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China: China "Clarifies" Commercial Secrecy

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Article by [Nicolas Groffman](#)  and [Shan Lai](#)

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The regulator of China's state owned enterprises (**SOEs**) recently released guidance on what constitutes a "commercial secret". With judgments being handed down last month in the Stern Hu/Rio Tinto case, this guidance is of great interest to foreign investors in China, as it may help identify the difference between state secrets and commercial secrets when dealing with Chinese enterprises.

There remain, however, a number of unanswered questions, and from the perspective of drafting, the circular has not fully clarified the definition of commercial secret. What it has done, however, is to remind practitioners that not all "secret" information held by SOEs is a state secret, and that some is merely a commercial secret.

Foreign investors should, as always, endeavour to establish a proper paper trail (or email trail) to show that any information/documents disclosed by the Chinese party were provided with the proper authority. This has particular significance now when dealing with SOEs, since there are specific exceptions to what constitutes a commercial secret, set out in Article 10 of the Circular (discussed below).

Background

On 25 March 2010, the State Owned Assets Supervision and Administration Commission issued a *Circular on Distributing Interim Regulations regarding Protection of Commercial Secrets of Central SOEs* [2010] 41 (**the Circular**). The Circular was released publically on 26 April 2010.

The law on "commercial secrets" is contained in the PRC Criminal Law and the PRC Anti-Unfair Competition Law. The Criminal Law defines "commercial secret" as *"technical information and operational information that are unknown to the public, can bring economic benefits to their rightful owner, are functional and are kept as secrets by their rightful owner"*.

That definition has been criticised as being vague and all encompassing.

Does the Circular provide a clearer guidance?

Under Article 2 of the Circular, a "commercial secret" is defined as "operational information and technical information which is unknown to the public, which can bring economic benefits to a central SOE (**CSOE**), can be practically used by the CSOE and is already subject to the protection measures of the CSOE".

Article 10 further defines the scope of "commercial secret", to include: "strategic plan, management method, business mode, reform and listing, merger, acquisition, restructure, transaction of property rights, financial information, investment and financing decision, manufacture, purchase and sale strategy, resource storage, client information, tender related information; technical information concerning design, procedure, product formula, processing technology, production method, knowhow, etc".

The combined effect of these definitions is basically that anything that has not been publically disclosed and could hold economic value can be regarded as a "commercial secret".

Overlap with state secrets

The Circular does not provide any clearer guidance on what constitutes a "commercial secret", but simply reaffirms the government's position in taking a vague and broad approach when it comes to "commercial secrets". However, as a matter of government policy, it may be that this is intended as a carve-out from the equally broad definition of "state secrets" in other laws. Our view is that part of the rationale behind this circular is to show that a secret held by an SOE is not necessarily a state secret. As a matter of law, this is not the case, because separate legislation on state secrets has not been amended to take into account the overlap with commercial secrets.

The Circular does provide that a commercial secret can be upgraded to a state secret if there is a policy change by the government, and so there is clear acceptance of the distinction. In a way this is good news for those who might

inadvertently find themselves in possession of secret documents belonging to SOEs, because the penalties for misuse of state secrets are much more serious than those for misuse of commercial secrets.

It is also worth noting here that China has also amended its law on state secrets, which we will discuss in a subsequent update.

Managing "commercial secrets"

Based on the extent of economic damage that may be caused by the leak of commercial secret, commercial secret shall be divided into two levels: Core Commercial Secret and Common Commercial Secret. It remains to be seen what will be the practical significance on this proposed classification.

The level of secrecy, protection term and permitted disclosure of commercial secret will be determined and managed by the relevant CSOE.

Protection measures

To protect the confidentiality of commercial secrets, the Circular sets out a range of measures to be put in place. In particular:

- confidentiality articles should be included in employment contracts;
- "non-compete" agreements should be entered into with core employees who have knowledge of such commercial secret (economic compensation clauses to be included);
- a confidential agreement should be signed where consultation, negotiation, technology assessment, appraisal of achievement, joint development, technology transfer, joint venture, outside audit, due diligence or asset and capital verification involving commercial secret is to be carried out.

The Circular also requires stricter, more comprehensive and encompassing protection mechanisms to be implemented.

The Circular does not specify any penalty for violation of the rules save to say breaches will be referred to judicial authorities.

The protection measures under the Circular impose greater responsibility on the CSOEs to better manage and safeguard commercial secrets.

What does it mean to foreign investors?

The Circular does not, in itself, offer any clarity or assistance to the foreign investors. The fresh parameters offered in the Circular are just as wide-ranging as before.

Note that this Circular is issued only by SASAC, and that other government departments of equal standing are entitled to issue their own legislation on commercial secrets. SASAC's views on the matter, however, are of particular importance, because previously there was an understanding held by many in government and in the judiciary that any secret held by an SOE was, prima facie, a state secret. This Circular recognises that secrets held by a state owned company are not necessarily state secrets.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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Corporate Focus (Clyde & Co)

As a result of its review of the Combined Code on Corporate Governance (the Code), the Financial Reporting Council (FRC) has published the new "UK Corporate Governance Code" applicable to all companies with a premium listing on the London Stock Exchange from any accounting period beginning on or after 29 June 2010.

Ministry of Justice announces delay for the Bribery Act (DLA Piper)

The Ministry of Justice has announced today (20 July 2010) that the implementation of the Bribery Act ("the Act") will be delayed until April 2011.

The Increasing Importance Of Non-Executive Directors (Crill Canavan)

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A Breakthrough in Turkish Litigation Practice: Proposed Amendments to Notification Law (Akdogan | Uslas Attorneys at Law)

Same as in most jurisdictions, "notification" constitutes an essential part of the Turkish legal system, particularly in terms of litigation.

Imminent Reform of Hong Kong Companies Legislation (Angela Wang & Co.)

The Hong Kong Companies Legislation is on the verge of a major overhaul.

What the Dodd-Frank Wall Street Reform and Consumer Protection Act Means for Public Companies (Foley & Lardner)

On July 15, 2010, the U.S. Senate approved the Dodd-Frank Wall Street Reform and Consumer Protection Act (Act), which the U.S. House of Representatives also approved on June 30, 2010. President Obama is expected to sign the Act into law within days.

Equity Claims And The Reform of Insolvency Legislation (Torys LLP)

A 2009 decision of the Alberta Court of Queen's Bench in EarthFirst Canada Inc. has brought attention again to the issue of the characterizations and rankings of equity and equity-type claims in the insolvency context.

Restructuring Debts In and Out of Court (Looper Reed & McGraw PC)

There are many reasons why a company may become financially distressed. Once it reaches a point of insolvency, however, management may consider a restructuring of the company's financial obligations in order to restore the company back to financial health.