

Basics of manufacturing non-disclosure agreements in China

Introduction: contracts in China

Many SMEs view Chinese manufacturers as cheap, technically-skilled, attractive options for manufacturing their products and as such pursue partnerships with them. While Chinese manufacturers can be the key to the products needed to give your company worldwide reach, China—like all countries—can be home to unscrupulous merchants with a taste for IP theft. As such, tailoring contracts to suit your intellectual property rights (IPR) is an important way to ensure that your company’s specific intellectual property assets are adequately protected when dealing with Chinese manufacturers. In particular, this article will address use of so-called NDAs (non-disclosure agreements) and NNNs (non-use, non-disclosure, and non-circumvention agreements) to protect an SME’s trade secrets—“any non-public technical or business information with commercial value that is guarded by confidentiality measures.”

What are NDAs and NNNs?

At its core, a non-disclosure agreement (NDA) between an SME and a Chinese manufacturer is an agreement which states that once the SME reveals its trade secrets to the Chinese manufacturer, the manufacturer will refrain from disclosing those secrets to anyone else. Once a secret loses its secrecy—once it is revealed to the public—it no longer has any kind of legal protection and, most likely, will lose its economic value. That is why NDAs are go-to contracts for any SME which seeks to use a Chinese manufacturer. Otherwise, the manufacturer could reveal the SME’s trade secrets, making those secrets impossible to protect and capitalise on.

Yet many times an NDA falls short of offering the comprehensive protection sought by SMEs for a variety of reasons, be it because the contract is shoddy and does not address all potential risks, because the contract includes wording or provisions which nullify it, or even because it was never signed to begin with. To address these points, we recommend that all SMEs sign an NNN agreement—not just an NDA agreement—before beginning any serious discussions with or revealing information to Chinese manufacturers. NNNs cover non-use, non-disclosure, and non-circumvention, providing a much more comprehensive framework for protecting SMEs’ IP.

The NNN: why NDAs might “Not Deter Anyone” in China

Although SMEs will likely be familiar with NDAs from their experiences in Europe, when searching for Chinese manufacturers the best course of action is to triple-down on protection and opt for a non-use, non-disclosure, and non-circumvention agreement.

Non-use will prevent manufacturers from using an SME’s IP to compete with it. Even for trade secrets, these are much more important than they may seem. Many manufacturers which illegally capitalise on trade secrets will not render those secrets useless by revealing them to the public. Instead, the manufacturer itself will attempt to use the secrets to produce goods to

compete with the SME. Strong non-use clauses in an agreement will discourage this behaviour.

Non-disclosure will protect trade secrets against manufacturers' next likely trick: disclosing a trade secret. To understand why a manufacturer would choose to do so, SMEs must understand that trade secrets only receive protection for as long as they remain secret. When they become public knowledge, any protection they had is lost. Manufacturers can thus bypass non-use agreements by disclosing the information and removing its protected status as a trade secret. In these circumstances, other firms will be free to use the information to compete with the SME. To prevent this, NNN agreements mandate that trade secrets cannot be disclosed without the SME's approval and that adequate steps must be taken to protect all such secrets. To discourage disclosure, SMEs can also craft agreements which bind companies whether the information is a trade secret or not, as described in our next article "Writing a good manufacturing non-disclosure agreement in China."

Non-circumvention will prevent the manufacturer from bypassing anti-counterfeiting methods built into an SME's IP. Beyond protecting trade secrets, non-circumvention clauses will prevent the manufacturer from capitalising on exclusive access to your products to sell unauthorised products in other markets. For example, without a non-circumvention agreement, a manufacturer could produce extra goods and sell them to markets which the SME plans to expand into in the near future such as South-East Asia or developing nations.

When to sign an agreement: sending in the canary

A fatal error among SMEs searching for Chinese manufacturers is delay in asking manufacturers to sign NNN agreements. Oftentimes, these agreements are considered to be of secondary importance and SMEs will either overlook their use or will wait until the last minute and will be forced to use a boilerplate agreement.

The best time to prepare an NNN agreement is while preparing to search for manufacturers. Furthermore, never forget to register your IP before you break into a new market or sign manufacturing contracts. Registering your IP will help prevent the manufacturer from registering in China and abusing China's first-to-file system.

Steps for designing a comprehensive agreement are covered in our next article "Writing a good manufacturing non-disclosure agreement in China," but once the agreement is written, it is critical to send NNN agreements to manufacturers before any secrets are disclosed. This will protect an SME's rights without burdening manufacturers. [China lawyers regularly detail horror stories](#) about companies which have failed to protect their IP or have been duped into thinking that not signing an NNN agreement is part of China's local business culture. A manufacturer's refusal to sign an NNN agreement before learning key information about an SME's product is a sure-fire indication of suspicious motivations. On the contrary, a manufacturer which signs the agreement or comes back and asks for provisions to protect their own proprietary information is much more likely to be a reliable partner. Even if the manufacturer had no intention of stealing your IP (unlikely in the case of a manufacturer

which tries to avoid signing an NDA), if the manufacturer refuses to install adequate IP safeguards then the business relationship is simply not suitable.

With a reliable manufacturer found, an SME can move forward with the relationship and can begin drafting other contracts to protect itself during the later phases of cooperation, including a product development agreement and, later, an original equipment manufacturing contract. Splitting up contractual negotiations in this way allows for discussions to begin and for concrete details regarding development and production to be addressed once IP is already shielded. In general, larger manufacturers which do more exporting work will be more likely to have experience with foreign firms and to respect foreign firms' IP.

Naming names: beware of the manufacturer's relationships with other firms

Deciding precisely who will sign contracts and receive classified information on behalf of the Chinese manufacturer is critical. SMEs should remember that while manufacturers may be linked to other firms through relationships between owners or long business ties, these separate companies will be separate legal entities in the eyes of Chinese courts.

This problem can crop up when a clever manufacturer wants to avoid its contractual obligations by signing an agreement with one company and asking that information be also disclosed to a sister company not covered by the original agreement. This will allow the manufacturer's sister organisation to freely exploit the SME's proprietary information. This is especially common with Chinese companies with sister companies located in Macau, Hong Kong, or Taiwan, where agreements enforceable by mainland courts may prove ineffective. If companies in these jurisdictions will be part of an agreement, they should be bound by separate NNN agreements designed to be enforceable in those jurisdictions.

Even honest manufacturers may see no harm in circumventing carelessly crafted contracts. In China, many companies belong to larger corporate groups or identify as state-owned enterprises. These companies may not consider other companies within their group or other state-owned enterprises operating within the same sector to be competitors and may see no harm in sharing an SME's trade secrets with them. In this case, what seems like harmless collaboration to the Chinese firm could actually constitute a grave blow to your firm's competitive advantage.

These kinds of relationships pose added security risks which need to be addressed while the contract is drafted. In such situations, it is not against decency or local business culture to insist that all manufacturers which will be privy to classified information are bound by agreements and will be fully liable if the information is disclosed within their group. Furthermore, if possible, asking that ranking individuals working for the manufacturer personally sign the NNN agreement and accept personal liability if it is broken can help to solidify a contract.

An often overlooked aspect of enforcing NNN agreements is ensuring that the SME's communications themselves abide by the agreement. Clearly marking out which information

is classified or is considered a trade secret can prevent abuse by unscrupulous manufacturers or costly errors by employees. Furthermore, once an NNN agreement is signed with a Chinese firm, an SME should be careful to only disclose secrets to that firm—and to insist that that firm not disclose those secrets to anyone else.

Conclusion

An SME should sign an NDA with any manufacturer to whom it plans to reveal confidential information such as sensitive product information, designs and sketches, business strategy, client information, etc. before doing so. NDAs are quick and inexpensive, and a basic knowledge of key clauses is enough for effective use with manufacturers or employees. NDAs are widely used in China and well-accepted by Chinese courts, so a Chinese third party that is unwilling to sign an NDA is likely not a trustworthy potential business partner and should be treated with caution.

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*The **China IPR SME Helpdesk** supports small and medium sized enterprises (SMEs) from European Union (EU) member states to protect and enforce their Intellectual Property Rights (IPR) in or relating to China, Hong Kong, Macao and Taiwan, through the provision of **free information and services**. The Helpdesk provides jargon-free, first-line, confidential advice on intellectual property and related issues, along with training events, materials and online resources. Individual SMEs and SME intermediaries can submit their IPR queries via email (question@china-iprhelpdesk.eu) and gain access to a panel of experts, in order to receive **free and confidential first-line advice** within **3 working days**.*

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