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Protection of Trade Secrets in China

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I. Introduction

As high quality and cheap labors were available in China previously and therefore foreign companies, including Japanese companies manufactured products in China and sold them all over the world. Due to the increase of labor cost, this business model could not be maintained by Japanese companies. It is, however, unable to ignore 1.3 billion market, thus the Japanese companies continue to manufacture in China and sell them in China.

For those Japanese companies staying in Chinese market, the protection of their trade secrets is critically important. Recent Chinese employees do not stay in the same company long. They normally do not care of using trade secrets of Japanese company.

In China, the legal system of protecting the trade secrets has been developed by new laws, judicial interpretations and court precedents.

The key is to administrate the trade secrets appropriately and educate the Chinese employees of the legal implications of the protection of trade secrets, including damage claims and criminal sanctions imposed on them upon the trade secrets infringement.

II. Protections of Trade Secrets under Chinese Law

1. Introduction

China joined World Trade Organization on 2001, and is now obliged to protect trade secrets held by the companies of member states (Article 39 (2) of TRIPS Agreement). Legislations themselves are significantly advanced in China.

2. Law of the People's Republic of China against Unfair Competition and Cases of Supreme People's Court

A. Law of the People's Republic of China against Unfair Competition

“Law of the People's Republic of China against Unfair Competition” (promulgated on September 2, 1993, and enacted on December 1, 1993) (“Anti-Unfair Competition Law”) regulates protection of trade secrets in China (“commercial secrets” under Chinese law).

B. Commercial Secrets

Commercial secrets consist of “technical information” and “operational information”. “Technical information” is technical and confidential knowledge that are not known to the public, have practicability, and may be acquired through actual experiences of manufacturing or technologies.

“Operational information” consists of operational secrets and management secrets. Operational secrets refer to secret information which relates to operation and close relatives such as customer lists. Management secrets refer to secrets related to organization and management such as management models, methods, experiences, and etc.

C. Requirements of Commercial Secrets

(1) Introduction

Under Chinese Law, the requirements of commercial secrets are (i) unknown to the public, (ii) being able to bring economic benefit to the right holder and being of practical use, and (iii) the right owner has taken confidential measures¹.

(2) Unknown to the Public

The term 'unknown to the public' refers to the inaccessibility of such information directly through public channels².

Also, “If the related information may not be aware of by the related personnel in the field therefrom and is difficult to be obtained, it shall be ascertained as unknown to the public”, and “In case of any of the following circumstances, it may be ascertained that the related information is not unknown to the public;

(i) It is the common sense or industrial practice as known by people in the related

¹ Article 10 (3) of Anti Unfair Competition Law

² Article 2 of “Regulations for Prohibiting Infringement of Commercial Secrets” (State Administration for Industry and Commerce enacted on November 23, 1995 and amended on December 3, 2008)

technical or economic field;

- (ii) It only involves the simple combination of dimensions, structures, materials and components of products, and can be directly obtained by observing the products by the public concerned after the products enter into the market;
- (iii) It has been publicly revealed on any publication or any other mass medium
- (iv) It has been publicized by reports or exhibits;
- (v) It can be obtained through other public channels; or
- (vi) It can be easily obtained with no price.”³

(3) Being Able to Bring Economic Benefit to the Right Holder, and Being of Practical Use

(i) Economic Benefit

Commercial secrets shall have economic value. That is, the secrets shall have value which may bring actual or potential economic benefit, or competitiveness to the right holder.

(ii) Practicability

Commercial secrets shall have practicability. The technical information or operational information shall be applicable to production or management, and produce positive effects.

(4) The Right Holder Has Taken Confidential Measures

Under Chinese law, “The security measures implemented by the right holders with a view to maintaining confidentiality as outlined in these Regulations include executing security agreements, setting up security systems and implementing other reasonable security measures.”⁴

It is important for right holder of commercial secrets to take this confidential measures to win at lawsuit regarding infringement of commercial secrets.

Also, “The people’s court shall ascertain whether the right holder has taken confidentiality measures in accordance with the features of the related information carrier, the willingness for keeping secret of the oblige, the identifiability degree of the confidentiality measures, the difficulty for others to obtain it by justifiable methods and other elements”, and “In case of any of the following normal circumstances that is sufficient to prevent the divulge of any classified information, it shall be ascertained

³ Article 9 of “Interpretation of the Supreme People’s Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition” (enacted on February 1, 2007)

⁴ Article 2 (4) of “Regulations for Prohibiting Infringement of Commercial Secrets”

that the right holder has taken confidentiality measures.

- (i) To limit the access scope of the classified information, and the contents shall only be notified to related personnel that must be aware of the information;
- (ii) To take such preventive measures as locking the carrier of the classified information up;
- (iii) To tag a confidentiality sign on the carrier of classified information;
- (iv) To adopt passwords or codes on the classified information;
- (v) To conclude a confidentiality agreement;
- (vi) To limit visitors to the classified machinery, factory, workshop or any other place or bring forward any confidentiality request; or
- (vii) Any other reasonable measure for guaranteeing the confidentiality of information.”⁵

D. Infringement of Commercial Secrets

(1) Introduction

Under Chinese law, below acts compose infringement of commercial secrets.

- (i) Acquiring right holder's commercial secrets through theft, inducements, threats, or any other unfair means;
- (ii) Disclosing, using or allowing another person to use the commercial secrets acquired from the right holder by the means mentioned in the preceding paragraph; or
- (iii) in violation of the agreement or against the right holder's demand for keeping commercial secrets, disclosing, using or allowing another person to use the commercial secrets he possesses.⁶

Commercial secrets are a kind of special intellectual rights, and the infringement of commercial secrets corresponds to tort. The approval of infringement shall be made pursuant to general requirements of tort. According to article 10 of Anti-Unfair Competition Law and general theory of Chinese tort, following points shall be noted in approving infringement of commercial secrets.

(2) Subject of Infringement of Commercial Secrets

Subjects of infringement of commercial secrets include following persons.

A. Employees of the Company

Employees of the Company refer to those who have access, understand and know the

⁵ Article 11 of “Interpretation of the Supreme People’s Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition”

⁶ Article 10 (1) of Anti-Unfair Competition Law

commercial secrets in the course of their business. These subjects include executives, R&D staffs, and sales department staffs.

B. Contractual Parties

Contractual parties refer to those who execute contract and are able to know commercial secrets. These subjects include contractual party of confidentiality agreements who use commercial secrets.

C. Third Parties (not including A and B above)

This category includes those who obtained commercial secrets through theft, inducements, threats and any other unfair means;

Employees of companies or parties of confidentiality agreements acquiring, using or disclosing another's commercial secrets by a third party who clearly knows or ought to know that the case falls under the unlawful means.

(3) Having Intent of Acquiring Commercial Secrets Directly

Those who infringe commercial secrets directly shall have intent to infringe the right of commercial secrets. Commercial purpose is not necessary.

(4) Infringing Commercial Secrets Objectively

Article 10 (1) and (2) of Anti-Unfair Competition Law provides 4 types of infringement of commercial secrets. However, this does not mean to deny other types of infringements, pursuant to Article 2 (2) of Anti-Unfair Competition.

A. Business Operator Acquiring Commercial Secrets Unfairly

The "Business Operator" refers to a legal person or any other economic organization or individual engaged in commodities marketing or profit-making services

(A) Disclosing, Using or Allowing another Person to Use the Commercial Secrets Acquired from the Right Holder by the Unfair Methods;

(B) In Violation of the Agreement or against the Right Holder's Demand for Keeping Commercial Secrets, Disclosing, Using or Allowing another Person to Use the Commercial Secrets He Possesses.

(C) Acquiring, Using or Disclosing Another's Commercial Secrets by a Third Party Who Clearly Knows or Ought to Know that the Case Falls under the Unlawful Methods.

Acquiring commercial secrets from those who directly infringed commercial secrets also corresponds to infringement of commercial secrets. In this case, the knowledge of direct infringement of commercial secrets are not necessary, and negligence is also included.

(5) Infringement of Commercial Secrets Causes Damage to Right Holder of Commercial Secrets.

(6) Causal Relationship Exists between Infringement of Commercial Secrets and Damage

(7) Judicial Interpretation regarding Protection of Trade Secrets⁷

Under Chinese Law, there are standards regarding the decision of infringement of commercial secrets in the following cases⁸.

A. Reverse Engineering

Article 12: As regards obtaining business secrets through development and research by itself or reverse engineering, it shall not be ascertained as an infringement upon business secrets as stipulated in Subparagraphs (1) and (2) of Article 10 of the Anti-unfair Competition Law.

Reverse engineering referred to in the preceding paragraph means to acquire the related technical information of the products in technical methods by way of disassembling, mapping or analyzing the products acquired from public channels. Any party concerned that knows the business secrets of someone else by unjustifiable methods and then claims its acquisition as lawful in excuse of reverse engineering shall not be supported.

⁷ Under Chinese Legal System, which originates from Civil Law, only the Statute law has binding authority but precedents. It is said that the quality of the judges differs among regions in China, it might be dangerous for the public interest if the precedents have binding authority. As the precedents cannot have the binding authority, it is difficult to have the uniform interpretation of statute. In China, the Supreme People's Court may issue judicial interpretation without actual case regarding the interpretation of Statute (Article 32 of Organic Law of the People's Courts of the People's Republic of China). According to article 5 of Regulations of the Court on Judicial Interpretations (promulgated on March 23, 2007 and enacted on April 1), the judicial interpretation issued by Supreme People's Court shall be legally binding.

Also, the Supreme People's Court Issued "Provisions on Case Guidance" in 2010, and issued concluded that case decisions (i) of wide attention from the society, (ii) when the law is not specific enough, (iii) typical, (iv) complicated or of new types of cases, (v) other cases of guidance, shall be regarded as guiding cases (article 2), and each judges shall refer to them in the similar cases (article 7).

⁸ "Interpretation of the Supreme People's Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition"

B. Customer Lists

Article 13: The client list in business secrets generally refers to the special client information that is different from related public information, including the name, address, contact information, business habits, intent, and contents of the clients and comprise the name roll of clients that collects lots of customers as well as the specific customers that have kept a long-term and stable transaction relationship.

3. Civil Remedy against Infringement of Commercial Secrets

A. Characteristic of Infringement of Commercial Secrets in China through Court Judgements

Through the analysis of recent court judgements, the overwhelming type of infringement of trade secrets in China is that the employees of right holder companies leak the commercial secrets to the third party during their tenure or after they resigned, or they establish competing companies and use the commercial secrets.

B. Points to Be Noted in the Trade Secret Disputes

(A) Advancement of Cases and Judicial Interpretation regarding Burden of Proof

a. Introduction

Each party owe burden of proof regarding statements which he/she claimed in the litigation. There are 6 types of litigation in which the defendant owe burden of proof, and the commercial secrets infringement case is not listed⁹.

Allocation of burden of proof relates to the results of the litigation. Plaintiff shall, as the right holder of commercial secrets, show the secrecy of commercial secrets and the defendant's infringement.

b. Cases

Regarding this point, on July 7, 2006, Guangdong high people' court ruled as below and rejected plaintiff's claim.

In the trade secret infringement case, the right holder's burden of proof contains two aspects. First, the right holder shall show that the trade secrets it claims fulfill the requirements provided in the article 10 of Anti-Unfair Competition Law.

Second, right holder shall show that infringer made an access to the trade secrets, and conditions that infringer acquires trade secrets were fulfilled or infringer acquired trade

⁹ Article 74 of Opinions of the Supreme People's Court on Some Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China cites

secrets unfairly such as by thefts, threats, etc.

Plaintiff has not submitted any evidences which support the above facts, thus plaintiff has not fulfilled this burden of proof.

c. 2007 Judicial Interpretation

On January 12, 2007, Supreme People's Court issued judicial interpretation which provides that right holder shall be responsible for providing proof to verify that (1) its business secret satisfies the statutory requirements, (2) the information of the other party concerned is identical or substantially identical with its business secret, and (3) the infringer has adopted unfair methods. This interpretation would be based on the above judgement¹⁰.

d. Problems of 2007 Judicial Interpretation and 2011 Judicial Interpretation

However, in these cases, it is normal that the infringers theft them secretly. Thus the right holder have difficulty to show how the infringers acquired commercial secrets. Therefore, this ruling of burden of proof may prevent right holder from winning the case.

Hence, the Supreme People's Court issued new judicial interpretation, under which the Court approved that the burden of proof may be reduced in trade infringement case saying that "Where an owner of trade secrets provides evidence proving that the information of the respondent is the same or substantially the same as its trade secrets and the respondent is capable to access or illegally obtain such trade secrets, if it can be presumed that the respondent is likely to have resorted to illegal means in light of specific situations of the case or the known facts and daily life experience, courts can presume that the respondent actually obtained the trade secrets by illegal means, unless the respondent can prove that it obtained such information by legal means"¹¹. This is the present standard of allocation of burden of proof in the commercial secrets infringement lawsuit.

(B) Protection of Commercial Secrets in Civil Procedure

As above, in the commercial secrets infringement lawsuit, plaintiff shall show the commercial secrets. But this cause a risk of the commercial secrets being leaked to the other parties or the third parties, which may shrink right holders to enforce their rights.

¹⁰ Article 14 of "Interpretation of the Supreme People's Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition"

¹¹ Article 25 of "Opinions of the Supreme People's Court on giving full play to the functional role of intellectual property trials in advancing the great development and prosperity of socialist culture and promoting independent and coordinated economic development"

In order to avoid this, the Supreme Court issued an opinion providing that courts shall take measures to protect trade secrets when adjudicating the trade secret cases. The courts shall explore the following protection measures: (a) Only allow lawyers to review or examine evidence containing confidential information; (b) Require the execution of confidentiality agreements; or (c) Disclosure of confidential information in different stages¹².

(C) Interim Measures

In practice, when commercial secrets were infringed, it is crucial to take methods such as ordering infringer to cease using commercial secrets or producing goods by using them, in order to minimize the amount of damages.

In this case, plaintiff may, after filing the case to the people's court, request the court to take interim measures to cease production or sales of goods.

Under Chinese Law, the people's court may, upon application of the party concerned, order advance execution in respect of cases involving urgent circumstances that require advance execution¹³.

However, in this interim measures, it is necessary to provide securities to the people's court when applying the measures.

(4) Amount of Damages

It is difficult for plaintiff to show the amount of damage caused by the infringement of commercial secrets (balance between financial situation of plaintiff if there was no infringement and that of present).

In order to reduce this burden, the Supreme People's Court issued a judicial interpretation which provides that "it may be performed with reference to the methods of determining damages for patent infringements"¹⁴.

Chinese patent law provides that "The amount of compensation for patent right infringement shall be determined according to the patentee's actual losses caused by the infringement. If it is hard to determine the actual losses, the amount of compensation may be determined according to the benefits acquired by the infringer through the infringement. If it is hard to determine the losses of the patentee or the benefits acquired by the infringer, the amount of compensation may be determined according to

¹² Article 25 of "Opinions of the Supreme People's Court on giving full play to the functional role of intellectual property trials in advancing the great development and prosperity of socialist culture and promoting independent and coordinated economic development"

¹³ Article 97 (iii) of Civil Procedure Law of the People's Republic of China

¹⁴ Article 17 of "Interpretation of the Supreme People's Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition"

the reasonably multiplied amount of the royalties of that patent. The amount of compensation shall include the reasonable expenses paid by the patentee for putting an end to the infringement.

If the losses of the patentee, benefits of the infringer, or royalties of the patent are all hard to determine, the people's court may, on the basis of the factors such as the type of patent right, nature of the infringement, and seriousness of the case, determine the amount of compensation within the range from 10,000 yuan to 1,000,000 yuan¹⁵.

(5) Supreme People's Court Cases regarding Protection of Trade Secrets

On August 9, 2007, the Supreme People's Court made judgement in favor of claim of damages by infringement of commercial secrets at the following case.

A. Outline of Fact

A and B, who were employees of plaintiff, executed employment agreement and confidentiality agreement with plaintiff. After A resigned and joined defendant, A used customer lists which he acquired during his previous position, and conducted export business. B also changed his job to work for defendant, and used plaintiff's customer list and conducted export business.

Plaintiff, knowing this fact, filed damage lawsuit against the defendants on the grounds of infringement of commercial secrets.

B. Supreme People's Court Decision

The Supreme People's Court ruled as follows, and ordered defendant to 934,834 CNY. Plaintiff is the trading company, and used customer list, thus it fulfills the requirement of subject of right holder.

The information listed in the customer list which defendant is said to be used unfairly has valuable information such as trade customs, payment form, intent to purchase goods, etc. The value of these information can be approved by the fact that there were advancement in trade opportunity, sales route and sales profits.

These trade information contain value as commercial secrets, as it helps to enhance competitiveness in broadening clients of export business, generate economic value, and actual advantages in competition. Plaintiff took confidentiality methods such as placing personal computers for each employees, giving passwords, and signing confidentiality agreements. Under ordinary situation, it is enough to prevent leakage of confidential information, and it fitted for fulfilling conditions of confidentiality methods.

¹⁵ Article 65 of Patent Law of the People's Republic of China

Therefore, the operational information listed in the customer lists corresponds to commercial secrets.

The defendant knew that when it hired A and B, they worked for plaintiff, and administrated operational information owned by plaintiff. And under the situation that A and B made massive export deal regardless of few customer information, the defendant owed duty to investigate them such as interviewing how they obtained operational information to start new export deals. However, the defendant did not conduct interviewing to A and B, and it did not instruct to cease new export deal, thus the defendant has negligence. Therefore, the defendant owe civil liability to compensate plaintiff regarding unfair competition acts conducted by A and B using plaintiff's commercial secrets.

Also, regarding calculation of damages in infringement of commercial secrets, it could be calculated pursuant to methods of infringement of patent (Article 17 (1) of Interpretation of the Supreme People's Court on Some Matters about the Application of Law in the Trial of Civil Cases Involving Unfair Competition). Under Article 20 (3) of Interpretations of the Supreme People's Court on Certain Issues Concerning the Application of Law in the Trial of Patent Infringement Cases, the courts may approve the operational benefits as acquired by use of said customer lists as the benefit of those who infringed commercial secrets.

4. Administrative Measures against Infringement of Commercial Secrets

A. Competent Authorities

Industrial and Commercial Administration Bureau shall be the competent authorities of commercial secrets protection¹⁶.

B. Administrative Mediation

The owner of the commercial secrets may request State Administration for Industry & Commerce for mediation for compensation and it may operate the mediation procedure¹⁷.

C. Administrative Order and Sanction

Article 25 of Anti-Unfair Competition Law provides that in case a business operator violates the provisions of Article 10 of this Law and infringes trade secrets, the Industrial and Commercial Administration Bureau shall order the ceasing of the illegal

¹⁶ Article 3 (2) of Anti Unfair Competition Law provides that

¹⁷ Article 9 of "Several Provisions on Prohibiting Infringements upon Trade Secrets"

acts and may impose a fine of not less than 10,000 yuan but not more than 200,000 yuan in light of the circumstances.

5. Criminal Measures against Infringement of Commercial Secrets

A. Protection of Commercial Secrets under Criminal Law

Chinese Criminal Law provides that whoever acquires an right holder's commercial secrets by stealing, luring , coercion or any other illegitimate means; (2) discloses, uses or allows another to use the commercial secrets obtained from the right holder by the means mentioned in the preceding paragraph; or (3) in violation of the agreement on or against the right holder's demand for keeping commercial secrets, discloses, uses or allows another person to use the commercial secrets he has, and thus causes heavy losses to the right holder shall owe criminal liability of infringing commercial secrets. Also, paragraph (2) provides that whoever obtains, uses or discloses another's commercial secrets, which he clearly knows or ought to know falls under the categories of the acts listed in the paragraph 1, shall be deemed as an infringer who infringes on commercial secrets¹⁸.

B. Occurrence of Damage and Penalty

According to the judicial interpretation, the losses of more than RMB 500,000 is the requirement, and to the oblige of business secrets and if there are losses of more than RMB 2.5 million, fixed-term imprisonment of not less than three years and fine¹⁹.

6. The Appropriate Measures of Protection of Trade Secrets for Japanese Companies

The most desirable measures for Japanese companies would be amicable settlement, by entrusting Chinese attorneys to negotiate injunction or damages. However, there are some Chinese individuals or companies who do not cease using trade secrets until the judgment is rendered. In this case, it is necessary to file litigation and also take preservation measures. Regarding injunction, administrative measures may be an option, which enable right holders to collect necessary information for damage litigation.

III. Protection of Commercial Secrets under Employment Agreement

1. Introduction

In China, it is often the case that employees leak the commercial secrets which he

¹⁸ Article 219 (1) of Criminal Law of the People's Republic of China provides that

¹⁹ Article 7 (1) of “Interpretation by the Supreme People’s Court and the Supreme People’s Procurate on Several Issues of Concrete Application of Laws in Handling Criminal Cases of Infringing Intellectual Property”,

acquired in his previous working place to his new working place which is the competing companies. Therefore, it is necessary to include confidentiality duty and non-competition duty in the employment agreement.

2. Risk of Hiring Chinese Employees in the Japanese Companies

Foreign companies which have production base in China, including Japanese companies, have been hired good Chinese workers in short-term and economically reasonable conditions. This was to enable employers to fire employees at any time, and easily. As a consequence, Chinese workers who work in foreign companies tend to change jobs or begin their business in short terms, seeking for better treatments. Especially, Japanese companies hesitate to pay high salaries to Chinese workers except executives. It is no exaggeration to say that Chinese workers have strong motives to steal commercial secrets, such as customer information.

3. Confidentiality Duty

Is necessary for Japanese companies to impose confidentiality duty to Chinese workers. In that case, the scope of confidential information, the contents of duty, and the amount of indemnity should be clarified.

For example, below sample may be referred.

Article 1 Confidentiality Duty

1. Employees shall keep confidentiality of Commercial Secrets which were disclosed from the Company. In this agreement, "Commercial Secrets" refer to all information materials of scientific research, sales, production and management, and sales materials, financial materials and R&D project, products, procedure, operation and service materials of the Company, the Associated Companies and the Associated Enterprises, and the all secret matters which are disclosed to the employees by the Company, or the employees should be able to know. Provided, however, those which became publicly known for any reason not attributable to employees.

2. Employees approve that the Company holds rights related to Commercial Secrets.

3. Employees shall not disclose, leak, publicize, offer, etc. Commercial Secrets directly or indirectly to the third parties (including managements or workers who are not employees) without written approval by managing director of the Company in advance.

Provided, however, that the employees may do so for the legitimate purpose of the business of the Company.

4. Employees shall not copy, translate, summarize or originate data of all or part of Commercial Secrets without written approval by managing director of the Company in advance. Provided, however, that the employees may do so for the legitimate purpose of the business of the Company.

5. Employees shall use Commercial Secrets for performing the operation of the Company in accordance with employment contract between employees and the Company (“Employment Contract”) only, and not for other purposes.

6. Employees shall keep the Company rules regarding confidentiality of the Company, and follow the instruction of the person in charge of managing Commercial Secrets.

7. Employees shall not approach or obtain Commercial Secrets which are not approved to do so by the Company for the purpose of operation.

8. Employees shall use or keep the Commercial Secrets in the location appointed by the Company. Employees shall not bring materials or data such as lists or manuals relating to the Commercial Secrets without the written approval of the managing director (including but not limited to bringing out by hard copy or CD-ROM, or sending E-mail).

9. Employees shall cease using materials relating to Trade immediately, and Secrets and return them to the Company in case the Employment Contract is terminated by expiration, termination, etc., or by Company’s request.

10. Employees shall cooperate with the Company in free charge in case the Company intends to hold or enforce rights relating to Commercial Secrets such as obtaining, application, preserving, registering, renewing the rights, filing litigation, stating in the litigation, etc.

11. Employees shall, in case they find the violation of duty listed in the paragraph 1 to paragraph 10, or the risk of violation of such duty by the managements or other workers, report to the person in charge of managing Commercial Secrets. In case the employees find the lack or loss of Commercial Secrets for some reasons, they shall take remedy

methods, and report in accordance with employment rules.

Article 2 Methods in Termination of Employment Contract

1. Employees shall, after the termination of Employment Contract by expiration, termination or other reasons, destroy or return the materials relating to Commercial Secrets in accordance with the request by the Company, and sign the covenant of confidentiality duty after the termination of Employment Contract.

2. The duties of employees provided in this Contract shall, after the termination of Employment Contract by expiration, termination of other reasons, exist until they become publicly known for the reasons not attributable to the employees. Employees shall, comply with these duties after the termination of Employment Contract.

Article 3 Damages

Employees shall compensate the Company in case they violate the confidentiality duty hereof and cause damages. The amount of damages shall be at least the double of the annual salary of latest year. In case the Company shows the exceeding amount of damages, the employees shall pay the remaining balance.

4. Non-Competition Duty

A. Nature of Non-Competition Duty

Japanese companies may impose non-competition duty to Chinese workers²⁰. By this duty, employees may not work for the competing companies, nor start their own business which competes with the company. It is not required to obtain approval of the employees, because it is the companies' rights.

B. Timing of Imposing Non-Competition Duty

Non-competition duty arises after the resignation of the employees, and it is not negligible to request non-competition agreement to the employees before their resignation. However, employees have rights to resign, and even though they do not agree with non-competition duty, they may resign. Therefore, it is necessary for the companies to execute employment agreement which includes non-competition clause.

C. Subject of Non-Competition Duty

Those who owe statutory non-competition duty are limited to executives of the

²⁰ Article 23 of Labor Contract Law of People's Republic of China

companies, highly leveled engineers, and other employees who owe confidentiality duties²¹. However, the companies may impose confidentiality duty to all Chinese workers by employment agreement. Therefore, in practice it is possible to impose non-competition duties to all Chinese workers.

D. Scope of Non-Competition Duty

In case the companies impose non-competition duty to the employees, they shall consult with the employees and confirm areas, terms and scope of business prohibited. Terms of non-competition shall not exceed 2 years²².

E. Economic Compensation Duty

Companies shall provide economic compensation each month to employees who are in non-competition terms²³. This economic compensation shall be paid every month after they resigned, and the salaries paid to employees during their tenure shall not include the above compensation.

The regulation of the amount of compensation varies among areas. For example, in Zhongguancun, Beijing, the compensation shall not fall below half of previous annual salary (Article 44 of Ordinance of High Technology Park, Zhongguancun, Beijing).

On the other hand, there is no regulation in Guangzhou, and in case there is a dispute, the court may decide the actual amount of compensation by considering contents of non-competition duty and impacts to the employees.

F. Exemption of Non-Competition Duty

As above, companies may impose confidential duty and non-competition duty to all Chinese employees²⁴. On the other hand, companies owe compensation duty to said employees. Therefore, Japanese companies shall, when hiring Chinese employees, at its discretion, choose employees who should owe non-competition duty.

G. Examples of Non-Competition Duty

1. Employees shall not, during their tenure, engage in business which competes directly or indirectly with the Company.
2. Employees shall not, during their tenure, work for other economic organizations,

²¹ Article 24 of Labor Contract Law of the People's Republic of China

²² Article 24 of Labor Contract Law of the People's Republic of China

²³ Article 23 of Labor Contract Law of People's Republic of China

²⁴ Article 24 of Labor Contract Law of People's Republic of China

individuals, etc. except from the Company. Employees shall also not offer consulting, or other business activities to other economic organizations, individuals, etc. except from the Company.

3. In case the Company requests at the time when the employment agreement terminates by expiration, termination or other reasons, employees shall not engage in business, establish a company or run a company which competes directly or indirectly with the Company for the terms and within the areas designated by the Company.

4. The Company shall compensate employees who owe non-competition duty while such duty exists. The economic compensation shall be [30%] of monthly salary which is paid to them at the previous month of the last business day of them. The payment shall be made 15th of each month.

5. The Company may exempt non-competition duty to the employees who resigned the Company at its discretion. In case the Company exempts non-competition duty, it may not pay compensation to the employees.

5. Damage

If employees breach the confidentiality clause or non-competition clause and cause damage to the company, the company may claim compensation to the employees. When employees breach the above clauses and leak trade secrets to the competing parties after the termination of the employment contract, article 6 of “Measures Concerning Economic Compensation for Breach and Termination of Labor Contracts” (promulgated and enacted on May 10, 1995) shall be applied. If the company hires the employee who has not terminated previous labor contract yet and cause economic damage to the former employer, the employer, as well as said employee, shall jointly be liable for compensation. The amount of compensation shall not fall below the 70% of economic damage the former employer suffered. The scope of compensation shall be (i) economic damages directly occurred in manufacture, operation and activities, and (ii) economic damages occurred by obtaining trade secrets. The damage (ii) shall be decided pursuant to article 20 of Anti-Unfair Competition Law.

6. Importance of Employee Education for Protecting Trade Secrets

As above, Chinese workers often lack importance of protecting trade secrets of Japanese companies. Thus it is essential for Japanese companies to educate Chinese workers the

protection of trade secrets. For example, preparing company rules and holding company seminars regularly. By these activities, Chinese workers may learn that infringement of trade secrets leads to civil, criminal and administrative liability, the amount of damage liability may be large if they gain profits, and that the new employer or the newly established company by themselves may jointly owe liability. It is necessary for Japanese companies to make efforts to have Chinese workers lose the incentives to infringe trade secrets,

IV. Conclusion

It becomes an unrealistic business model to manufacture in China as the world's factory, and sell the products worldwide. However, it is also impossible to neglect the Chinese 1.3 billion market, with the boosted purchasing power, and companies need to expand their business in China, by manufacturing and selling in China. For Japanese companies who expand their business in China, it is necessary to prepare against infringement of trade secrets by Chinese workers.

The Chinese legislation regarding protection of trade secrets is quite advanced considering judicial interpretations. However, in order to protect trade secrets in practice, Japanese companies shall control these trade secrets thoroughly. The statements and proof of the infringement of trade secrets are tough. Thus it is desirable to take amicable negotiation to prevent leak of trade secrets and claim damage. In case the infringement do not cease, a civil litigation would be essential. But regarding injunction only, it could be a possible option to use administrative procedure, which enables companies to collect necessary information for lawsuits.

For the purpose of protecting trade secrets of Japanese companies in China, Japanese companies also need to educate Chinese workers to have them recognize the importance of protecting trade secrets and criminal sanctions, which decreases or extinguishes the incentives of infringing trade secrets.

(Over)