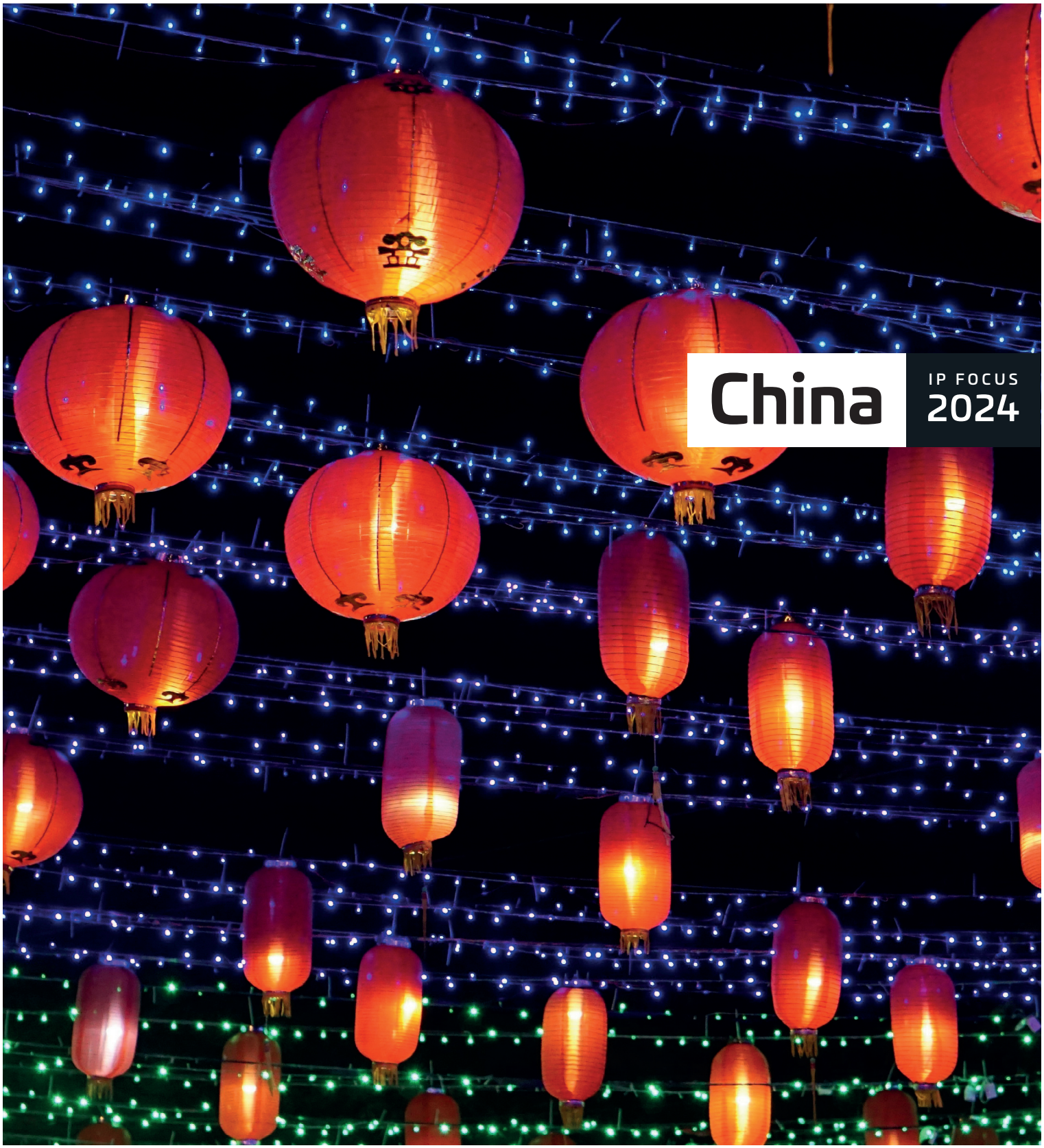

China

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China's labour and unfair competition laws: trade secrets, confidentiality, and non-compete issues

Feng Zheng and Xiaoyang Yang of Wanhuida Intellectual Property provide an insight into current Chinese practice concerning trade secrets and non-compete clauses/agreements based on the legal framework and recent court decisions

In today's highly competitive business environment, trade secrets are often pivotal in maintaining the competitive edge of innovative companies. In China, confidential information may be protected by way of trade secrets, but the law has a stringent legal test for what constitutes trade secrets and not all confidential information can pass muster.

Among other things, whether confidential information constitutes a trade secret in China largely depends on whether a proprietor has taken appropriate measures to protect the confidential information of commercial value. Furthermore, to invoke trade secret protection, the portion of the confidential information to be protected as a trade secret must be clearly identified.

This could be problematic in an employment setting: confidential information obtained during employment does not necessarily constitute trade secrets, but unauthorised use or disclosure of such information could still have an impact on the business of the employer. In those cases, non-compete clauses/agreements may kick in as a safeguard, provided that certain legal requirements are met.

By dissecting the legal framework and some recent court decisions on trade secrets and non-compete clauses/agreements, this article aims to provide a glimpse into how these two related, yet distinct, instruments operate to protect confidential information in China.

Trade secrets

In China, legal provisions regarding trade secrets are scattered across a number of laws, including the Anti-Unfair Competition Law, the Corporate Law, the Civil Code, the Labour Contract Law, and the Criminal Law; among which, the Anti-Unfair Competition Law is the major governing law.

Under Article 9 of the Anti-Unfair Competition Law, trade secrets are defined to be business-related information such as technical or operational information that is not known by the public, of commercial value, and safeguarded by appropriate protective measures by proprietors. Obtaining, disclosing, exploiting, or allowing others to exploit trade secrets without authorisation constitutes infringement of trade secrets.

Where infringement of a trade secret is claimed, the plaintiff bears the burden of proof to reasonably establish that the trade secret has been infringed upon (Article 32 of the Anti-Unfair Competition Law), despite appropriate protective measures having been adopted concerning the trade secret at issue.

Infringement could be preliminarily established, provided that the plaintiff shows that the defendant had a channel to access the trade secret at issue and the information the defendant illegally obtained or used is essentially identical to the said trade secret.

Once the plaintiff adduces the prima facie evidence, the ball will be in the defendant's court to argue non-infringement. No infringement can be found if the defendant obtained the trade secret at issue by reverse engineering, under Article 14 of the Provisions of the Supreme People's Court on Several Issues Concerning the Application of Law in the Trial of Civil Cases Involving Infringements upon Trade Secrets.

Thresholds in Chinese trade secret infringement cases

Given that the law sets a high bar for proprietors to satisfy the burden of proof, the chances of success in winning trade secret infringement cases is quite low in China. Statistics released by the Beijing Intellectual Property Court, one of the busiest courts hearing trade secret infringement cases in China, indicate that the court tried 86 trade secret infringement cases from 2021 to October 2023, of which the proprietors prevailed in only 15%.

Proprietors used to fret about the high threshold in satisfying the Chinese courts that sufficient protective measures have been taken to safeguard the trade secret at issue. Fortunately, the situation has significantly improved in recent years. This welcome change is partly attributable to the second amendment to the Anti-Unfair Competition Law, relaxing the stringent test over the 'appropriateness' of protective measures to a more reasonable level, and partly attributable to proprietors' increased awareness of trade secret protection.

Under current practice, the Chinese judiciary is prone to find that regular and reasonable internal measures employed by proprietors cut the mustard, such as setting forth confidentiality obligations in employment contracts, creating company policies specifying proper procedures regarding the handling of confidential information, and providing confidentiality training to employees.

However, the collection of evidence pertaining to unauthorised obtaining, exploitation, or disclosure of trade secrets by the accused and that relates to damages remains an onerous task for proprietors. Proprietors therefore rely heavily on parallel criminal prosecution proceedings to furnish evidence in trade secret infringement cases.

Yet in a recent court decision, *Ingersoll Rand v Sun* ((2020) Zui Gao Fa Zhi Min Zhong No. 1276), China's Supreme People's Court (SPC) sets a good example that a proprietor can still establish its case as long as effective and responsive measures are adopted within the company to protect the trade secret at issue.

Ingersoll Rand v Sun

In the case, the defendant, Sun, an ex-employee of Ingersoll Rand Shanghai, downloaded nearly 700,000 design figures from the company's database and saved them to external storage devices. Sun's anomalous downloading activities were immediately detected and investigated by his former employer.

Ingersoll Rand Shanghai requested Sun to turn in his computer for further investigation and during the ensuing interview, Sun admitted his misconduct and signed a confirmation statement. Ingersoll Rand Shanghai produced a notarial certificate for Sun's download history within the company's internal database, commissioned a judicial appraisal of Sun's computer and ex-

ternal storage devices, and applied for in-court inspection of Sun's download history.

In view of the evidence, the Shanghai Intellectual Property Court found that Sun infringed the trade secrets of Ingersoll Rand Shanghai in 2020. The decision was affirmed by the SPC the following year.

Other notable Chinese trade secret cases

It is also gratifying to see that the SPC has been aggressively raising the amount of damages since 2020. For instance, among the Ten Most Influential Cases released at the fifth anniversary of the SPC's Intellectual Property Court, there are four high-calibre trade secret infringement cases.

In the carbomer case of 2020 (*Guangzhou Tinci Materials Technology Co., Ltd. et al. v Anhui Newman Fine Chemicals Co., Ltd. et al.*, (2019) Zui Gao Fa Zhi Min Zhong No. 562), the SPC awarded RMB 30 million for damages. In the vanillin case of 2021 (*Jiaxing Zhonghua Chemical et al. v Wanglong Group Co., Ltd. et al.*, (2020) Zui Gao Fa Zhi Min Zhong No. 1667), the SPC awarded approximately RMB 159 million to the plaintiffs. In the melamine case of 2022 ((2022) Zui Gao Fa Zhi Min Zhong No. 541), the SPC awarded RMB 98 million. In the rubber antioxidant case of 2023 ((2022) Zui Gao Fa Zhi Min Zhong No. 816), the SPC affirmed damages of approximately RMB 202 million.

The vanillin case is an example of how proprietors may address the damages issue in trade secret infringement cases. In the case, the defendants defied the court order and refused to provide evidence on the sales of the infringing products.

The plaintiff presented three calculation models. The first model was based on the estimated operating profit of the defendants, calculated by the amount of infringing products manufactured and sold by the defendants × the plaintiff's selling price × the plaintiff's operating profit margin for the same period, giving a total of approximately RMB 179 million. The second calculation model was based on the estimated sales profit of the defendants, giving a total of approximately RMB 156 million. The third model was based on encroachment on the plaintiff's selling price, as calculated by an analysis report submitted by the plaintiffs, giving a total of approximately RMB 791 million.

The SPC chose the calculation method based on the defendant's sales profit, taking into consideration factors such as wilful infringement by the defendants, the scale of the infringement, the defendants' obstruction of evidence production, and bad faith, as well as two of the defendant companies being founded solely for implementing infringement. As a result, the SPC awarded approximately RMB 155 million for damages.

It is very welcome that the SPC pierced the corporate veil, holding the controller of a defendant company jointly and severally liable for the damages, along with other corporate defendants. It should also be noted that punitive damages were not meted out in this case, since the plaintiffs claimed damages for the period until the end of 2017, when the law did not provide for punitive damages at that time. However, the SPC indicated that the plaintiffs may seek punitive damages for the persistent infringement of the defendants after 2018.

Non-compete clauses/agreements

The purpose of non-compete clauses/agreements is to limit a party's ability to engage in unfair competitive activities. In China, non-compete clauses/agreements are mainly governed by the Labour Contract Law.

Article 23 of the law provides that an employer may introduce a non-compete clause in the employment contract or confidentiality agreement with its employees. Once the employment contract is terminated, the employer makes a monthly payment of financial compensation to its employees bound by the non-compete obligation, and the employees are liable for damages if they fail to meet the non-compete obligation.

Under Article 24, the non-compete obligation only applies to senior executives of the employer, senior technical staff, and other employees carrying the confidentiality obligation. The non-compete obligation prohibits employees from working in a competing busi-

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ness or starting up their own competing business for a maximum of two years.

A non-compete clause/agreement may be rescinded if the employer fails to comply with its contractual obligation to pay financial compensation for three months.

Wang v Wande Information Technology

Though non-compete obligations are widely recognised by the Chinese judiciary, there has been controversy over how a 'competing business' should be defined. In that regard, a guiding case published by the SPC, *Wang v Wande Information Technology* ((2021) Hu 01 Min Zhong No. 12282), sets a good precedent.

In that case, the accused, Wang, signed a non-compete agreement with his employer, an information technology company, where he worked as a data analyst. In July 2020, Wang resigned and joined another information technology company within two weeks of his departure, without reporting the new employment to his ex-employer as mandated by the non-compete agreement.

In November 2020, Wang's former employer filed a complaint with the Labour Dispute Arbitration Board, requesting compliance with the non-compete agreement, return of the received non-compete compensation, and liquidated damages of RMB 2 million for breach of his non-compete agreement.

In February 2021, the board returned a decision to fully support the claims of Wang's ex-employer. Wang filed a civil proceeding before a first-instance court, which partially sustained the arbitral award but reduced damages to RMB 240,000. Wang appealed. In 2022, a second-instance court ruled in Wang's favour, concluding that he did not breach the non-compete agreement.

The second-instance court reasoned that whether an employee breaches a non-compete agreement hinges on whether the employee's ex-employer and new employer are in competition. The court cautioned that such a finding shall be based on a comprehensive review of all the relevant facts, as a non-compete obligation limits the employee's rights to be employed. In that regard, the court noted that the scope of business as indicated in the business licence of a market entity is not necessarily consistent with its actual business activities. It is the latter that matters.

In that case, the court noted that while there was some overlap in the scope of business of Wang's former and new employers, the two employers differed markedly in their business modes, target customers, and target markets. Wang's former employer focused on providing financial information with individual and institutional investors as targeted customers, whereas his new employer operated a platform where users could upload videos and interact for entertainment purposes.

Accordingly, the court concluded that Wang's former and new employers were not in competition and Wang did not breach his non-compete agreement. The court repealed all the monetary damages awarded to Wang's ex-employer but further held that Wang would still be bound by his non-compete agreement and is obligated to notify his ex-employer about his employment condition until the expiry of the non-compete agreement.

Non-compete clauses as an alternative protection tool

Under the Chinese legal framework, non-compete clauses/agreements could be used as a complementary and alternative route to protect the employer's confidentiality. Unlike trade secrets, which are protected without a prescribed time limit until they become publicly known, a non-compete clause/agreement is valid for two years at most, provided that the employer complies with the clause/agreement and is mindful not to miss the payment of financial compensation for a prescribed period.

As such, it would be advisable for businesses to plan ahead and make the best of these legal instruments for confidentiality protection.

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