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The evolution of China trade secrets protection

An analysis of two recent decisions by the Supreme People's Court of China

In the December 2020 *Insights*, we discussed changes China made in trade secret administrative, civil, and criminal laws.

In February 2021, the Intellectual Property Tribunal of the Supreme People's Court of China (the "Court" or "SPC") released its list of 10 representative cases in 2020.¹ Two of the cases involved trade secrets misappropriation: The "Vanillin" case and the "Carbomer" case, through which the Court intended to "send a strong signal for strengthening the judicial protection of intellectual property rights" in China.² In this *Insights*, we discuss how the Court reached the damages decisions in these two cases and the significance of these decisions.

Background

The main legislation that covers trade secrets in China is the Anti-Unfair Competition Law (AUCL), established in 1993 and amended in November 2017 and April 2019.³ The April 2019 amendment includes changes related to determining damages awards in trade secret infringement—specifically an increase in the upper limit of statutory damages and an introduction of punitive damages.⁴

Article 17 of the AUCL currently provides that damages shall be based on the right holder's actual loss, and if the actual loss is difficult to determine, damages shall be based on the infringer's benefits from the infringing act. If the infringing act is malicious and serious, courts may award compensation to the right holder up to five times the amount determined in accordance with the above-mentioned method, plus the right holder's reasonable expenses related to its effort to stop the infringement. If both the actual loss and the infringer's benefits are difficult to measure, courts may award damages up to RMB 5 million (approx. USD 761,000 at current exchange rate).

¹ Available at <https://www.chinacourt.org/article/detail/2021/02/id/5825027.shtml>.

² The Supreme People's Court of China, press release, February 26, 2021, <http://www.court.gov.cn/zixun-xiangqing-288061.html>.

³ Available at http://gkml.samr.gov.cn/nsjg/fgs/201906/t20190625_302771.html.

⁴ See, e.g., The Library of Congress, "China: Trade Secret Provisions Under Anti-Unfair Competition Law Revised," *Global Legal Monitor*, June 6, 2019, <https://perma.cc/Y3YQ-STBJ>.

On March 3, 2021, the SPC issued the judicial interpretation on the application of punitive damages to civil cases involving intellectual property infringement (Judicial Interpretation [2021] No. 4).⁵ This interpretation provided clarification regarding the criteria for determining the seriousness of the infringing act, and the method of calculating the base for punitive damages, among other things.

The “Vanillin” case

On February 26, 2021, the Court ruled that a Chinese Vanillin maker Wanglong must pay RMB 159 million (approx. USD 24 million) for stealing technical secrets from another Chinese Vanillin maker Zhonghua Chemical—the highest damages ever awarded in China for trade secrets misappropriation.

The plaintiff presented three damages calculations: (1) operating profits of RMB 116.8 million calculated by applying plaintiff’s unit price and operating profit margin to defendant’s sales of the infringing products; (2) sales profits of RMB 155.8 million calculated by applying plaintiff’s unit price and sales profit margin to defendant’s sales of the infringing products; and (3) price erosion of RMB 790.8 million. The second calculation was fully adopted by the Court in arriving at the final damages award.⁶

The Court’s Order provides insights into how the Court reached its decision on damages, and why it picked the second calculation over others. *First*, when determining whether to base damages on sales profits or operating profits (the former equals revenue minus sales costs and sales tax; the later equals the former minus additional costs such as other operating expenses, management expenses, and financing costs), the Court referred to a Judicial Interpretation related to patent cases, which states that operating profits are usually applied, but if the infringer solely engaged in the business of infringement, sales profits can be applied.⁷ The Court decided to adopt the higher of the two: sales profits, based on considerations of facts in the case, including malice and seriousness of the misconduct, defendant’s obstruction of proof, and that the defendant engaged solely in the business that infringed trade secrets.⁸ *Second*, although purported to calculate the infringer’s (i.e., defendant’s) total sales profit, the Court based the calculation on the plaintiff’s sales profit margin because the defendant refused to provide relevant books and records and that the Court considered the plaintiff’s sales profit margin to be a proper proxy for the defendant’s.⁹ *Third*, even though the Court did not adopt the numerical result of the plaintiff’s price erosion calculation due to “limitation of data and method used,” the Court acknowledged that there was indeed a price erosion due to the infringement, and used this fact as a reference in deciding the final damages award amount.¹⁰ *Fourth*, although the Court decided that punitive damages are not applicable to this case because the punitive damages clause was not included in the AUCL until April 2019 (after the damages period claimed in this case), the Court made an effort to point out that the plaintiff can

⁵ Available at <http://www.court.gov.cn/fabu-xiangqing-288861.html>.

⁶ The total damages award RMB 159 million, equals RMB 155.8 million plus reasonable expenses. See Supreme People’s Court Order (2020) No. 1667, https://www.sohu.com/a/453354208_195414.

⁷ *Ibid.*, 66–67.

⁸ *Ibid.*, 79.

⁹ Supreme People’s Court Order (2020) No. 1667 at 79, https://www.sohu.com/a/453354208_195414.

¹⁰ *Ibid.*, 75, 78–80.

initiate another suit that covers a later time period, during which punitive damages may be recoverable.¹¹

Last, the Court's Order went through an extended analysis of eight factors in its consideration for awarding the damages. Two of the factors are particularly relevant to an economic damages expert: the high commercial value of the trade secrets at issue, and the serious impact of the defendant's infringing act on global markets. The Court concluded that the trade secrets contributed tremendously to plaintiff's sales of vanillin products and were the key to the defendant's commercial success. Specifically, only after stealing and using the trade secrets at issue was the defendant able to generate large sales and profits and gained 10% of the global market share.¹² The Court also pointed out that two other vanillin makers, one of which is the plaintiff, used to account for the majority of the global market share and that the vanillin market price had been generally stable, but the defendant gained significant market share by stealing trade secrets and sold its products at lower prices.¹³

The "Vanillin" case demonstrates that the Chinese courts are willing to award higher damages in IP infringement cases and are receptive to analyses and evidence that lead to a determination of actual damages rather than resorting to the statutory damage award amount. Also, when critical evidence from the infringer, such as profit margin, is not available, the right holder may still present a reasonable damages calculation to the court by utilizing other available information to approximate the damages.

The "Carbomer" case

On November 24, 2020, the Court ruled that Anhui Newman Fine Chemicals must pay RMB 30 million (approx. USD 4.6 million) plus reasonable expenses for stealing technical secrets related to Carbomer products from Tinci Materials Technology (Guangzhou and Jiujiang).¹⁴ It was the first time that the SPC awarded punitive damages for trade secrets misappropriation.

The SPC upheld the lower court's decision to measure damages based on defendant's benefits from the infringing act and calculate defendant's benefits by applying plaintiff's sales profit margin¹⁵ to defendant's partial infringing product sales.¹⁶ However, the Court pointed out that defendant's benefits need to be causally linked to the infringing act, and profits attributable to other factors should be excluded from the damages calculation. The SPC, therefore, decided that a 50% apportionment factor should be applied to the defendant's benefits calculated by the lower court. Lastly, the SPC increased the punitive damages multiplier from a factor of 2.5, applied by the lower court, to five. Combining all the changes above, the total damages award amount decided by the SPC remains the same as the amount decided by the lower court.

The SPC explained that its decision on applying a factor of five times, the highest provided by the AUCL, to determine punitive damages, was based on the subjective malice and seriousness of the

¹¹ Ibid., 77–78.

¹² Ibid., 74.

¹³ Ibid., 75.

¹⁴ Supreme People's Court Order (2019) No. 562, http://www.iprdaily.cn/news_27182.html.

¹⁵ The Court's Order appears to use "sales profits" and "gross profits" interchangeably.

¹⁶ The Court believed that the sales data provided by defendant was not complete.

infringement act. The Court specifically pointed out that the defendant had been making Carbomer products since it was founded, the defendant did not stop making the products even after its former legal representative was found guilty for trade secrets misappropriation, and the defendant committed obstruction of proof by refusing to provide relevant books and records.

It is worth noting that similar to the “Vanillin” case, the SPC also did not adopt defendant’s proposed lost profit analysis, even though calculating damages based on the right holder’s actual loss is specified as the first-considered approach under the AUCL. It appears that the defendant’s proposed lost profit calculation was based on an estimation of past and future price erosion, and the Court deemed this estimation to be insufficient and lacking proof.

Summary

The SPC’s decisions on the “Vanillin” case and the “Carbomer” case have drawn wide public and media attention due to the unprecedented large damages award and the first-time application of punitive damages for trade secrets misappropriation. The decisions also shed light on specific issues that should be considered by the right holders, legal counsel, and economic experts in assessing trade secrets damages for future cases.

We will keep monitoring key case decisions by Chinese intellectual property courts and provide update in future *Insights*.

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