

## **Protecting your valuable trade secrets in China**

If you're a company with valuable trade secrets to protect in China, this article will be useful in breaking down the elements of proof in the context of a recent landmark win for Bird & Bird client, VMI Holland BV and a similar case issued in the same month, for Beijing Semiconductor Specialist Equipment Research Institute<sup>1</sup>.

While we know each case is different and some are more complex than others, just taking these basic steps to protect your rights might go a long way if there is a need for enforcement. These legal changes will alleviate the rights owners' burden and are welcoming changes to trade secret owners facing copying and unauthorised filings of patents using their proprietary information.

### **Welcome changes to trade secrets law**

Bird and Bird recently helped client VMI Holland BV win three landmark patents ownership disputes at the PRC Supreme People's Court ("SPC")<sup>2</sup>. The decisions were handed down in December 2022, which together with another SPC decision in favour of Beijing Semiconductor Specialist Equipment Research Institute<sup>3</sup> issued in the same month, are great judicial examples of how the burden of proof should be allocated when adjudicating issues of trade secret misappropriation.

In both disputes, the plaintiffs lost in the first instance court for reasons of insufficient proof or insufficient delineation of trade secret points. On appeal, the SPC explained the correct application of the laws and overturned the first instance judgment, finding in favour of the trade secret owners.

### **The first dispute**

In the cases between VMI and Safe-Run, the plaintiff VMI claimed that the defendant Safe-Run had misappropriated its trade secrets and filed three patents based on the trade secrets. VMI requested for those patents to be transferred back to it as their rightful owner. The first instance court relied on prima facie evidence to deduce that the defendant's own independent research generates the invention. Even though the plaintiff had come up with

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<sup>1</sup> Beijing Semiconductor Specialist Equipment Research Institute v. Gu Haiyang et al regarding the infringement of technical trade secret, Case Number (2021) Zui Gao Fa Zhi Min Zhong No. 2526.

<sup>2</sup> VMI Holland B.V. v. Safe-Run Intelligence Equipment Co. Ltd, Case Number (2020) Zui Gao Fa Zhi Min Zhong No 661, 902, and 1003.

<sup>3</sup> Beijing Semiconductor Specialist Equipment Research Institute v. Gu Haiyang et al regarding the infringement of technical trade secret, Case Number (2021) Zui Gao Fa Zhi Min Zhong No. 2526.

the technology first, the first instance court requires that it still needs to prove that the defendant actually obtained the trade secrets from the plaintiff via unlawful means and applied the patents using those trade secrets. By unlawful means, the plaintiff needs to prove that the defendants knew that the plaintiffs had adopted reasonable confidentiality measures in protecting the trade secret.

The first instance decision imposed a very high burden on the trade secret owners. The plaintiff will be the last person that the defendant would allow any visibility of its activities, which inevitably would be conducted in covert.

The undisputable proof that the defendant has stolen a trade secret can never be effectively obtained by the plaintiff without an effective discovery procedure or criminal investigative power. China's civil law system does not have a mechanism to compel the defendant to produce the relevant disclosure.

While the police have strong investigative power to look into an issue of trade secret theft, criminal investigation is only pursued in few selected cases. Admittedly this is one of the reasons why trade secret protection is perceived to be weak in China and a much-lamented pain for both domestic and foreign innovators. In September 2020, China adopted a range of reforms to strengthen trade secret protection. One of which is the announcement of the Trade Secret JI in alleviating the burden of proof in all pending cases.

The SPC applied the JI to the VMI v. Safe-Run case and found that the correct sequence of proof in a patent ownership case filed based on trade secret misappropriation should be for the plaintiff to establish a prima facie case of:

- (1) whether the information qualifies as trade secret;
- (2) whether there is a possibility or opportunity of access by the defendant;
- (3) whether the prior trade secret is the same or substantially the same as the patents-in-dispute.

### **Burden of proof**

Once these elements are established, it is up to the defendant to bear the burden of proof that the patents were created based on its independent research.

The shifting of the burden of proof means the defendant would need to produce authentic and credible evidence of its independent research and contribution to the inventive concept embodied in the patents.

The SPC found that VMI had produced sufficient proof on each of the three elements, but Safe-Run could not carry out the burden of proof. The SPC further found that Safe-Run's R&D process was merely a record of the conclusion and not the development process which led to the invention. Also, the defendant's evidence is not in line with the typical timeline and threshold of technical obstacles anticipated in the industry. The SPC also took notice of circumstantial evidence in finding that there was no genuine R&D done.

Such evidence include that the alleged R&D process only took 7 months from the creation of a project plain in January 2014 to the completion of the project in July 2014, and that there is a lack of customisation, adjustment, and procurement process for specific component parts in creating the new invention.

The SPC found that the defendant's claim that it has exceptionally strong research power is not to be trusted. The defendant failed to prove that it developed the invention independently, or that it has made any substantive contribution to the invention.

### **Confidentiality measures**

The application of the Trade Secret JI is notable in this case. When assessing whether the plaintiff had taken reasonable confidentiality measures in protecting its trade secret, the SPC applied Article 5 and 6 of the JI. Article 6 states that:

*“A people's court shall identify that a right holder has taken appropriate confidentiality measures under any of the following circumstances if it is sufficient to prevent the leakage of trade secrets under normal conditions:*

*1. it executes a non-disclosure agreement or stipulates the obligation of confidentiality in a contract;*

*2. by means of articles of association, training, rules and regulations, written notification, etc., it puts forward confidentiality requirements on those who can access and acquire trade secrets, including its employees, former employees, suppliers, customers and visitors;*

*3. it restricts visitors' access to, or conducts differentiated management of secret-involved factory buildings, workshops and other production and business premises;*

*4. it differentiates and manages trade secrets and the carriers thereof by means of marking, classifying, isolating, encrypting, and sealing them, and by limiting the scope of personnel that can access or acquire them;*

5. *it takes measures to prohibit or restrict the use of, access to, storage in or reproduction from computer devices, electronic devices, network devices, storage devices, software, etc. that can access or acquire trade secrets;*

6. *it requires departing employees to register, return, remove or destroy trade secrets and the carriers thereof accessed or acquired by them, and continue to assume the obligation of confidentiality; or*

7. *it takes other reasonable confidentiality measures.”*

Applying the concrete checklist above, the SPC found that the plaintiff has adopted reasonable confidentiality measures to protect its trade secrets including through contract and actual access restriction.

The defendant argued that those confidentiality measures were however not strictly complied with by some of the plaintiff's customers. The SPC applied Article 5 and found that *“a people's court shall identify whether a right holder has taken corresponding confidentiality measures based on such factors as nature of the trade secret and carrier thereof, commercial value of the trade secret, identification degree of confidentiality measure, degree of correspondence between the confidentiality measure and trade secret, and right holder's willingness to maintain confidentiality.*

Whether or not a third party might have breached those measures does not negate the efforts made by the right holders. Also, the sale of a product under confidentiality terms would not destroy the secrecy of the information embodied in it.

### **Outcome**

The SPC's conclusion on confidentiality measures follow naturally from the application of Article 3 of the JI which states that the secrecy is only destroyed if the information is “generally known” to the public prior to the misappropriation, such as whether it belongs to common knowledge or practice of the industry. The SPC parsed through each sub-section in Article 3 and found that the Plaintiff has satisfied the requirement.

This is a notable and welcome departure from the previous practice where courts often require the right holder to prove that its trade secret enjoys absolute novelty over prior art.

### **Guidelines for disputes**

The rationale and allocation of burden of proof by the SPC can serve as guidelines on similar issues in the trade secret-based patent ownership disputes. It is a practical example

of the change that is intended to be brought by the new Trade Secret Law, and an encouraging reform to protect innovations.

### **The second dispute**

The second dispute involves a state-owned enterprise Beijing Semiconductor Specialist Equipment Co Ltd, also known as the #45 Research Institute. In 2020 it filed a lawsuit against two ex-employees and their new company Hangzhou Sizone Electronic Technology Co., Ltd. The claim alleges that Sizone had misappropriated and misused trade secret from the plaintiff in manufacturing and selling CMP equipment.

The first instance court rejected the plaintiff's claim because it failed to delineate the boundary of its alleged trade secrets. The plaintiff's case is that its technical trade secret comprises of certain technical drawings. The first instance court found that the drawings are only carrier of the trade secret points, and asked the plaintiff to specify which information embodied in those drawings is claimed to be trade secret.

The plaintiff refused to summarise down to trade secret points and insisted that a direct comparison of the drawings with the infringing product is more efficient and apparent. The first instance court dismissed the action on the basis that a plaintiff bears the burden of proof of the information is protectable as trade secret under Article 9 of the Anti-unfair Competition Law.

In order for the court to assess this, the first step is for the plaintiff to specify in writing which specific technical feature it claims as trade secret. This is said to facilitate subsequent examination of the case. The plaintiff cannot claim that the whole of the drawings comprises a trade secret.

On appeal, the SPC supported the plaintiff's definition of trade secret as the 23 pieces of drawings. The SPC started its reasoning with the meaning of "not generally known to the public" in Article 9(4) of the Anti-Unfair Competition Law and the application of Article 32 which reduces the burden of proof for the trade secret owner.

Article 32 of the Anti-Unfair Competition Law states that:

During civil trials of infringement cases of trade secrets, where the preliminary evidence provided by an obligee of a trade secret can prove that it has taken measures to keep the confidentiality of its trade secret and can reasonably indicate that such trade secret has been infringed, the alleged infringer shall prove that the trade secret claimed by the obligee does not fall with the scope of trade secrets as provided in this Law.

Where the obligee of trade secrets provides preliminary evidence that can reasonably indicate that the trade secret has been infringed and provides any of the following evidence, the alleged infringer shall prove that there is no infringement of the trade secret:

1. evidence showing that the alleged infringer has any access to or opportunity to obtain such trade secret and the information used by the alleged infringer is substantially identical to such trade secret;
2. evidence showing that such trade secret has been or is at the risk of being published or used by the alleged infringer;
3. any other evidence showing that such trade secret has been infringed by the alleged infringer.

The SPC explained that the requirement for secrecy means the specific information is not commonly known to all in the industry. The requirement is not that nobody knows. The SPC emphasised on the importance not to impose too much of a burden of proof on the right owner.

Although trade secret is now formally categorised as a type of intellectual property rights under the Civil Code, the requirement for secrecy is different from that of a patent. The pertinent part of the SPC judgement is worth citing here:

*“Although trade secret and patents are both intellectual properties, the protection of the two is different. In order for a trade secret to be protectable by law, it does not require to be novel or inventive, so long as it fulfils the legal requirements of secrecy, commercial value, and confidentiality measures. Even if part of the information embodied in the trade secret is in the public domain, as long as the combination of the technical information as a whole satisfies the legal requirement, it can still be protected as trade secret. In daily life, almost all information can be traced from a source, one cannot require every information embodied in the drawings to be independent creation of the right holder. Even if some of the information exists in the public domain, if the right holder has generated new information through sorting out, improving, or processing and/or compiling, combining any information know to the public, and other cannot easily obtain it without making certain effort, the new information can also qualify as trade secret and protected by the law after adopting confidentiality measures.”*

## Outcome

The underlined = wording above is taken from, and an application of, Article 4(2) of the Trade Secret JJ. The SPC went on to find that technical drawings are created through calculation and testing. There are no public channels to obtain those drawings. Therefore, the right holder is entitled to assert the whole of the technical information as an integral part to form the trade secret, or that a particular or a number of technical information forms the trade secret. The trade secret in the form of drawings as asserted by the plaintiff is definite. The SPC therefore sent the case back to the first instance court for trial.

The finding breaks away from the unusual court practice of requiring the right owner to narrow down their case to particular, narrowly-scoped trade secret points. Right owners have been asked to select those points painstakingly for fear that if the points are defined too broadly, they will be found to be a part of the common knowledge; and if the points are defined too few and far between, an infringer can bypass infringement easily. Also, the burden of narrowing down a trade secret to one or more dots might not reflect the actual grievance that it is the whole of the drawings that are often stolen by an infringer.

### **Conclusion: A beacon of light**

It is yet to see how the first instance court will follow this new finding, and more importantly, whether this signifies a broader change in the practice of all courts which will benefit all innovators. Protecting trade secrets is still a long and difficult battle, but as growth and development in China calls for stronger protection, these new cases certainly are beacons of light that show a way of how this can be done.