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LUNG TIN IP ATTORNEYS

# NEWSLETTER

## 知产快报

● An option for victims of trade secret theft, though often overlooked, is the initiation of criminal proceedings, in parallel with or alternatively in lieu of civil litigation. Currently, China does not have a trade secret law, and China's rules defining and regulating trade secrets are scattered among a series of laws and regulations. The most important of these is the Anti-Unfair Competition Law (2017) which in Article 10 defines the trade secrets as technical and business information that is unknown to the public, that may create business interests or profits for its legal owner, and that is the subject of reasonable measures to maintain secrecy by its legal owner. For initiating criminal proceedings, companies have to demonstrate sizable losses due to trade secret infringement.





## Difficulties and Practical Tips: Enforcing Trade Secret Rights through Criminal Prosecution in China

An option for victims of trade secret theft, though often overlooked, is the initiation of criminal proceedings, in parallel with or alternatively in lieu of civil litigation. Currently, China does not have a trade secret law, and China's rules defining and regulating trade secrets are scattered among a series of laws and regulations. The most important of these is the Anti-Unfair Competition Law (2017) which in Article 10 defines the trade secrets as technical and business information that is unknown to the public, that may create business interests or profits for its legal owner, and that is the subject of reasonable measures to maintain secrecy by its legal owner. For initiating criminal proceedings, companies have to demonstrate sizable losses due to trade secret infringement.

In practice, many companies often found that their filings with a public security bureau ("PSB," i.e., police) for trade secret criminal investigation were rejected or required to submit additional materials to supplement the filings. Some lawyers report that "difficulty to file a case" is the primary problem in pursuing trade secret criminal cases.

### I . Difficulties in Initiating Criminal Proceedings for Trade Secret Infringement

First of all, the procedure for criminal proceedings is complicated. According to the criminal procedure system in China, once a local PSB has investigated, he should turn over the case to procuratorate for examination and prosecution. If procuratorate has decided not to prosecute, it often means the investigation may have flaws, which, in turn, affects the motivation of the PSB to accept a case for investigation. Although in general prosecution rate from procuratorate is very high (i.e., the Supreme People's Procuratorate reports that from 2013 to 2016, prosecution rate is 98.6%<sup>1</sup> nationwide), the prosecution rate of trade secrets infringement is relatively low as indicated in a report from 3rd branch of Shanghai Procuratorate (i.e., from 2010 to 2018, the number of examination and arrest of trade secrets infringement case is 26 involving 46 persons and 5 companies, while only 9 cases, 19 persons and 4 companies is prosecuted for trade secrets infringement with 65% of non-prosecution rate<sup>2</sup>). Such a low rate would make a PSB more and more cautious in accepting a

criminal case of trade secrets infringement.

Why criminal cases are difficult? We conducted a research and reviewed published judgements: among selected 221 criminal judgments for infringing trade secrets, there are 6 judgments declaring the suspect(s) innocent or

not convicting crime including 4 cases where information involved did not constitute trade secrets and 2 cases where the losses cannot be calculated to meet the threshold of criminal prosecution. This result corresponds with opinions from commentaries, for instance, Fang Changying opined that the criteria of calculating the loss is unclear; Zhang Zhongqing elaborated three issues in criminal prosecution of trade secret infringement (i) too many requirements and high threshold in filing a case, (ii) inaccessible to evidences of infringement, and (iii) disputes in loss calculation.<sup>3</sup> Through the above research, we summarize difficulties in initiating criminal proceedings in trade secret infringement as follows.

*1. It is difficult to prove that information involved is not known to the public*

It is reasonable for trade secret owners to bear the burden of proof when filing a case since only they can prove information involved is trade secrets. According to 2nd section of article 219 of

<sup>1</sup> Refer to Report of the Supreme People's Procuratorate on Strengthening Investigation Supervision and Preservation of Judicial Justice (Summary)

<sup>2</sup> Refer to A case of infringement of trade secrets has been prosecuted by the Shanghai Procuratorate 3rd branch recently issued by Wechat official account, "Shanghai Procuratorate 3rd branch" on 17th October, 2018.

<sup>3</sup> Refer to Current Situation and Prospect of Trade Secret Protection issued by Wechat official account, "Shanghai Procuratorate 3rd branch" on 1st November, 2018.



*Criminal Law, trade secrets refer to technical and operation information not known to the public and can bring economic benefits to the obligee with practicability and subject to secrecy measures taken by the obligee.* The trade secret owners should provide three sets of evidences. The first is that information involved is unknown to the public. Secondly, information involved can bring benefits to bligee with practicability. Last but not least, obligee takes secrecy measures to protect information involved from exposure. Among them, the first one is the most difficult to prove. The aforementioned cases demonstrate that in judging whether it is "not known to the public", the court adopts an absolute criterion, that is, as long as there is or may be evidence to prove that the information involved has been made public, it is not thought to be "not known to the public". Take *Zhejiang Fu Rui De Chemical Co., Ltd case, Zhang and others committed crime of infringing trade secrets, and Wang committed crime of infringing trade secrets* cases for example<sup>4</sup>, the court declared suspects innocent because the conclusion of "not known to the public" in appraisal reports was suspicious. In practice, in order to prove the information involved is "not known to the public", the trade secret owner usually submits an appraisal report, but some business information such as customer lists does not belong to the scope of appraisal. Thus, it is very difficult to prove "not known to the public". This is also the reason why infringement of business secrets is rarely remedied through criminal proceedings.

*2. It is difficult to prove that trade secret owner takes reasonable measures to protect information involved from exposure*

The information can be deemed as trade secrets legally only if the trade secret owner takes reasonable measures to protect it from exposure. However, at the stage of evidence submission, the owner hardly can submit evidences meeting the burden of proof although the owner has already taken secrecy measures. We take *Zhejiang Fu Rui De Chemical Co., Ltd case, Zhang and others committed crime of infringing trade secrets, and Zhang committed crime of infringing trade secrets* cases for example<sup>5</sup>, the court

declared suspects innocent on the basis of failure to verify NDA between parties. The similar problem of insufficient evidence to prove secrecy measures to be taken is very common. The reason lies in the deviation of obligee's management which only pays attention to physical protection of carriers of trade secrets but does not express obligation of confidentiality to obligors; or although there is an explicit obligation of confidentiality, but not be recorded as admissible evidence, which leads to difficulties in proof.

*3. It is difficult to prove the "tremendous loss" caused by infringement of trade secrets*

As an intellectual property right, the economic value of trade secrets can be assessed by evaluation. However, unlike common property crime, the major loss of the crime of infringing trade secrets cannot be equated with the value of trade secrets itself. "Because traditional crime of infringing tangible property, such as theft and fraud, is direct acquisition of property, deprive legitimate owner the original property, while infringement of trade secrets generally deprives the exclusive rights of trade secrets owner." Infringement of trade secrets may bring different results of loss. One situation is that the infringement leads to trade secrets thoroughly known to the public so the loss should be assessed with full value of trade secrets themselves. The other is that infringement brings benefits to suspects which is relative loss of the exclusive right, so the loss should be assessed with profits of infringing products. When a PSB or procuratorate deals with the crime of infringing business secrets, if cannot provide evidence according to the actual situation of the case, it may result in the failure of prosecution.

## **II. Practical Tips of Filing of Criminal Cases of Trade Secrets Infringement**

*1. Effectively collect evidence*

When owner's trade secrets are infringed, he often goes to a local PSB to file a case at first time, but often fails because of insufficient evidences. In our experience, the trade secret owner often thought it is a crime like other crimes committed to common property and did not realize that trade secret is a kind of legal fiction right, different from natural rights such as

<sup>4</sup> Refer to (2014) No. 66 first instance of Binhan criminaland (2015) No.00012 second instance of Jiangsu Intellect Criminal

<sup>5</sup> Refer to (2014) No. 66 first instance of Binhan criminal and (2014) No.6 private prosecution of Wenlu criminal



tangible property and real estate. Only when there is sufficient evidence to prove that the information involved in the case belongs to trade secrets, can it be protected. It can be protected only if evidence is sufficient enough to prove information involved is trade secrets. In practice, some companies often expect PSB officers to investigate and obtain evidences when their own evidences cannot meet the threshold of filing, but this is incorrect. In view of the accessibility to the information, only the owner has evidences to prove information involved that is not known to the public, that can bring benefit, and that is protected under secrecy measures. But that does not mean the burden is without limit since suspect infringing behaviors are usually very furtive, the trade secrets owner is not capable to acquire evidences of behaviors as well as benefits brought by infringing behaviors due to limited capability to investigate. As a way out, the owner should provide clues according to which the PSB officers could investigate to collect evidences.

#### *2. Clarify secret points in the information involved in the case*

Secret points are core of trade secrets, and also the fundamental basis to prove information involved as trade secrets. In practice, trade secrets claimed by obligee are often drawings, source code, formula, technical implementation blue print, customer list, etc. However, those can only be deemed as carriers of trade secrets, not trade secrets themselves. Trade secrets should be confidential information carried on aforementioned carriers. It should be noted that those carriers carry a large amount of information, some of which is confidential, and some is not. Only the former is protected by Article 219 of the Criminal Law. If the trade secret owner directly submits the information carrier to a PSB, it will inevitably bring heavy burden to the criminal proceedings. From the principle of economical litigation point of view, the obligation of sorting out secret points should be heard by the owner. Before submitting secret points, there are two points to be noted. One is that secret points should have "three elements" of trade secrets, i.e., "unknown to the public", "carrying economic benefits and practicability," and "subject of reasonable measures taken to maintain secrecy." The other is that those "three elements" must be evidentially supported. If the

evidence of some secret points is insufficient or weak, we do not recommend submitting them at the filing stage, because the submission of these secret points will slow down the progress of the proceedings.

#### *3. Obtain appraisal of information "not known to the public"*

According to *Interpretation of the Supreme People's Court on Application of Law in the Trial of Unfair Competition Civil Cases*, "Not known to the public" is defined as "relevant information is not universally known and easily accessible to the relevant personnel in its field", which, a relatively vague standard, is in line with the characteristics of civil litigation. However, the above-mentioned vague standards cannot be applied in criminal proceedings because of the higher bar for burden of proof. In practice, "not known to the public" in criminal proceedings of infringing trade secrets is generally handed over to a special intellectual property appraisal institution using a method similar to a technology novelty search with standards similar to patent novelty. Generally, an appraisal institution verifies whether the information is "not known to the public" or not by the following dimensions: (i) searching the relevant information to confirm whether it has been published in part or all domestically and abroad; (ii) verifying whether a technical personnel can or cannot acquire the information through a direct observation of products; and (iii) confirming whether the information involved belongs to the general knowledge in the relevant industry. The trade secret owner may, after sorting out the secret points, entrust a qualified appraisal institution for an appraisal report, and submit it to the PSB as evidence. Of course, the appraisal report can only verify whether technical information is "not known to the public" or not. Business information, such as customer lists, market plans, business models and so on, cannot be verified.

#### *4. Submit information about reasonable measures taken as evidences*

According to first and third section of article eleven of *Interpretation of the Supreme People's Court on Application of Law in the Trial of Unfair Competition Civil Cases*, *secrecy measure is any reasonable protection measures taken by the owner of rights for the prevention of information disclosure corresponding to its commercial value. Under any of*





*the following circumstances, where it is sufficient to prevent disclosure of confidential information under normal conditions, it shall be deemed that the owner of the rights has taken confidentiality measures:*

*(1) restricting the confidential information only to the relevant personnel for whom knowledge of such information is necessary;*

*(2) taking preventive measures, such as locking, for the carrier of the confidential information;*

*(3) putting a confidential mark on the carrier of the confidential information;*

*(4) using passwords or codes, etc., for confidential information;*

*(5) entering into a confidentiality agreement;*

*(6) restricting access by visitors to confidential machinery, plant, garage and other premises, or making a confidentiality request to such visitors.*

The trade secret owner should submit evidences to meet above standards.

#### *5. Assessment of the economic value of the information involved*

The primary purpose of assessment evaluation is to prove that the information involved "can bring economic benefits and has practicability". As one of the three elements of trade secrets, the trade secrets owner is obliged to provide relevant evidences. The evaluation report can not only prove the economic value of business secrets, but also clarify the specific amount of it. Another purpose of assessment evaluation is to prove that the violation caused significant losses. A substantial loss stipulated in Article 219 of the Criminal Law starts with the amount of 500,000 RMB. Although the result of assessment evaluation cannot be equal to amount of loss, it is an important reference for determining the amount of loss. The determination is comprehensively made based on actual loss of the owner, illegal income of the criminal suspect, and profit brought by trade secrets in infringing products, so the loss is generally limited to the value of trade secrets. Often, a PSB sets 500,000 RMB as the threshold

for accepting a criminal case, which is in line with the reality. The trade secret owner can acquire the information involved by entrusting a qualified evaluation institution by applying assessment methodologies such as a market methodology, an income methodology, or a cost methodology. Generally, the evaluation institution analyzes comprehensively with two or more evaluation methodologies and finally issues a report.

#### *6. Submit clues of suspects contacting, acquiring, disclosing or using the information involved*

Criminal behaviors are the core of criminal facts. However, criminal behaviors often occur in a covert way, so a PSB need to obtain evidence through investigative means, the accuser only needs to submit evidentiary clues when reporting a case for investigation. In the crime of infringing trade secrets, because the suspect is often the employee or partner of the trade secret owner, and the information involved is generally in the owner's hand, it is reasonable for the owner to submit informative clues. The so-called contact refers to suspect' acquiring trade secrets legally with authority. There are various carriers of trade secrets, some of which exist in tangible forms such as documents, disks, CD-ROMs and objects, and some in intangible forms such as electronic data. The clues provided by the owner should focus on relationship between suspect and these carriers. The so-called acquisition refers to the illegal holding of trade secrets by suspects without right to contact trade secrets, such as acquiring the carrier of trade secrets through theft, deception, robbery and hacker intrusion. The so-called disclosure or use refers to the illegal delivery of trade secrets to a third party by suspects or use trade secrets for commercial production. Since crime of infringing trade secrets is defined as consequential offense taking harmful consequences as constitutive requirements, the obligee should also provide corresponding clues, such as suspects manufacturing and selling products by using trade secrets.



*The newsletter is not intended to constitute legal advice. Special legal advice should be taken before acting on any of the topics addressed here.*

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Mr. Shen specializes on IP related legal services in the field of all kinds of intellectual property disputes. Prior to joining in Lung Tin, Mr. Shen served as a judge in Beijing Haidian District People's Court for many years, handling approximately one thousand civil litigation cases, administrative litigation cases, and executive cases with in-depth understanding of civil litigation, administrative litigation, and civil execution procedures. Particularly, he is experienced in civil and commercial disputes practices.