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Legal Updates

Legal Updates

1. Company Law Interpretation V: Explanations and Analysis

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The Supreme People's Court on April 28, 2019 promulgated the *Rules (V) on Issues Involving Application of the Company Law of the People's Republic of China* ("**Interpretation V**"), which officially came into effect on April 29, 2019. The primary objectives of Interpretation V are to protect company shareholders, particularly minority shareholders, and to optimize the business environment, according to the relevant person responsible from Civil Adjudication Tribunal No. 2 of the Supreme People's Court at a news briefing[1] ("**Briefing**") describing the promulgation background. Based on these objectives, Interpretation V separately provides for (i) judicial review and remedies for related-party transactions, (ii) director removal without cause and compensation, (iii) a time limit for profit distributions, and (iv) mechanisms for resolving material differences between shareholders of a Limited Liability Company.

In general, Interpretation V provides relatively specific judicial rules for certain types of corporate disputes, and plays a guiding role for common disputes and issues unaddressed in judicial practice. However, due to the level of generality of Interpretation V, there remains room to discuss the reasonableness and feasibility of some provisions, which will also be subject to examination and improvement in judicial practice. The authors have combined their practical experience to interpret the key clauses of Interpretation V to provide a preliminary discussion of potential issues for the reference of clients and colleagues.

I. Due process is insufficient to defend against damage claims for related-party transactions

Article 1 *Where a related-party transaction damages a company's interests, if a plaintiff claims for compensation against the controlling shareholder, actual controller, directors, the supervisor or senior management for losses caused under Article 21 of the Company Law, and the defendants' only defense is that performance of the transaction had been disclosed and approved through procedures such as a shareholders' assembly or general assembly of shareholders under provisions of laws, administrative regulations or the company's articles of association, the People's Court shall not sustain [such defense].*

Where the company has not filed a lawsuit, shareholders who conform to conditions stipulated in paragraph 1 of Article 151 of the Company Law may initiate legal proceedings in the People's Court in accordance with the provisions of paragraphs 2 and 3 of Article 151 of the Company Law.

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[1] *Protecting shareholders' rights according to law, serving the business environment – New briefing by the relevant person responsible from Civil Adjudication Tribunal No. 2 of the Supreme People's Court on Rules (V) on Issues Involving Application of the Company Law of the People's Republic of China*, Apr. 28, 2019, http://www.court.gov.cn/zixun-xiangqing-155282.html (Chinese).

The legal remedy for damages caused by related-party transactions to the interests of a company is found under Company Law at Art. 21, which provides for a legal basis for "company related-party transaction liability disputes." Based on our observations, such cases account for a small proportion of corporate disputes, and the plaintiff success rate in such cases is relatively low, which is partially attributable to the impracticability of the law and the excessive burden of proof on plaintiffs.

The issues contended in company related-party transaction liability disputes typically include: (i) whether there exist related parties and related-party transactions, and (ii) whether the related-party transactions, if existing, have caused any losses to the companies. It is relatively easy for a plaintiff to prove the existence of related parties and related-party transactions. However, it is not easy to prove that the related-party transactions have harmed the interests of the company and to quantify damages, which are the biggest risks that plaintiffs face and common reasons for dismissal. The core criteria for the legality of related-party transactions is to judge whether the price was fair and the procedures were legitimate. There are no statutory provisions or criteria for judging fairness of price, and it depends on the opinion of the judge in the litigation. The Company Law only has provisions on recusal for certain related-party transactions. For example, a shareholder or actual controller must recuse itself from voting when it seeks to provide guarantees to the company (Company Law, Art. 16), and directors of listed companies must recuse themselves on matters involving related entities (Company Law, Art. 124). However, well-established mechanisms for recusal and related-party transactions have not been established, which has led to decision-makers of actual controlling companies to control voting procedures for related-party transactions (typically controlling shareholders, actual controllers and senior managers). After entering litigation, defendants often prevail by showing that there was sufficient information disclosure and that the voting procedures were legitimate. It is not uncommon for judges to rule against plaintiffs in such cases, unless the plaintiff provides convincing evidence proving the unfairness of the related-party transactions.

In this context, Article 1 clarifies that a defendant will not prevail merely by proving that the information disclosure and voting procedures were legitimate. This is highly relevant to problems existing with the plaintiff's burden of proof in judicial practice, it could even be considered to imply a reversal of the burden of proof in such cases. Although Article 1 does not clearly specify the defendant's burden of proof, it is implied that defendants in these cases will inevitably have to prove fairness or lack of causality between the related-party transactions and claimed damages, etc.

Considering the defendant's control and influence over the company, it is difficult for the company to decide to file a lawsuit on its own behalf. Article 1, para. 2 explains that a shareholder derivative suit may be filed by shareholders of a Limited Liability Company or by one or more shareholders of a Joint Stock Limited Company who have collectively one percent or more of the company's shares for 180 consecutive days or more. This paragraph is not part of a newly created procedure in this judicial interpretation. In past judicial practice, there have been many cases where shareholders have brought derivative lawsuits against related-party transactions that have damaged the interests of the company in accordance with the Company Law at Art. 151.

In general, it has yet to be tested in judicial practice whether the provisions of Article 1 have certain deterrent power to the controlling shareholders, actual controllers and senior managers of the company and protect the rights and interests of minority shareholders. That said, a defendant's risk of losing in a related-party transaction case will significantly increase if the courts require the defendant to bear the burden of proof in respect of the fairness of the related-party transactions and the absence of causality between the related-party transaction and the claimed damages.

II. Shareholders entitled to file derivative lawsuits to invalidate or revoke related-party transaction contracts

Where invalid or revocable conditions exist in a related-party transaction contract and the company does not sue the counterparty to the contract, shareholders who conform to conditions stipulated in paragraph 1 of Article 151 of the Company Law may initiate legal proceedings with the People's Court in accordance with paragraphs 2 and 3 of Article 151 of the Company Law.

Use of related-party transactions to damage the interests of a company constitutes a tort, for which the Company Law at Art. 21 provides compensatory damage liability as a remedy. In practice, however, damages may not fully protect a company's interests, especially where damages are difficult to prove and quantify. Related-party transactions generally need to be realized through contract. Thus, in practice, where damages cannot fully protect the company's interests, it is necessary to allow relief through a mechanism such as invalidation or rescission. Taking into account the special context of related-party transactions, Article 2 gives shareholders the right to file a derivative lawsuit in cases where the company does not file a lawsuit against the contract counterparty.

This provision is undoubtedly positive from the perspective of affirming shareholders' right to sue. That said, Article 2 is extremely principled and simple, and there are still many issues to be further clarified. For example, suppose there is a lawsuit in which a company sues the controlling shareholder for compensatory damage liability from a related-party transaction and, concurrently, the shareholders seek to rescind the contract in accordance with the requirements of Article 2. The company may confirm the amount of damages based on the completion of the contract, which would be contrary to the claim for rescission of the contract under the shareholders' derivative lawsuit. Article 2 does not answer whether courts should give priority to respecting the company's exercise of its right to claim for damages or whether they should first wait for the shareholders' derivative suit to determine the validity of the contract before hearing the claim for damages and determining the scope of damages. Considering the complexity, we believe that it would be difficult to formulate a unified provision. It would be reasonable, for example, to give priority to a derivative suit where the controlling shareholder has directed the company to drop the transaction counterparty from the suit. However, priority should be given to the company's lawsuit where it is shown that it is suing on its own volition and to maximize shareholder returns and is able to operate and exercise its rights.

In addition, the issue of shared losses needs to be addressed in cases where the minority shareholders prevail in invalidating or rescinding a contract and the parties cannot be returned to the status quo ante. According to the Contract Law at Art. 58, both parties to the contract will bear liability in proportion to their degree of fault. In cases of related-party transactions damaging a company's interests, the company is often found to be at fault for the conduct of the controlling shareholder, since the company is a nominal party to the contract while the controlling shareholder manipulates the company's decision-making.

Article 2 does not provide clarity as to whether minority shareholders can name the controlling shareholder as a defendant and seek recovery in a derivative action. However, we believe the answer is affirmative because the law does not prohibit minority shareholders from concurrently suing the controlling shareholder and contract counterparties, and the minority shareholders' right to request that the controlling shareholder bear liability for damages is a right implied in the invalidation or rescission of the contract, which should be dealt with at the same time.

III. Clarifying the nature of no-cause removal of directors

Where a director, before expiration of his term, has been removed from office by an effective resolution of the shareholders assembly or general shareholders assembly, and the director asserts that such removal is not legally effective, the People's Court shall not sustain [such assertion].

Where a director, upon removal from office, initiates legal proceedings due to a dispute with the company over compensation, the People's Court shall determine whether and how much compensation to award in accordance with provisions of law, administrative regulations, the company's articles of association or contractual undertakings, and by fully considering other factors, such as the cause for removal, remaining term and the director's remuneration.

Article 3 further confirms the principle that a director may be removed without cause. Debate exists in respect of for-cause and no-cause removal of directors. The Company Law initially stipulated that removal of directors was to be for cause. The Company Law as adopted in 1993 provided at Art. 47 that "the shareholders assembly of a company may not, without cause, dismiss a director of the board prior to the expiration of his term in office." This provision was deleted in the 2005 revision to the Company Law, which indicated an inclination towards the principle of removal without cause.

Removal without cause is generally accepted both in theory and practice, based upon the idea that the relationship between company and the director constitutes an entrustment—either the company or the director thus has the right to arbitrarily terminate the mutual relationship. However, the concept that "a director may not be replaced during his term of office" still has some influence in practice. Many directors and officers who are removed from office sue to revoke the resolutions for their removal on the ground that the reason for removal was unfounded, and some courts will accept such reasoning. For example, in the Supreme People's Court's 2012 Guiding Case No. 10, the plaintiff filed suit to revoke the resolution for his removal because he believed a factual error existed in the cause for removal, i.e., "without consent of the board of directors, privately used company funds to trade stocks in the secondary market, resulting in substantial losses." The first instance held that "the resolution to remove the general manager is unjustified for lack of factual and legal bases, and the result of the resolution is improper. For the purposes of safeguarding the legitimate interests of the plaintiff and to improve the fairness and legitimacy of the resolutions of the board of directors, the resolution is hereby ordered revoked." However, the second instance court corrected the first instance court, finding that the statement of cause for removal in the resolution did not violate the company's articles of association and the resolution should before considered valid in the absence of other grounds for revocation. This case demonstrates the Supreme People's Court's position on the no-cause removal of officers.

Removal without cause is again confirmed in Article 3, para. 1 by characterizing the company-director relationship as an entrustment. However, parties to an entrustment may legally agree to dissolve the entrustment only for cause. Therefore, a further concern of ours about Article 3 is whether a resolution for removal can be resisted if the director and company have expressly agreed that removal may only be for cause. Article 3 does not answer this question, and it is foreseeable that differences will appear in judicial practice.

To balance the protection of directors' rights, Article 3, para. 2 provides directors reasonable compensation and grants the right to file a lawsuit against removal from office. However, Article 3 does not explicitly resolve the conflicts that arise in the case of removal between the Company Law and the Labor Law. Debate also remains in judicial practice as to whether a director's removal is equivalent to the termination of labor relations with the company. Shanghai courts have taken the position that a board resolution dismissing an officer who has signed a labor contract with the company should be regarded as an adjustment in position, which does not necessarily result in the dissolution of labor relations between the officer and the company (e.g., (2015) Hu Er Zhong Min San (Min) Zhong Zi No. 747). In terms of legal procedures, disputes over remuneration and employment compensation for a director should be handled separately by following different legal procedures; disputes over employment compensation are to first be submitted to labor arbitration. However, failure to clearly distinguish between remuneration and compensation in a director's engagement letter or contract is indeed prone to disputes over jurisdiction, which will depend on the judgment in the case.

IV. Distributions of profits shall be made no later than one year following the making of a resolution

After the shareholders assembly or general shareholders assembly has made a resolution to distribute profits, the company shall complete the distribution of profits within the time specified in the resolution. Where the resolution does not specify the time, it shall be subject to provisions of the company's articles of association. Where the resolution and the articles of association both do not stipulate the time or the time exceeds one year, the company shall complete the profit distribution within one year from the date of the resolution.

Where the time to complete the distribution of profits specified in the resolution exceeds the time stipulated in the company's articles of association, the shareholders may apply to the People's Court to revoke the provisions of the resolution regarding the time in accordance with paragraph 2 of Article 22 of the Company Law.

Article 4 provides a time limit for the completion of profit distributions. The earlier Interpretation IV of the Company Law shared three provisions on the issue of lawsuits regarding shareholders' rights to distributions: the subject to the action (the company as defendant), a pre-existing resolution requirement (the action is preconditioned on an effective resolution for the distribution of profits having been adopted the shareholders assembly or shareholders general assembly) and provisions for exceptional circumstances. Interpretation IV, notably, does not provide for how to deal with the distribution of profits if the resolution fails to specify a concrete time for distribution, which had led to inconsistent rulings.

However, based on our observations, it is uncommon for courts to dismiss shareholders' claims for the distribution of profits merely on the ground that the resolution failed to specify an exact time for distribution. Some courts have found that shareholders' right to claim for profit distributions becomes a creditor's right after the adoption of a resolution, and shareholders have the right to make a claim at any time ((2018) Chuan 01 Min Zhong 13591 Judgment).

Article 4 further resolves this remaining issue regarding the right to distributions in Interpretation IV. The timing of profit distributions is in principle based on the time specified in the resolution, and under different circumstances is based on the provisions of the resolution and the company's articles of association. However, upon a careful reading of the article, we believe that some of the language of may be subject to misinterpretation, and the reasonableness of the process is still open to debate. Specifically, the situation in which the company should complete the distribution within one year from the date of the resolution is "[w]here the resolution and the articles of association both do not stipulate the time or the time exceeds one year," but it is questionable whether "both" modifies "the time exceeds one year." Based on a strict contextual interpretation, "both" should modify "do not stipulate the time" or "the time exceeds one year"—and the resulting issue may frustrate the purpose and original intent of Article 4. For example, suppose the resolution does not specify a time for the distribution, but the company's articles of association stipulates a time in excess of one year; this sentence cannot be applied to conclude the profit distribution is completed within one year, but the profit distribution will essentially exceed one year by applying "[w]here the resolution does not specify the time, it shall be subject to provisions of the company's articles of association." A major shareholder could, in theory, act not to pay or to postpone payment of dividends so long as a long dividend payment term is specified in the articles of association and the dividend resolution does not specify a payment term. Therefore, in terms of contextual logic and legislative purpose, the completion of distributions within one year should be applied in all cases where either the time stipulated in the resolution or the articles of association is greater than one year.

Article 4, para. 2 stipulates that when the time specified in the resolution exceeds that stipulated in the company's articles of association, the shareholders may file a lawsuit to revoke the provisions on timing of distributions in accordance with Company Law Art. 22, para. 2. It is worth noting in this case that under the Company Law, shareholders will need to file a revocation suit rather than a suit demanding the right to distribute profits in accordance with the company's articles of association. In practice, disputes over company resolutions and distributions of surplus are independent company lawsuits. It is rare to resolve a profit distribution issue while at the same time revoking the resolution. This means that shareholders will still need to file a separate lawsuit on dividends after revoking the provisions on timing. In addition, the right to revoke a resolution must be exercised within 60 days after the resolution is made, claims filed outside the time limit shall be rejected, according to the Company Law at Art. 22. Although Article 4 does not clearly stipulate the consequences of exercising the right to revoke beyond the 60-day time limit, it should mean, after the plaintiff's failure in the case, that the resolution continues to be effective and that the profit distribution is subject to the resolution.

We understand the purpose of Article 4 is to urge companies to constrain the timing of the payment of dividends, protect the interests of minority shareholders effectively, and the overall legal effect is that once a resolution is made to distribute profits, the distribution should be completed within one year, regardless of whether the resolution or the articles of association stipulate otherwise. However, we are uncertain whether a one-year time limit is necessary, or whether it will excessively interfere with shareholder autonomy. As in the previous example, if there is no clear definition of profit distribution, the court will refer to provisions of the Contract Law regarding unspecified periods of performance, which can also protect the interests of plaintiffs and be more flexible. However, after setting an upper limit of one year, if all shareholders adopt a resolution to distribute profits in more than one year, the shareholders who voted in favor may still question the validity of the resolution and apply to a court for an early distribution. Doing so would essentially contradict the estoppel principle, and not be conducive to maintaining strict enforcement and stability of corporate resolutions. In this sense, the balance between profit distribution rights and autonomy still requires further exploration and research.

V. Mediation shall be emphasized when hearing cases of major disputes among shareholders of limited liability companies

When the People's Court hears cases involving material differences among shareholders of a Limited Liability Company, mediation shall be emphasized. Where the parties agree to resolve their differences by means of the following methods and it does not violate mandatory provisions of law and administrative regulations, the People's Court shall support [such resolution]:

(1) The company partially repurchases the shareholders' shares

(2) Shareholders partially purchase the other shareholders' shares

(3) Other parties partially purchase the other shareholders' shares

(4) Reduction in company capital

(5) Company separation

(6) *Other methods that may resolve differences, restore normal business operations, and avoid company dissolution*

Article 5 expressly states that mediation will be emphasized when the People's Court hears cases involving major differences among shareholders of a Limited Liability Company for purposes of maintaining the company's operations. We note that although the first sentence of Article 5 refers to the application of differences among shareholders of a Limited Liability Company, the later text references "shares" rather than "equity", which may cause misunderstandings that this Article 5 also applies to joint-stock limited companies. The wording used at the Briefing may resolve such doubts. During the Briefing, the spokesperson mentioned that "Article 74 of the Company Law stipulates the right of shareholders of a Limited Liability Company to request to repurchase shares." In fact, however, the Company Law at Art. 74 stipulates the right of shareholders of a Limited Liability Company to request the company to repurchase "equity" rather than "shares." By analogy, the "shares" used in Article 5 appears more like a typographical error and should not be interpreted to expand the scope of application to joint stock limited companies. Moreover, Article 5 provides that mediation methods must not violate mandatory provisions of laws and administrative regulations. However, for joint-stock limited companies, especially those that are publicly listed, mediation of shareholders' differences must comply with CSRC ministerial rules and exchange trading rules. Based on the above, we believe Article 5 is not intended to apply to joint-stock limited companies.

Mediation is already emphasized in Interpretation II of the Company Law at Art. 5, para. 1. By comparison, the types of cases subject to mediation in Article 5 are expanded from disputes involving the company dissolution to all major differences involving Limited Liability Company shareholders. And the mediation methods have also been expanded to include the shareholder buyouts by a third party, company separation as well as a catch-all method.

Mediation is the first dispute resolution method that the courts should consider in resolving disputes. Article 5 reflects the efforts of the Supreme People's Court to promote diversification of dispute resolution methods and optimization of the business environment. It is worth noting that the dispute resolution methods stipulated in Article 5 involve many additional parties and procedures in addition to the parties to the dispute, but this Article 5 fails to clearly stipulate how the court will provide judicial support with respect to those additional issues and procedures. Therefore, the effect of implementing Article 5 remains to be seen in judicial practice.

Generally speaking, Interpretation V, although short in length with six articles only, provides strong guidance for the resolution of disputes and controversies arising in case trials, which reflects the position of the Supreme People's Court to truly deal with concrete issues existing in judicial practice. However, as discussed in this article, Interpretation V leaves open many procedural and substantive issues and has the potential risk of impeding company decision-making procedures and governance due to over-protection of the interests of minority shareholders. We believe that those open issues should be resolved through continuous exploration in judicial practice, and we will monitor implementation of the rules.

2. Strengthening Protection of Corporate Trade Secrets to Create a Favorable Environment for Innovation — Introduction of Revisions to Anti-Unfair Competition Law

Author: Lili WU | Faye WANG

It has been less than two years since the last revisions in 2017 to the *Law of the People's Republic of China Against Unfair Competition* (the "**Anti-Unfair Competition Law**"), but Chinese legislators have adopted on April 23, 2019 a decision again revising the Anti-Unfair Competition Law[2]. The revisions to the Anti-Unfair Competition Law took effect from the date of adoption.

These revisions only involve content related to trade secrets, and show China's ambition to strengthen protections and provide legal safeguards for innovators. The following is a brief introduction to the revisions.

I. Adding means considered as trade secrets infringement and expansion of persons subject to infringement

Current "Anti-Unfair Competition Law"	Revised "Anti-Unfair Competition Law"
Article 9 A business operator shall not use any of the following means to infringe upon trade secrets: (1) obtaining an obligee's trade secrets by theft, bribery, fraud, intimidation or any other unfair means; (2) disclosing, using or allowing others to use an obligee's trade secrets obtained by the means mentioned in the preceding paragraph; or (3) disclosing, using or allowing others to use an obligee's trade secrets in violation of an agreement or the obligee's requirements on keeping such trade secrets confidential. Where a third party knows or should know of the fact that an employee or former employee of the obligee of trade secrets or any other entity or individual conducts any of the illegal acts specified in the preceding paragraph, but still obtains, discloses, uses or allows others to use	Article 9 A business operator shall not use any of the following means to infringe upon trade secrets: (1) obtaining an obligee's trade secrets by theft, bribery, fraud, intimidation, **electronic intrusion** or any other unfair means; (2) disclosing, using or allowing others to use the trade secrets obtained from an obligee by the means mentioned in the preceding paragraph; or (3) disclosing, using or allowing others to use an obligee's trade secrets in violation of **confidentiality obligations** or the obligee's requirements on keeping such trade secrets confidential. **(4) Instigating, tempting, aiding others in violation of confidentiality obligations or the obligee's requirements to keep trade secrets confidential, to obtain, disclose, use, or**

[2] 《全国人民代表大会常务委员会关于修改《中华人民共和国建筑法》等八部法律的决定》[Decision of the Standing Committee of the National People's Congress on Revising the Construction Law of the People's Republic of China and Eight Other Laws] (*adopted by* Standing Comm. Nat'l People's Cong. on April 23, 2019).

such secrets, such practice shall be deemed as infringement of trade secrets. For the purpose of this Law, trade secrets refer to any technical information or operational information which is not known to the public and has commercial value, and for which its obligee has adopted measures to ensure its confidentiality.	**allow others to use the obligee's trade secrets.** **Any natural person, legal person or unincorporated organization other than the operator who conducts the illegal acts stated in the preceding paragraph shall be deemed to have infringed upon trade secrets.** Where a third party knows or should know of the fact that an employee or former employee of the obligee of trade secrets or any other entity or individual conducts any of the illegal acts specified in the preceding paragraph, but still obtains, discloses, uses or allows others to use such secrets, such practice shall be deemed as infringement of trade secrets. For the purpose of this Law, trade secrets refer to **any commercial information including technology information, business operation information and the like** which is not known to the public and has commercial value, and for which its obligee has adopted measures to ensure its confidentiality.

A. New means considered as trade secrets infringement

According to Article 9, the act of obtaining trade secrets of the obligee by means of electronic intrusion is regarded as trade secrets infringement. Also, instigating, inducing, or help others to obtain, disclose, use or allow others to use trade secrets by means of the above is considered infringement.

The above revisions clarify that, based on current technological developments, obtaining information illegitimately by electronic means is considered infringement of trade secrets, and they further provide a clear legal basis for enterprises to exercise their rights.

B. Expansion of persons subject to infringement

According to Article 9, persons subject to infringement is also expanded from only business operators to natural, legal persons or unincorporated organizations other than business operators.

This expansion of persons subject to infringement also directly combats a sore spot in modern trade secrets infringement—there is now a clear legal basis for determining eligible defendants, especially where trade secrets disputes arise due to employee departures.

II. Supplementing punitive damage provisions, increasing administrative penalties

A. Supplementing punitive damage provisions

Current "Anti-Unfair Competition Law"	Revised "Anti-Unfair Competition Law"
Article 17 A business operator that violates this Law and thus causes damage to others shall bear civil liability for such damage in accordance with the law. A business operator whose lawful rights and interests are infringed by an unfair competition act may file a lawsuit with a people's court. The amount of compensation for damage caused by any unfair competition act to a business operator shall be determined depending on the actual losses suffered by such operator as a result of the infringement; where it is truly difficult to work out the actual losses, such amount shall be determined in accordance with the benefits obtained by the infringer from the infringement. The amount of compensation shall also include the reasonable expenses paid by the damaged business operator to stop the infringement. Where a business operator violates the provisions stipulated in Article 6 or Article 9 herein, and it is truly difficult to determine the actual losses suffered by the obligee as a result of the infringement or the benefits obtained by the infringer from the infringement, the people's court shall award the obligee less than RMB 3 million in damages, depending on the seriousness of the infringement.	Article 17 A business operator that violates this Law and thus causes damage to others shall bear civil liability for such damage in accordance with the law. A business operator whose lawful rights and interests are infringed by an unfair competition act may file a lawsuit with a people's court. The amount of compensation for damage caused by any unfair competition act to a business operator shall be determined depending on the actual losses suffered by such operator as a result of the infringement; where it is truly difficult to work out the actual losses, such amount shall be determined in accordance with the benefits obtained by the infringer from the infringement. **Where the business operator maliciously conducts an infringement upon trade secrets, and where the circumstances are serious, the amount of compensation may be determined as more than one time and less than five times the amount determined according to the above method.** The amount of compensation shall also include the reasonable expenses paid by the damaged business operator to stop the infringement. Where a business operator violates the provisions stipulated in Article 6 or Article 9 herein, and it is truly difficult to determine the actual losses suffered by the obligee as a result of the infringement or the benefits obtained by the infringer from the infringement, the people's court shall award the obligee less than **RMB 5 million** in damages, depending on the seriousness of the infringement.

In the past, the amount of compensation for trade secrets infringement was determined based on the actual loss to the infringed party or the benefit to the infringer. Now, if a business operator is found to have committed serious malicious infringement, the amount of compensation may be determined to be more than one time but less than five times the amount mentioned above. Further, in the past, if the loss to the infringed party was difficult to determine, the court could decide to award the infringed party less than RMB 3 million in damages. This discretionary amount has now been increased from RMB 3 million to 5 million.

Following the 2017 revision to the Anti-Unfair Competition Law, which increased the maximum amount of compensation for trade secrets infringement to RMB 3 million from an amount which may be determined by referring to provisions on patent infringement (the maximum amount of compensation for patent infringement is RMB 1 million), the statutory maximum amount of compensation for trade secrets infringement is now raised again to RMB 5 million, which greatly strengthens the protection of trade secrets.

B. Increasing administrative penalties

Current "Anti-Unfair Competition Law"	Revised "Anti-Unfair Competition Law"
Article 21 Where a business operator infringes any trade secret in violation of Article 9 herein, the supervision and inspection authority shall order it to cease the illegal act and impose on it a fine of between RMB 100, 000 and RMB 500, 000; where the circumstance is serious, the fine shall be between RMB 500, 000 and RMB 3 million.	Article 21 Where a business operator and **other natural person, legal person and unincorporated organization** infringes any trade secret set forth in violation of Article 9 herein, the supervision and inspection authority shall order it to cease the illegal act, **confiscate the illegal income** and impose on it a fine of **between RMB 100,000 and RMB 1,00,000**; where the circumstance is serious, the fine shall be **between RMB 500, 000 and RMB 5 million**.

First, for trade secrets infringement, persons subject to penalties has been expanded from "business operator[s]" to "business operator[s] and other natural person[s], legal person[s] and unincorporated organization[s]".

Second, the amount of penalties has been increased. Confiscation of illegal gains has been added as a penalty for trade secrets infringement. Fines have been increased from between RMB 100,000 and RMB 500,000 to between RMB 100,000 and RMB 1 million. For serious circumstances, the fines have been increased from between RMB 500,000 and RMB 3 million to between RMB 100,000 and RMB 5 million. Punishments have been greatly increased.

III. Relaxing the burden of proof of obligees and shifting the burden of proof to defendants after the initial production of evidence.

Current "Anti-Unfair Competition Law"	Revised "Anti-Unfair Competition Law"
	Article 32 **(New)** In civil trial procedures for infringing trade secrets, where the obligee of trade secrets provides primary evidence proving he has taken confidential measures against the claimed trade secrets and reasonably indicates that the trade secrets have been infringed, the alleged infringer shall prove that the trade secrets claimed by the obligee do not constitute trade secrets as set forth in this Law. Where the obligee of the trade secrets provides primary evidence reasonably indicating that the trade secrets are being infringed and provides one of the following as evidence, the alleged infringer shall prove that he has not infringed upon the trade secrets: (1) There is evidence indicating that the alleged infringer had access to the trade secrets or had an opportunity to obtain the trade secrets and that the information used is substantially the same as the trade secrets; (2) There is evidence indicating that the trade secrets have been disclosed, used or are at risk of being disclosed, used by the alleged infringer; (3) There is other evidence indicating that the trade secrets have been infringed by the alleged infringer.

A. Trade secrets constitute a shifting of the burden of proof

According to the new Article 32, where the trade secrets obligee initially proves that the claimed trade secrets are confidential and reasonably indicates that the trade secrets have been infringed, the alleged infringer must prove that the trade secrets claimed by the obligee do not constitute trade secrets under the Anti-Unfair Competition Law.

B. Trade secrets infringement shifts the burden of proof

According to the new Article 32, under certain circumstances, as long as the obligee provides primary evidence that his trade secrets have been infringed, the alleged infringer must prove that he has not infringed the trade secrets.

The production of evidence has long been a barrier and difficulty for trade secrets obligees to safeguard their legitimate rights and interests. In past cases of trade secrets infringement, obligees have borne the full burden of proof. Obligees had to prove that the information was secret, valuable, and confidential, and constituted trade secrets in a legal sense, and that the obligee was the owner of the trade secrets. The obligee also had to prove that the alleged infringer met the conditions for and used illegitimate means to obtain the trade secrets, and finally the obligee had to prove the losses caused by the disclosure of the trade secrets.

According to this new article, after an initial production of evidence by the trade secrets obligee, the burden of proof can be partially shifted to the alleged infringer. Thus, the burden of proof of the obligee can be greatly reduced. This will help obligees to effectively protect their legitimate rights and interests.

In summary, the foregoing revisions to the Anti-Unfair Competition Law increase punishments for trade secrets infringement, while also alleviating the burden on obligees to prove their claims. These are positive developments for the protection of trade secrets, which reflect the ambition and intensity of the government to strengthen the intellectual property rights protections for innovators

3. Amended Trademark Law: Combat Misconduct, Increase Compensation

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On April 23, 2019, a decision amending the *Trademark Law of the People's Republic of China* (the "**Trademark Law**") was adopted at the Tenth Meeting of the Standing Committee of the Thirteenth National People's Congress. Amended provisions of the Trademark Law will come into effect on November 1, 2019. This is the fourth time the Trademark Law has been amended, following amendments in 1993, 2001 and 2013.

This amendment primarily involves three aspects and revisions to six articles. Overall, the amendment tends to strengthen intellectual property protections, combat malicious registration of trademarks not for real use, improve the remedy system for malicious registration and malicious litigation, and increases the amount of compensation for trademark infringement, especially malicious infringement of trademark rights. The costs of violating the law are clearly increased, which will act to deter malicious registration, malicious litigation and malicious infringement. This article briefly introduces the key details of the amendment for your reference.

I. Combating malicious trademark registrations

A prominent problem currently existing in practice is that substantial trademark squatting and hoarding activities which lack real uses have made it difficult to protect domestic emerging enterprise brands and present obstacles for the entry of foreign brands into China. For these reasons, rights holders have had to spend substantial sums to buy the brands created by themselves from trademark squatters.

In most previous cases, such circumstances have been governed in accordance with Article 44 of the Trademark Law, which provides that dispute procedures to invalidate trademarks can be initiated only once a trademark has been approved for registration. In case trials, there are relatively high requirements for the number of trademarks squatters have registered and for the public profiles in China of rights holders' trademarks. These factors greatly increase the cost and risk for brand rights holders to protect their rights, and are also not conducive to effectively curbing the malicious registration of trademarks.

In recent years, the courts and the Trademark Office of the State Intellectual Property Office have begun to explore pre-examinations of such circumstances, that is, at the preliminary examination stage, to directly refuse "large quantities of trademark registration applications that have no actual intended use and are for illegitimate purposes." This amendment to the Trademark Law provides a clear legal basis for combating malicious registrations in four aspects: the initial examination process, trademark agency process, and in trademark application opposition and invalidation procedures. It is good news for reputable business operators that legal protections are now provided in full aspects, from applications and regulating agents to authorization and dispute resolution.

Specifically, the amended Article 4 of the Trademark Law adds that "malicious applications to register trademarks not intended for use shall be refused," which gives examiners the right to voluntarily refuse applications at the preliminary examination stage. Article 19, para. 3 increases the obligations of trademark agents to review applications, and stipulates that agents may not accept malicious applications to register trademarks not intended for use. Articles 33 and 44 together provide for this circumstance as a reason for filing an opposition or invalidation. The amended Trademark Law can be seen as establishing a comprehensive system to combat malicious squatting and hoarding of trademarks, and this system can be described as interlocking with multiple levels of supervision.

Naturally, application of the amended Article 4 of the Trademark Law and the applicable procedures and circumstances will be further clarified in relevant supporting laws and regulations, judicial interpretations or examination guidelines. In general, we believe that “malicious applications to register trademarks not intended for use” should at least include: applying for the same or similar trademarks as the trademarks of different entities which have a certain familiarity with the public or relatively strong distinctiveness, and the application involves large quantities of trademarks or involves other serious circumstances; applying for the same or similar trademarks as the same entity’s trademarks which have a certain familiarity with the public or relatively strong distinctiveness, and the application involves large quantities of trademarks or involves other serious circumstances;; and applying to register the same or similar trademarks as others which have certain influence in the categories that are far beyond the applicant’s business scope.

II. Punishing malicious registration and malicious litigation

The amendment not only stipulates strict examination procedures during the trademark rights confirmation process, it also stipulates punishment during rights confirmation and litigation procedures.

The amended Trademark Law stipulates punishments for trademark agents who violate the amended Article 4 in Article 68, para. 1, clause 3, and also adds punishment provisions in Article 68, para. 1, clause 4. The first half of paragraph 4 stipulates that the competent authorities will impose “administrative penalties such as warnings and fines … according to the circumstances” for malicious applications for registration, and the latter half stipulates “the People's Court shall impose a penalty” for malicious trademark litigation.

The Supreme People’s Court has previously found that maliciously obtaining and using trademark rights to seek illegitimate gains was not protected under the law, in trademark infringement dispute case Zui Gao Fa Min Zai [2018] No. 396 (one of the 2018 top ten intellectual property rights cases in China). It can thus be seen that the new amendment to Trademark Law and this guiding case are of great significance in establishing sound and orderly trademark system, purifying the market environment, and curbing the use of unfairly obtained trademark rights in malicious litigation.

III. Increased compensation for trademark infringement

Another highlight of the new amendment is the increase in compensation for trademark infringement. Article 63 of the amended Trademark Law amends the method for calculating compensation in cases of malicious infringement of trademark rights from “more than one and less than three times” to “more than one and less than five times”. The maximum amount of statutory compensation has been raised from the original RMB “three million” to RMB “five million”. The amendments to these clauses reflect further increases in punitive damages for intellectual property infringement.

In recent years, the courts, the State Intellectual Property Office and other departments and leaders at all levels have been implementing and emphasizing punitive damage systems for intellectual property rights to effectively curb intellectual property rights infringement. It is foreseeable that the cost of intellectual property rights infringement will continue to increase in the future. Malicious trademark infringers may find themselves “ruined with nowhere to go”. This is more good news for reputable business operators. Now more than ever, it is increasingly meaningful for business operators in China to actively design and establish their own intellectual property systems, timely and effectively discover infringement and vigorously take action to defend their rights.

Annex: Comparison Table of Provisions before and after the revision of PRC Trademark Law[3]

PRC Trademark Law in effect in China	**Amended PRC Trademark Law** **(Revised at the 10th meeting of the 13th National People's Congress Standing Committee on April 23, 2019)**
Article 4 Any natural person, legal person, or other organization that needs to acquire the exclusive right to the use of a trademark for the goods or services it or he provides shall file an application for registration of the trademark with the Trademark Office. Provisions regarding the goods trademarks in this Law shall be applicable to service trademarks.	Article 4 Any natural person, legal person, or other organization that needs to acquire the exclusive right to the use of a trademark for the goods or services it or he provides shall file an application for registration of the trademark with the Trademark Office. Malicious applications to register trademarks not intended for use shall be refused. The provisions of this Law on trademarks for commodities shall apply to service marks.
Article 19 Trademark agencies shall handle trademark registration applications or any other trademark matters by adhering to the principle of honesty and trustworthiness, complying with laws and administrative regulations, and in accordance with the entrustment of the entrusting party, and shall keep confidentiality of the entrusting party's commercial secrets which they become aware of in the course of handling the entrusted matters. Where the trademark to be registered by the entrusting party falls under the scope stipulated by this Law in which registration is not allowed, the trademark agency shall notify the entrusting party clearly. Where a trademark agency is or should be aware that the trademark to be registered by the entrusting party falls under the circumstances stipulated in Article 15 and Article 32 of this Law, it shall not accept the entrustment for registration application.	Article 19 Trademark agencies shall handle trademark registration applications or any other trademark matters by adhering to the principle of honesty and trustworthiness, complying with laws and administrative regulations, and in accordance with the entrustment of the entrusting party, and shall keep confidentiality of the entrusting party's commercial secrets which they become aware of in the course of handling the entrusted matters. Where the trademark to be registered by the entrusting party falls under the scope stipulated by this Law in which registration is not allowed, the trademark agency shall notify the entrusting party clearly. Where a trademark agency is or should be aware that the trademark to be registered by the entrusting party falls under the circumstances stipulated in Article 4, Article 15 and Article 32 of this Law, it shall not accept the entrustment for registration application.

[3] http://www.npc.gov.cn/npc/xinwen/2019-04/23/content_2086193.htm

The trademark agency shall not apply for registration of any other trademark except the trademark that it is entrusted to register.	The trademark agency shall not apply for registration of any other trademark in addition to the trademark registration as entrusted.
Article 33 After a trademark that has undergone preliminary examination has been given approval and announced, a prior rights holder or a party having an interest in the trademark who holds that the trademark violates the provisions of the second and third paragraphs of Article 13, Article 15, the first paragraph of Article 16, Article 30, Article 31 and Article 32 of this Law, or any person who holds the trademark violates the provisions of Article 10, Article 11 and Article 12 of this Law may raise an objection against the trademark with the Trademark Office within three months from the date of announcement. Where no objection is raised at the expiration of the time limit, the trademark shall be registered upon approval, a trademark registration certificate shall be issued, and the matter shall be announced.	Article 33 After a trademark that has undergone preliminary examination has been given approval and announced, a prior rights holder or a party having an interest in the trademark who holds that the trademark violates the provisions of the second and third paragraphs of Article 13, Article 15, the first paragraph of Article 16, Article 30, Article 31 and Article 32 of this Law, or any person who holds the trademark violates the provisions of Article 4, Article 10, Article 11, Article 12 or paragraph 4 of Article 19 of this Law may raise an objection against the trademark with the Trademark Office within three months from the date of announcement. Where no objection is raised at the expiration of the time limit, the trademark shall be registered upon approval, a trademark registration certificate shall be issued, and the matter shall be announced.
Article 44 Where a trademark is registered in violation of the provisions of Article 10, 11, or 12 of this Law, or it is registered by deceitful or other illegitimate means, the Trademark Office shall declare the trademark invalid. Any unit or individual may request that the Trademark Review and Adjudication Board to make a ruling to declare such registered trademark invalid. Where the Trademark Office has made a ruling to cancel a registered trademark, it shall notify the party concerned in writing. Where a party concerned disagrees with the ruling of the Trademark Office, it may apply to the Trademark Review and Adjudication Board for review within 15 days from the date of receipt of the notice. The Trademark Review and Adjudication Board shall make a ruling either to maintain or to revoke a registered trademark within nine months from the date of receipt of the application, and shall notify	Article 44 Where a trademark is registered in violation of the provisions of Article 4, Article 10, 11, or 12 or paragraph 4 of Article 19 of this Law, or it is registered by deceitful or other illegitimate means, the Trademark Office shall declare the trademark invalid. Any unit or individual may request that the Trademark Review and Adjudication Board make a ruling to declare such registered trademark invalid. Where the Trademark Office has made a ruling to cancel a registered trademark, it shall notify the party concerned in writing. Where a party concerned disagrees with the ruling of the Trademark Office, it may apply to the Trademark Review and Adjudication Board for review within 15 days from the date of receipt of the notice. The Trademark Review and Adjudication Board shall make a ruling either to maintain or to revoke a registered trademark within nine months from the

the party concerned in writing. Such review period may be extended for three months upon approval of the industry and commerce administration department of the State Council under special circumstances. Where the party is dissatisfied with the ruling of the Trademark Review and Adjudication Board, he may, within 30 days from the date the notification is received, bring a suit in a People's Court. After receiving the application for a ruling from other units or individuals, the Trademark Review and Adjudication Board shall notify the parties concerned in writing and ask them to put forward their arguments within a specified time limit. The Trademark Review and Adjudication Board shall make a ruling either to maintain or to revoke a registered trademark within nine months from receipt of the application, and shall notify the party concerned of the ruling in writing. Such review period may be extended for three months upon approval of the industry and commerce administration department of the State Council under special circumstances. Where the party is dissatisfied with the ruling of the Trademark Review and Adjudication Board, he may, within 30 days from the date the notification is received, bring a suit in a People's Court. The People's Court shall notify the other party involved in the trademark adjudication proceedings to take part in the legal proceedings as the third party.	date of receipt of the application, and shall notify the party concerned in writing. Such review period may be extended for three months upon approval of the industry and commerce administration department of the State Council under special circumstances. Where the party is dissatisfied with the ruling of the Trademark Review and Adjudication Board, he may, within 30 days from the date the notification is received, bring a suit in a People's Court. After receiving the application for a ruling from other units or individuals, the Trademark Review and Adjudication Board shall notify the parties concerned in writing and ask them to put forward their arguments within a specified time limit. The Trademark Review and Adjudication Board shall make a ruling either to maintain or to revoke a registered trademark within nine months from receipt of the application, and shall notify the party concerned of the ruling in writing. Such review period may be extended for three months upon approval of the industry and commerce administration department of the State Council under special circumstances. Where the party is dissatisfied with the ruling of the Trademark Review and Adjudication Board, he may, within 30 days from the date the notification is received, bring a suit in a People's Court. The People's Court shall notify the other party involved in the trademark adjudication proceedings to take part in the legal proceedings as the third party.
Article 63 The amount of compensation for infringement of the exclusive right to the use of a trademark shall be the amount of the losses that the infringed has suffered as a result of the infringement. Where the losses suffered by the infringed as a result of the infringement is hard to determine, the compensation shall be the amount of the profits that the infringer has earned as a result of the infringement; Where the profits earned by the infringer or the losses suffered by	Article 63 The amount of compensation for infringement of the exclusive right to the use of a trademark shall be the amount of the losses that the infringed has suffered as a result of the infringement. Where the losses suffered by the infringed as a result of the infringement is hard to determine, the compensation shall be the amount of the profits that the infringer has earned as a result of the infringement; Where the profits earned by the infringer or the losses suffered by

the infringed as a result of the infringement are hard to determine, the compensation shall be reasonably determined to be an amount in multiple of the license rate of the said trademark. Where the exclusive rights to use trademarks is maliciously infringed, if the case is serious, the compensation shall be an amount of more than one and less than three times of the amount determined in accordance with the method stated in preceding sentences. The compensation shall include any reasonable expenses the infringed has paid in its effort to put an end to the infringement.	the infringed as a result of the infringement are hard to determine, the compensation shall be reasonably determined to be an amount in multiple of the license rate of the said trademark. Where the exclusive rights to use trademarks is maliciously infringed, if the case is serious, the compensation shall be an amount of more than one and less than five times of the amount determined in accordance with the method stated in preceding sentences. The compensation shall include any reasonable expenses the infringed has paid in its effort to put an end to the infringement.
In order to determine the compensation amount, People's Court may order the infringer to provide accounts books and materials relating to the infringement where the infringed has fulfilled its burden of proof and the key accounts books and materials relating to the infringement are possessed by the infringer; where the infringer fails to provide accounts books and materials as requested or provides false accounts books and materials, the People's Court may determine the compensation amount with reference to the assertion of the infringed and the evidence provided by the infringed .	In order to determine the compensation amount, People's Court may order the infringer to provide accounts books and materials relating to the infringement where the infringed has fulfilled its burden of proof and the key accounts books and materials relating to the infringement are possessed by the infringer; where the infringer fails to provide accounts books and materials as requested or provides false accounts books and materials, the People's Court may determine the compensation amount with reference to the assertion of the infringed and the evidence provided by the infringed .
Where the profits earned by the infringer or the losses suffered by the infringed as a result of the infringement or the license rate of the concerned trademark, as mentioned in the preceding paragraph, are hard to determine, the People's Court shall, on the basis of the circumstances of the infringement, decide to make it not more than RMB 3,000,000 yuan.	Where the profits earned by the infringer or the losses suffered by the infringed as a result of the infringement or the license rate of the concerned trademark, as mentioned in the preceding paragraph, are hard to determine, the People's Court shall, on the basis of the circumstances of the infringement, decide to make it not more than RMB 5,000,000 yuan.
	In handling a trademark dispute, the People's Court shall, at the request of the right holder, order the destruction of the goods bearing counterfeit registered trademarks, except under special circumstances; order the destruction of materials and tools used primarily for the manufacture of goods bearing counterfeit registered trademarks

	without compensation; or, under special circumstances, issue an order to prohibit without compensation the aforementioned materials and tools from entering commercial channels. Goods bearing counterfeit registered trademarks may not enter commercial channels after merely removing the counterfeit registered trademarks.
Article 68 Where a trademark agency commits any of the following acts, the administration for industry and commerce shall order it to make correction within a stipulated period and give a warning and impose a fine of over RMB10,000 and less than RMB100,000. In addition, a warning shall also be given to person(s)-in-charge who is/are directly responsible for the matter and other directly accountable personnel of the agency and a fine of over RMB5,000 and less than RMB50,000 shall be imposed on them. Where the violation constitutes a breach under criminal law, the violating agency shall be held liable for criminal liabilities in accordance with the law: (1) forge or alter or use forged or altered legal documents, seals or signatures in the course of handling trademark matters; (2) solicit trademark agency business by defaming other trademark agencies, etc. or otherwise disrupt the order of the trademark agency market; or (3) violate the third and/or fourth paragraph of Article 19 of this Law. Where a trademark agent commits any of the above-mentioned acts, a record shall be entered into the credit file of the administration for industry and commerce; in serious cases, the Trademark Office and the Trademark Review and Adjudication Board may rule to suspend the handling of trademark matters for the violating agency, and an announcement shall be made. A trademark agency shall bear civil liabilities pursuant to the law if it violate the principles of	Article 68 Where a trademark agency commits any of the following acts, the administration for industry and commerce shall order it to make correction within a stipulated period and give a warning and impose a fine of over RMB10,000 and less than RMB100,000. In addition, a warning shall also be given to person(s)-in-charge who is/are directly responsible for the matter and other directly accountable personnel of the agency and a fine of over RMB5,000 and less than RMB50,000 shall be imposed on them. Where the violation constitutes a breach under criminal law, the violating agency shall be held liable for criminal liabilities in accordance with the law: (1) forge or alter or use forged or altered legal documents, seals or signatures in the course of handling trademark matters; (2) solicit trademark agency business by defaming other trademark agencies, etc. or otherwise disrupt the order of the trademark agency market; (3) violate the Article 4 and/or third and/or fourth paragraph of Article 19 of this Law; or (4) For malicious registration of trademarks, administrative penalties such as warnings and fines shall be given according to the circumstances; if a trademark lawsuit is filed for malicious purposes, the People's Court shall impose a penalty according to law. Where a trademark agent commits any of the above-mentioned acts, a record shall be entered into the credit file of the administration for industry and commerce; in serious cases, the Trademark

honesty and trustworthiness and harms the legitimate interests of an entrusting party, and shall be punished by the trademark agency industry organization pursuant to the provisions of its articles of association.	Office and the Trademark Review and Adjudication Board may rule to suspend the handling of trademark matters for the violating agency, and an announcement shall be made. A trademark agency shall bear civil liabilities pursuant to the law if it violate the principles of honesty and trustworthiness and harms the legitimate interests of an entrusting party, and shall be punished by the trademark agency industry organization pursuant to the provisions of its articles of association.

Important Announcement

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