

Chapter 22

The Disgorgement Damage System in Chinese Law

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Abstract The disgorgement damage or gain-based damage is a relatively new term in Chinese law. The disgorgement damage system was first introduced in China's company law. It was later expanded to other topical laws including intellectual property, securities, torts and the contract law. We can also find cases where Chinese courts have cited rules or jurisprudential basis of disgorgement damage to recover the damage of the injured parties in some of their opinions. This reflects that such provisions have to some degree become an important instrument for private relief and compensation in practice in China. However, it is pity that the practice of the system has lagged behind the expression of the law itself. Also, we do not have a general theoretical legal basis for the system. Besides, existing rules in intellectual property, torts and securities law only assume a supplementary role. To fully develop the functions of Chinese disgorgement system, we need to have a general theoretical basis, establish an internal structure with rich layers, strengthen the criteria for proving the gains, and return to the idea of putting the parties at the center of the system, as required in private law.

Keywords Disgorgement damage (gain-based damage) • Loss-based damage • Theoretical basis • Internal structure • Proving criteria

Introduction

Chinese Laws of damage mainly aim at compensating the injured party for loss suffered. The remedies are therefore in most cases compensatory in nature rather than punitive. The calculation of indemnity is based on the actual loss suffered by the injured party, who will be entitled to an indemnity for damage that is

The authors are grateful to Professor Hu Che for his assistance of this chapter.

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equal to the actual loss. Where there is no actual loss or such loss could not be proven, the court normally will not support the plaintiff's claim for damage. However, social development and legislative reforms have brought about changes to this. In some Chinese cases and legal practices, the loss of the injured party is calculated on the basis of the gain of the infringer or wrongdoer. This is called disgorgement damage or gain-based damage, a relatively new term in Chinese law. The disgorgement damage system was first established in China's company law.¹ It was later introduced to other laws including that of securities,² intellectual property³ and torts.⁴ This chapter will have a comprehensive study and analysis of the disgorgement damage system in the PRC by examining the relevant provisions in the statutes and cases to provide our views to make it more practical and effective in protecting parties' rights and interests.

Relevant Provisions in the Statutes

Relevant provisions with regard to disgorgement damage system mainly appear in four areas of law – company law, securities law, intellectual property law and tort law.

Provisions in Company Law

In the *Company Law of the People's Republic of China* (hereinafter referred as "Company Law"), there are four articles which are about corporation disgorgement damage.

First, Article 61 of the Company Law, which is related to the gains in the violation of prohibition of business strife, provides "A director or the general manager may not engage in the same business as the company in which he serves as a director or the general manager either for his own account or for any other person's account, or engage in any activity detrimental to company interests. If a director or the general manager engages in any of the above mentioned business or activity, any income so

¹The Company Law of the People's Republic of China was promulgated in 1993, and amended in 1999, 2004 and 2005. Unless acknowledged otherwise, quotations of all the statutes are from the latest version.

²The Securities Law of People's Republic of China was promulgated in 1998 and amended in 2004, 2005 and 2013.

³The Copyright Law of the People's Republic of China was promulgated in 1990, and amended in 2001 and 2010. The Patent Law of People's Republic of China was promulgated in 1984, and amended in 1992, 2000 and 2008. The Trademark Law of People's Republic of China was promulgated in 1982, and amended in 1993, 2001 and 2013.

⁴The Tort Law of People's Republic of China was promulgated in 2010.

derived shall be disgorged to the company. Unless otherwise provided in the articles of association or otherwise agreed by the shareholders' committee, a director or the general manager may not execute any contract or engage in any transaction with the company”.

Secondly, Article 147 of the Company Law, which is related to promoters and administrators' gains from improper shares transfer, provides “Shares of a company held by its promoters shall not be transferred for a period of 3 years commencing from the date of the company's establishment. Directors, supervisors and general manager of a company shall report to the company the number of the company's shares held thereby, and shall not transfer such shares while they are in office”.

Thirdly, Article 214 (2) of the Company Law governs company management improper personal gains, providing “Where a director or the general manager misappropriates company funds or lend company fund to third parties, he shall be ordered to return the company fund and shall be disciplined by the company, and the gains derived from such transaction shall be turned over to the company. Where such action constitutes a crime, criminal liability shall be imposed in accordance with the law. Where, in violation hereof, the directors or the general manager use company assets as security for personal debt of any director of the company or any other person, the security arrangement shall be ordered to be canceled, and such persons shall be held liable for damages in accordance with the law, and the gains derived from the illegal provision of security shall be turned over to the company. Where the circumstance is serious, such persons shall be disciplined by the company.”

Fourthly, Article 215 of the Company Law, which also governs gains in violation of prohibition of business strife, provides “Where, in violation hereof, a director or the general manager engages in the same business as the company either for his own account or for another person's account, in addition to turning over any income so derived to the company, such person may also be disciplined by the company.”

Provisions in Securities Law

There is only one article in the *Securities Law of the People's Republic of China* (hereinafter referred as “Securities Law”) on corporation disgorgement damage. Article 42 of the Securities Law provides that majority shareholders' gains from “short-swing trading” shall belong to the company, saying: “Where any director, supervisor and senior manager of a listed company or any shareholder who holds more than 5 % of the shares of a listed company, sells the stocks of the company as held within 6 months after purchase, or purchases any stock as sold within 6 months thereafter, any gains therefrom shall belong to the company. The board of directors of the company shall obtain the gains from these transactions for the company. However, where a securities company holds more than 5 % of the shares of a listed company, which are the unsold stocks that the securities company has purchased from the company for resale, the sale of these stocks will not be limited by a term of 6 months. Where the board of directors of a company

fails to implement the provisions as prescribed in the preceding paragraph herein, the shareholders concerned have the right to demand that the board of directors implement them within 30 days. Where the board of directors of a company fails to implement them within the aforesaid term, the shareholders have the right to directly file a law suit with the people's court in their own names for the interests of the company. Where the board of directors of a company fail to implement the provisions as prescribed in paragraph one herein, the directors in charge shall be jointly and severally liable according to law.” Compared to regulations in the Company Law, this provision is technically designed better. However, the provisions in the Company Law include more instances of corporation disgorgement damage and thus cover a wider regulatory area.

In addition, there are similar provisions in two special laws relating to securities. They are the *Trust Law of the People's Republic of China* (hereinafter referred as “Trust Law”) and the *Law of the People's Republic of China on Funds for Investment in Securities*⁵ (hereinafter referred as “Securities Investment Fund Law”). Article 26 of the Trust Law provides that “the trustee must not take advantage of the trust property to seek profits for his own except getting remuneration according to the provisions of this Law. If the trustee violates the provisions of the preceding paragraph to take advantage of the trust property to seek profits for his own, the profits he obtains shall be brought into the trust property.”

Article 130 of the Securities Investment Fund Law provides that “a fund management institution or fund custodian which commits any act as set out in items (1) to (5) and item (7), paragraph 1 of Article 74 of this Law or violates paragraph 2 of Article 74 of this Law shall be ordered to make rectification and be fined from 100,000 Yuan up to one million Yuan; and the directly responsible person in charge and other directly liable persons shall be warned, with their fund business qualifications suspended or revoked, and be each fined from 30,000 Yuan up to 300,000 Yuan. Any property and income obtained from the utilization of fund assets by a fund management institution or fund custodian committing any act prescribed in the preceding paragraph shall become part of the fund assets, except as otherwise provided for by any law or administrative regulation.”

Provisions in Intellectual Property Law

The laws on intellectual property have been revised multiple times. But the provisions on disgorgement damages have stayed largely unchanged.

Article 49 of the *Copyright Law of the People's Republic of China* (hereinafter referred as “Copyright Law”) provides that “if a copyright or copyright-related right is infringed, compensation shall be paid according to the actual loss of the

⁵The Law of the People's Republic of China on Funds for Investment in Securities was promulgated in 2003 and amended in 2012.

right owner by the person who made the infringement; if the computation of the actual loss is difficult, compensation may be paid according to the illegal gains of the person who made the infringement. The compensation shall also include the reasonable expenses of the right owner for preventing the act of infringement. If the actual loss of the right owner or the illegal gains of the person who made the infringement could not be ascertained, the people's court shall judge the compensation not exceeding 500,000 Yuan depending on the circumstances of the act of infringement”.

Article 65 of the *Patent Law of the People's Republic of China* (hereinafter referred as “Patent Law”) provides that “the amount of compensation for the damage caused by the infringement of the patent right shall be assessed on the basis of the actual losses suffered by the right holder because of the infringement; where it is difficult to determine the actual losses, the amount may be assessed on the basis of the profits the infringer has earned because of the infringement. Where it is difficult to determine the losses the right holder has suffered or the profits the infringer has earned, the amount may be assessed by reference to the appropriate multiple of the amount of the exploitation fee of that patent under a contractual license. The amount of compensation for the damage shall also include the reasonable expenses of the right holder incurred for stopping the infringing act”.

Article 63 of the *Trademark Law of the People's Republic of China* (hereinafter referred as “Trademark Law”) provides that “the amount of damages for infringement upon the right to exclusively use a registered trademark shall be determined according to the actual losses suffered by the right holder from the infringement; where it is difficult to determine the amount of actual losses, the amount of damages may be determined according to the benefits acquired by the infringer from the infringement; where it is difficult to determine the right holder's losses or the benefits acquired by the infringer, the amount of damages may be a reasonable multiple of the royalties. If the infringement is committed in bad faith with serious circumstances, the amount of damages shall be the amount, but not more than three times the amount, determined in the aforesaid method. The amount of damages shall include reasonable expenses of the right holder for stopping the infringement. Where the right holder has made its best efforts to adduce evidence but the account books and materials related to infringement are mainly in the possession of the infringer, in order to determine the amount of damages, a people's court may order the infringer to provide such account books and materials; and if the infringer refuses to provide the same or provide any false ones, the people's court may determine the amount of damages by reference to the claims of and the evidence provided by the right holder.”

Article 20 of the *Anti-Unfair Competition Law of the People's Republic of China* (hereinafter referred as “Anti-Unfair Competition Law”) provides that “where an operator, in contravention of the provisions of this Law, causes damage to another operator, i.e., the injured party, the infringer shall bear the responsibility for compensating for the damages. Where the losses suffered by the injured operator are difficult to calculate, the amount of damages shall be the profit gained by the infringer during the period of infringement through the infringing act. The infringer

shall also bear all reasonable costs paid by the injured operator in investigating the acts of unfair competition committed by the operator suspected of infringing the injured operator's lawful rights and interests".

Provisions in Tort Law

Article 20 of the *Tort Law of the People's Republic of China* (hereinafter referred as "Tort Law") governs the infringement disgorgement damage. It provides that "where any harm caused by a tort to a personal right or interest of another person gives rise to any loss to the property of the victim of the tort, the tortfeasor shall make compensation as per the loss sustained by the victim as the result of the tort. If the loss sustained by the victim is difficult to be ascertained and the tortfeasor obtains any benefit from the tort, the tortfeasor shall make compensation as per the benefit obtained. If the benefit obtained by the tortfeasor from the tort is difficult to be ascertained, the victim and the tortfeasor disagree to the amount of compensation after consultation, and an action is brought to a people's court, the people's court shall determine the amount of compensation based on the actual situation".

Some Chinese legal scholars believe that this provision has its root in relevant provisions of the intellectual property law. Some other Chinese legal scholars believe that this provision is borrowed directly from similar provisions in the Netherlands Civil Code or German Civil Code. As early as 2001, before the Tort Law was even promulgated, the Supreme People's Court of the PRC issued the Interpretation of the Supreme People's Court on Problems Regarding the Ascertainment of Compensation Liability for Emotional Damages in Civil Torts "hereinafter referred as "Tort Interpretation"). Some of the provisions in the Tort Interpretation recognized the infringement disgorgement damage system to some extent. Article 10 of the Tort Interpretation expressly recognizes "circumstances regarding earnings gained through the infringement" as an important basis for calculating emotional damage. Though the Tort Interpretation is not a general rule for infringement disgorgement damage, it essentially recognizes the rule of disgorgement damage by using the infringer's gains as calculation factor and method.

Practice of Disgorgement Damage in the PRC

The provisions on disgorgement damage in different legal subject matters are recognized and accepted by Chinese courts. We can find cases where Chinese courts have cited rules or jurisprudential basis of disgorgement damage to recover damage for the victim. This shows that these provisions have been to some degree implemented in China's legal practice and become an important tool for granting private relief and compensation in practice.

Practice of Disgorgement Damage in IPR Infringement

The IPR law has the most influential provisions on the disgorgement damage system in China as well as their application in practice. The leading case on this point is *Chint Group Corporation v Schneider Electric Low Voltage (Tianjin) Co., Ltd. and Ningbo Free Trade Zone Star Electrical Equipment Co., Ltd. Yueqing Branch*,⁶ the so-called “the No. 1 case of compensation of China’s patent infringement” in 2007. In this case, Chint Group Corporation (hereinafter referred to as “Chint”) sued Schneider Electric Low Voltage (Tianjin) Co., Ltd. (hereinafter referred to as “Schneider”) and Ningbo Free Trade Zone Star Electrical Equipment Co., Ltd. Yueqing Branch (hereinafter referred to as “Star’s branch company”) for infringement of its utility model patent, and the Wenzhou Intermediate People’s Court expressively supported the plaintiff’s claim to calculate the damage on the basis of the standard of the operating profit gained by the defendant from the patent infringement and therefore ordered that Schneider compensates for the plaintiff’s loss of more than RMB 330 million Yuan. The court believes that “Schneider’s act of manufacturing and selling the patented product for the purpose of production and operation without the consent of patentee Chint and the act of Star’s branch company of selling the patented product for the purpose of production and operation without the consent of patentee Chint have constituted infringement of patent right and should therefore bear corresponding civil liabilities. Since Schneider is not an infringer who only engages in patent infringement, it should pay indemnity according to its profit from operations. Schneider’s sales volume of the infringed patented product during the infringement term shall be first of all determined with the data that Schneider provides; the smaller figure between Schneider’s average operating profit margin from selling all its products and the data in the sheet of Schneider’s operating profit margin from selling the infringed patented product (the sheet is submitted by Chint) shall be the final operating profit margin for calculating the amount of indemnity. In this way, Schneider’s operating profit from selling the infringed patented product from August 2, 2004 to July 31, 2006 is calculated as RMB 355,939,206.25 Yuan. As Chint has claimed for an indemnity of RMB 334,869,872 Yuan, we determine that the smaller figure shall be the amount of indemnity that Schneider shall pay.

In this case, the plaintiff filed an action against a joint venture of Schneider Electric, one of world’s top 500 largest companies. It attracted a lot of attention from both business community and legal community at home and abroad. Furthermore, the subject matter involved here is a utility model, usually called as petty invention while the damages claimed is over RMB 330 million, the highest amount ever supported by a court of first instance in a Chinese IPR case. That’s why it has won itself the name of “the No. 1 case of patent infringement in China”.⁷

⁶Wenzhou Intermediate People’s Court (2006) Wenmingsanchuzi No. 135 Judgment.

⁷Yan (2007).

On August 2, 2006, Chint filed law suit in Wenzhou Intermediate People's Court against Schneider for the cause of patent infringement. In the beginning it just requested the defendant stop producing products accused for patent infringement and claimed compensation of RMB 500,000. Later in January, 2007, at the request from the plaintiff, the court chose a local accounting firm to conduct auditing on the sales and profits of circuit breakers from Schneider. According to the auditing report, the sales amounted to RMB 880 million while the actual profit was not ascertained. Base on pertinent evidence, Chint concluded that the profit margin of Schneider was over 30 % and thus raised the damages to over RMB 330 million. There is no doubt that without the support of patent infringement disgorgement damage rules and system, the plaintiff would never won RMB 330 million compensation, since the plaintiff could not prove that the loss amounted to such a figure. This is the very reason why the damages originally claimed was only RMB 500,000.

Practice of Disgorgement Damage in Tort Law

Legal practices of disgorgement damage for infringing right to personality began before the promulgation of the Tort Law. In the case of *Wang Junxia v Kunming Cigarette Factory*,⁸ which was handed down in early 2001, the defendant used the portrait of the former Olympic Game champion in commercial advertisement without Wang's permission. During the trial, Liaoning provincial people's Court did not reject the plaintiff's claim even though the plaintiff failed to prove the amount of pecuniary loss. Instead, on the ground that the defendant's gains can be regarded as equivalency of loss for the plaintiff, the court ruled in Wang Junxia's favor, awarding damages of RMB 800,000.

In the case of *Mo Shaocong v Quanzhou Xinhua Co.*⁹ in 2005, the Quanzhou Intermediate People's Court in Fujian made a similar conclusion, saying that "the trial court did not commit error to consider the agreement on remuneration for portrait use in advertisement contract and the plaintiff's social reputation, the infringer's degree of fault and the possible economic gains for the appellant, in determining the amount of compensation." Though at that time in China the Tort Law had not been promulgated, these cases applied the method of tort disgorgement damages to calculate the loss of victims. The practices reflected in these cases provided support to the draft of Article 20 in Tort Law in 2010, and provided guidance for future practice.¹⁰

⁸Wang Junxia v. Kunming Cigarette Factory, Liaoning High People's Court (2001) Liaominzhongzi No. 162 Judgment.

⁹Quanzhou Intermediate People's Court (2005) Quanminzhongzi No. 1178 Judgment.

¹⁰Certainly, contrary judgments exit at the same time. Similar to details of the case of Wang Junxia and the case of Mo Shaocong, there are the case of the actor Hanxue, the case of the athlete Liu Xiang and the case of Zhang Bozhi. However, the method of disgorgement damages was not

The Practice of Disgorgement Damage for the Breach of Contract

Article 113 of *Contract Law of the People's Republic of China* (hereinafter referred as "Contract Law") has provided general principles for default damages. It says that "where a party fails to perform or rendered non-conforming performance, thereby causing loss to the other party, the amount of damages payable shall be equivalent to the other party's loss resulting from the breach, including any benefit that may be accrued from performance of the contract, provided that the amount shall not exceed the likely loss resulting from the breach which was foreseeable or should have been foreseeable by the breaching party at the time of conclusion of the contract". In other words, damages just consist of the non-breaching party's loss resulting from the breach, including actual loss and loss of contingent interests. Gains from the breach and received by the breaching party are not included. Therefore there are no rules or system of the default disgorgement damage in the Contract Law in China.

However, in Chinese judicial practices, there have been cases which explicitly recognize rules of default disgorgement damages. In the most precedential case that clearly recognizes the use of calculating the gains of the breaching party as the standard for calculating damages, Loulan Store Co., Ltd, Shanghai sued Fengxian Property Co. Ltd., Shanghai over the dispute of a lease contract.¹¹ The Shanghai Fengxian District People's Court clearly stated that "according to the reality of the case that Fengxian Property did not agree to continue to perform the lease contract, therefore the Court cannot support the claim of Loulan Store Co. Ltd, Shanghai on the continued performance of the lease contract. It is not against the law that Loulan Store Co. Ltd, Shanghai claimed to calculate the amount of its loss and damage according to the amount of the gains that Fengxian Property obtained from leasing the house to persons not involved in the case when the contract with Loulan Store for the same property was still in force. Fengxian Property obtained a rental of RMB 710,200 Yuan from leasing the house of No. 1, Nanjing Road for 2 years and earned a profit of RMB 170,200 Yuan after deducting the rental of RMB 540,000 Yuan that

adopted. Even in the only case applying article 20 after the enforcement of the Tort Law – the case of Ren Dahua's right to portrait, the court held that the plaintiff fails to identify the actual loss. In addition, the court could not ascertain economic benefits for using Ren Dahua's portrait. Therefore, the amount of compensation should be, on the basis of actual conditions, determined discretionally by the court. The court of first instance, considering the actual circumstances, ruled that Charoen Pokphand Group should pay 20 damages for the plaintiff. Thus the original judgment is not improper and shall be sustained. In other words, the court just discretionally determined the tort disgorgement damages according to infringer's degree of fault, circumstances of infringing act, consequence and influence, without applying article 20, which is about the rule of infringer disgorgement damages. See Hainan Provincial People's Court (2013) Qiongmingsanzhongzi No. 59 Judgment.

¹¹ Shanghai Fengxian District People's Court (2013) Fengmingsanchuzi No. 2190 Judgment.

Loulan Store would have paid during this period. Therefore the Court supported the claim of Loulan Store against Fengxian Property for an economic loss of RMB 170,200 Yuan.”

In a similar case, Zhuozhou Longma Aluminium Product Co., Ltd. sued Sichuan Huaxi General-Purpose Machine Company over the dispute of a technical contract.¹² In this case, the Court held that the defendant actually infringed the right of sales of the plaintiff and illegally took the interests that should have been received by the plaintiff. According to the contract, the price of the 13 extruding machines was RMB 800,000 Yuan each, while the actual selling price of the defendant in 1994 was RMB 1,490,000 Yuan. The difference between these two prices should belong to the plaintiff. Since the defendant has sold the 13 machines itself, it should compensate the losses of the plaintiff. Considering the factors of the market price and charges against revenue, the defendant should compensate the plaintiff 50 % of the total price difference, i.e. RMB 4,485,000 Yuan.

The Practice of Corporation Disgorgement Damage

The system of the corporation disgorgement damage is a specific legal practice of the disgorgement damage theory applied in the field of commercial law such as the company law and the securities law. For example, Information Technology Co., Ltd. in Shanghai (hereafter as company A) sued Luo and others for harming the interests of the company, Shanghai No. 1 Intermediate People’s Court decided that “the duty of non-competition is one of the duties of loyalty of the company directors and senior executives. The reason that the duty of loyalty is confirmed by law is because senior management controls the actual operation of a company to a large extent. They are properly authorized to manage the company. Therefore what they do determines whether the interests of the shareholders can be effectively protected. For this reason, when there is a conflict between their interests and the company’s, they should put the company’s interests first. In this case, Luo, as one of the shareholders and general manager of company A, did not perform the duty of non-competition when he co-founded company B with others and gained profit from it. His acts should be subject to the non-competition restriction. Following Articles 148 (1), 149 (1)(e) and (2) and 217(1) of the Company Law, the Court decides that the interest of RMB 22,125 Yuan that Luo gained from company B should be paid to company A within ten (10) days after this judgment comes into force.”¹³

¹²Baoding Intermediate People’s Court (1998) Baoshijingerchuzi No. 85 Judgment.

¹³See Shanghai No. 1 Intermediate People’s Court (2011) Huyizhongminsizhongzi No. 889 Judgment.

Problems Facing the Disgorgement Damage System in the PRC

Lack of Universal Theoretical Basis

The rules of disgorgement damage in Chinese law exist in regulations for different legal subject matters with different inception time and imbalance in their development. For example, the disgorgement damage system was formed as the earliest in corporate law and intellectual property law and now is in a relatively maturity stage; while the disgorgement damage system for breach of contract has not been found in any statute. It can be said that there is not a coordinated structure for the disgorgement damage rules in each legal subject matter, and the most important reason for that is that there is no universal and internal legal basis for them. There already exist three thoughts about this legal basis, but none of them is fully convincing, thus leaving a universal legal basis still absent.

The first thought considers the legal basis of disgorgement damage as a theory of unjust enrichment. The basic logic of unjust enrichment system is that the gain of the party results in the loss of the other party and the gain is not due to rightful cause permitted by law, then a legal obligation formed between the aggrieved party and the party with the gain and the former is entitled to the return of all the gain. It is generally acknowledged by the academia that the first case in which the disgorgement damage was dealt with the theory of unjust enrichment was found in the intellectual property law, including Article 18 in the 1870 UrhG, Article 14 in the 1876 GebrMG and the famous case of “Ariston” that conducted by the Reichsgericht in 1895.¹⁴ However, the problem of unjust enrichment theory is that it is based on legal interest distribution theory without requirement of the element of fault or illegality, while the disgorgement damage system is aimed at gains through illegal actions, which cannot be covered only by the unjust enrichment theory.

The second thought states that the legal basis of the disgorgement damage theory is the tort compensation theory.¹⁵ If the tortfeasor gains profit through his or her tortious acts, then the injured party can certainly claim compensation for damages. However, the problem of tort compensation theory lies in the fact that the aim of the law is to make up for the damages, so even if what the tortfeasor gained from its tortious acts exceeds much more than the injured party’s loss, the injured party can only claim compensation based on his or her actual damage value. The tortfeasor can still keep much gain after paying the injured party all the compensation damages. That is to say that it lacks sufficient theoretical basis to require the tortfeasor return all his or her gains only on basis of the tort compensation damage theory.

The last thought considers that the disgorgement damage system is the base of right of the request and a system of compensation for damages. German civil jurist

¹⁴See Yan (2011).

¹⁵Wang (2011), 280.

Canaris once said that there is a transitional zone between unjust enrichment and the damage compensation liability, namely the independent disgorgement system and the disgorgement damage problems should be solved with a combination of the theory of the attribution and distribution of unjust enrichment and the core of the illegality theory of the compensation for damages.¹⁶ However the problem of this independent disgorgement damage theory is whether it is possible to cover with a universal theory all the provisions of compensation system that scatter in different legal branches varying much in concepts and systems, such as intellectual property, torts, corporate and securities law and contract law; even if the answer is yes, it is still doubtful whether there is a difference in the level of the content, the institutional composition and the legal effects.

Complementary in the Tort Disgorgement Damage System

In Chinese intellectual property law, the tort disgorgement damage system is just a complementary and alternative method for the compensation of infringement of intellectual property. Only when the right owner cannot prove his or her damage or the damage cannot be confirmed, the law allows the right owner to count his or her damage value on the basis of the gains of the infringer. In other words, taking the damage value of the right owner as the compensation standard has priority, while the standard of considering the gains of the infringer is just an alternative for exceptional occasions. Even if the damage value can be proved or confirmed, the right owner can only claim compensation for the actual damage value without the disgorgement damage. Besides, despite of the request of the right owner for a disgorgement, if the infringer can prove or confirm the actual damage value, he or she has the right to raise a plead to deny the disgorgement request.¹⁷

The provisions in Chinese Copyright Law, Trademark Law, Patent Law and Anti-Unfair Competition Law are in line with the above situation. Moreover, Article 20 in the Tort Liability Law also states this order of priority of claim of compensation for damage and claim of disgorgement for damage. This shows the marginal and complementary nature of the disgorgement damage system in Chinese intellectual property law and tort law and makes it a non-mainstream theory and system in this field.

Furthermore, no matter in the infringement of intellectual property or personal right, the gains of the infringer is hard to be proved. In most cases, it is even harder than to prove the damage of the injured party. This is not only due to the fact that the gains of the infringer is decided by many factors that are difficult for the injured party to prove, meanwhile, the account books that are necessary

¹⁶See Yan (2011).

¹⁷Sun (2011).

for the proof of the gains will not be provided by the infringer.¹⁸ Therefore, if the law says the disgorgement damage system should give priority to the system of compensation for damage, the standard of disgorgement becomes meaningless. Courts can conduct almost all the trials with a standard of legal compensation or discretionary compensation, of which the statement would be “considering the plaintiff couldn’t prove the actual damage value caused by the defendant or the gains of the defendant, and taking into consideration the popularity of the registered trademark, the business scale and scope of the infringer and the sales mode, quantity and price and the reasonable expense of the plaintiff to stop the infringement actions, the Court accordingly decides the amount of compensation is RMB xxx Yuan.”¹⁹ That is why although laws about disgorgement of intellectual property have already been existed in China for years and thousands of precedents regarding to this aspect have emerged in legal practice, cases that were conducted with disgorgement damage theory were quite rare. It took the author much efforts to finally find out from the database of “Bei Da Fa Bao” the case that Chint Group Corporation sued the Schneider Electric, which is probably the only one supported by the tort disgorgement of intellectual property.

Lack of Operability in Corporate Disgorgement Damage

The corporate disgorgement damage is stated in the Chinese corporation law and securities law to protect the interests of corporations. Despite of that, those provisions are too rigid and lack of operability. As a result, in the legal practice, even under the condition where the corporation disgorgement damage can be applied, many people would choose an alternative method after considering the trade-off. Thus, the superiority of the corporation disgorgement damage cannot be reflected. Hence, cases that were conducted by the corporation disgorgement damage were rarely seen in Chinese legal practice. This system exists in name only, which compels us to rethink. The major defects of Chinese corporation disgorgement damage are as follows:

First, there is a loophole in defining the subject harming the interests of corporation. For example, under the condition in which the directors, supervisors and senior executives harm the interests of corporation due to a violation of the obligation of non-competition, whether the general managers and vice-general managers of the branch company can be regarded as senior executives so that the corporation disgorgement damage can be exercised on them. There is still no clear definition, which brings about the difficulty in legal practice. In the appeal of a case between Yunnan Zhongji Tubular Pile Corporation and Yan and others, the Court held that

¹⁸Chen and Zhao (2013).

¹⁹See *Louis Vuitton Malletier v Xiongyan and others*, Sichuan Provincial People’s Court (2013) Chuanminzhongzi No. 579 Judgment.

“Yunnan Zhongji appeals to claim the disgorgement of their illegal gains based on Yan’s violation of non-competition. This claim should be under the premise that the identities of these two appellees are the directors, supervisors or senior executives. However according to the evidence provided by Yunnan Zhongji, Yan A is just the general manager of the Shanghai branch and Yan B deny his identity as the vice general manager. The two appellees are not senior executives even if the evidence is true. Neither the law nor the charter of Yunnan Zhongji recognizes the two appellees as senior executives. Therefore, the claim of Yunnan Zhongji of disgorgement damage lacks in constitutive requirements and preconditions.”²⁰

Second, the organs that exercise the right of disgorgement are not clear. In China, only the securities law clearly states that the board of directors represents the company to perform the right of disgorgement. However, in corporation law, the right of shareholders, the board of directors, the board of supervisors and managers don’t include the right to perform disgorgement. In other words, none of the company organs have the right to represent the company to perform disgorgement.

Finally, it is hard to prove the gains by the senior executives. In a case in which MCC Quantai (Beijing) Engineering and Technology Corporation sued Cong Aiming and other senior executives for damaging the interests of the company, the Court held that the senior executives took the business opportunity of the company and should compensate for the expected profit. In this case, the expected profit should be calculated according to the profit amount of Jingtai Corporation, profit margin of other business of Quantai and other evidence. What should be made explicit is that in the corporation law, the disgorgement is among the consequence of the senior executives’ violation of duty of loyalty. But in this case, it is difficult to prove the profit of the senior executives and the expected profit required by Quantai apparently overlapped with it. For this reason, it is reasonable to calculate the expected profit with the possible profit of Jingtai.²¹

Occasionality and Inconsistency in Judgments in Disgorgement Damage for Breach of Contract

As is presented above, Shanghai Fengxian District People’s Court, in the case of Loulan Store Co., Ltd, Shanghai, has expressly recognized the legal practice of disgorgement damage for breach of contract. But judging from the overall judicial practice in China, such cases are rare. In general, courts do not support the legal practice of disgorgement damage for breach of contract. The leading case is *Shenyang Nongda Seed Co., Ltd. vs. Du Mingluan and others*,²² a case concerning

²⁰Shanghai Second Intermediate People’s Court (2012) Huerzhongminsizhongzi No. 261 Judgment.

²¹Beijing First Intermediate People’s Court (2010) Yizhongminzhongzi No. 10249 Judgment.

²²Shenyang People’s Intermediate People’s Court (2007) Shenminsizhichuzi No. 76 Judgment.

the dispute over the license contract of the implementation of new plant varieties, where the court pointed out that “this term is the compensation term for breach of contract that the two parties have agreed upon against the defendant for its act of assigning the plant varieties to any third party without authorization. Now the defendant has breached the contract by assigning the plant varieties to others without authorization, and should therefore bear responsibilities for breach of contract. In regard to plaintiff’s claim that the second defendant compensates the plaintiff for its economic loss of RMB 500,000 Yuan due to the defendant’s breach of contract, this court believes that the plaintiff has not provided effective proof for such economic loss, therefore this court does not support plaintiff’s claim of calculating its damage on the legal basis of the disgorgement damage of the defendant.”²³

Furthermore, in those rare cases where courts seem to have supported disgorgement damage, courts, instead of carrying out the practice of disgorgement damage to the contract-abiding party, are in fact employing factors concerning disgorgement contract-breaching party for deciding whether or not the liquidated damage is appropriate. For example, in the case on appeal where Shanghai Mingtai Investment Development Co., Ltd. (hereinafter referred to as Mingtai Company) and others sued Ye Yuequn over the dispute of share ownership transfer, the court holds that: Huang Fan’s act of transferring the same share ownership to several transferees constitutes dishonesty upon the conclusion of the share ownership transfer contracts. Where both the two contracts have legal force, Huang Fan can only chose one to perform and the other one is therefore breached. Huang knew that the breach of the share ownership contract in dispute would lead to the compensation of a liquidated damage of RMB 45 million Yuan but chose to do so; this court therefore has sufficient reason to believe that Huang’s anticipated benefit by such breaching is bound to exceed the liquidated damage. After breaching the contract, Huang Fan has not taken effective remedial measures. In consequence, the continual performance of the contract was frustrated. Huang’s act has constituted a malicious breach of contract. Mingtai Company therefore lost the chance to manage Shanghai Tianhong Yihai Enterprise Development Co., Ltd., but got the possibility of gaining much more profit. A liquidated damage of RMB 45 million Yuan is higher than Mingtai Company’s actual loss and the share ownership transfer contract was then in performance, but taking all factors into consideration including Huang Fan’s maliciousness and anticipated interest, this court believes that RMB 45 million Yuan is not that much high as liquidated damage. Therefore, the judgment of adjusting the liquidated damage to RMB five million Yuan made by the court of first instance lacks acceptable ground and this court hereby rectifies the judgment. However, as Mingtai Company now claims only for a liquidated damage of RMB 15 million, this court therefore supports such claim.²⁴

Similarly, in the case where NGS Supermarket Group Co., Ltd. (hereinafter referred to as NGS Supermarket) sued Shanghai Yitana Travel Products Co., Ltd.

²³Shenyang People’s Intermediate People’s Court (2007) Shenminzizhichuzi No. 76 Judgment.

²⁴Shanghai High People’s Court (2012) Hugaominerzhongzi No. 5 Judgment.

(hereinafter referred to as Yitana Company) over the dispute of house-leasing contract, the court holds: defendant Yitana Company asked for lowering the agreed liquidated damage, and the judgment of the court of first instance can be supported only when the original liquidated damage agreed upon by the two parties is indeed excessive. NGS Supermarket has in the first instance provided relevant lease contract and supplementary agreement which indicate that Yitana Company, instead of fulfilling its obligation of making the house available, has actually rented the house to a third party, Shanghai Ruhai Supermarket Chain Co., Ltd. (hereinafter referred to as Ruhai Supermarket), and Yitana Company raised no objection against this fact. Both the lease term in above-mentioned lease contract and supplementary agreement by and between Yitana Company and Ruhai Supermarket and that in the house-leasing contract by and between Yitana Company and NGS Supermarket are 15 years. But Ruhai Supermarket undertook that the annual rent in the first 5 years is RMB 280,000 Yuan and will increase year-on-year by 3 % in the following 10 years, while NGS Supermarket had undertaken that the annual rent in the first 3 years is RMB 200,000 Yuan and will increase by 3 % in the following 12 years. Thus the rent that should be paid by Ruhai Supermarket in the first 3 years is RMB 240,000 Yuan more than the rent of NGS Supermarket. In the following 12 years, the annual rent agreed upon by and between Ruhai Supermarket and Yitana Company is over RMB 60,000 Yuan in average more than the annual rent originally agreed upon by and between NGS Supermarket and Yitana Company. Therefore, NGS Supermarket has sufficiently proved the fact that Yitana Company would benefit more by breaching the original contract. By contrast, Yitana Company has not provided corresponding proof to support its claim that it has notified NGS Supermarket to accept the house in dispute, nor has it provided proof for NGS Supermarket's refusal of accepting the house. Taking all those factors into consideration, the judgment of lowering the liquidated damage agreed upon by and between the two parties in the original contract made by the court of first instance with judicial discretion shall be overruled.²⁵

In addition, the contract academia in China has neither carried out systematic researches nor identified mature solutions for such questions as whether or not the profit or gains should be considered in damages for breach of contract; if so, how to make it consistent with the theory of efficient breach; whether there is any unjust enrichment in the whole contract damage process; etc.

Lack of the Central Role of the Parties Involved

There is a strong tendency of statism in China's disgorgement damage system. The illegal gains of actors are in general taken over to the national treasury and seldom used to relieve the injured party. Chinese private law system pays little attention

²⁵Shanghai First Intermediate People's Court (2005) Huyizhongminerzhongzi No. 2194 Judgment.

to the central role of parties involved. In details, Article 131 of *Opinions of the Supreme People's Court on Several Issues concerning the Implementation of the General Principles of the Civil Law of the People's Republic of China* provides that "the returned illegal profits shall include the original object and the fruits arising therefrom. Other interests obtained through illegal profits shall be taken over after deducting the labor service overheads." Article 209 of the *Securities Law* provides that "all the illegitimate incomes and fines lawfully confiscated and collecting from issuing and trading securities against the law shall be delivered to the national treasury." The Supreme People's Court's *Reply on How to Deal with Debtor's Overdue Unpaid Loan in Enterprise Loan Contract* has similar provisions in this regard as shown by "enterprise loan contracts against relevant financial rules are invalid. The interests agreed shall be taken over by the state." The list of such provisions goes on, reflecting statism and the negligence on private subjects.

Suggestion for Improvement

Unifying the Theoretical Basis for Disgorgement Damage System

The establishment of a disgorgement damage system in China that can properly operate and efficiently protect the rights of private subjects rests on a general legal basis for the system, which can integrate the various fragmented rules on disgorgement damage dispersed in IP law, torts, company law, securities law and contract law into an independent system of right of claim for disgorgement damage. The system shall have its own internal structure. After all, the legal basis of the disgorgement damage system differs from those of the unjust enrichment system, tort damage system and the default damage system, in particular, the differences in legal bases of the disgorgement damage system and the unjust enrichment system shall be distinguished. Though very similar, "no one shall benefit from other's damage" is the legal basis of the former and "no one should benefit from his/het/its own illegal acts" is the legal basis of the latter.

At the same time, we should pay close attention to the latest development of foreign laws. For instance, in the 2011 US Restatement of Restitution and Unjust Enrichment, it is clearly recognized that disgorgement may be appropriate in some cases.²⁶ Also in Germany a general instrument, "disgorgement damages" is lacking in the Civil Code of 1900. However, recently well-known scholars as *Gerhard Wagner* do support for an inclusion of disgorgement damages in the law of damages

²⁶See American Law Institute (2011), §39, 'Profit From Opportunistic Breach', §51, 'Enrichment By Misconduct; Disgorgement; Accounting' and §53, 'Use Value; Proceeds; Consequential Gains'.

(for intentional infringements).²⁷ The foreign experience is an effective resource for China to unify its disgorgement damage system and improve the relevant domestic laws and systems as well.

Clarifying the Structure Within the Disgorgement System

A unified disgorgement damage system in China does not mean a monolithic whole. A whole without distinction of internal structure is not pertinent or effective in addressing specific problems. Therefore, from the perspective of different influence of public laws declining in strength, the disgorgement damage system can be divided into the following three internal layers:

The first layer is the company (investor) disgorgement system where the public laws have the strongest influence. The disgorgement system in the company law and the securities law are established for the protection of interests of investors and are exposed most to the influence of public laws. Where the directors, supervisors, senior managerial staff, shareholders, trustees and others breach the fiduciary duties in the company law and the investment law, the profit or gains of the person shall be unconditionally deprived or disgorged, a system we may call compulsory disgorgement model.

At the second layer, there are the disgorgement damage system of intellectual property infringement and the disgorgement damages system of personal right infringement, both with heavy influence from public law. To protect injured party' interests, the disgorgement damage system at this layer need go beyond the existing supplementary legislative model for intellectual property law and tort law, where only when a right owner could not prove his or her loss or the loss could not be determined, he or she then may calculate the damages amount according to infringer's benefits. Instead, we shall employ an optional legislative model, where a right owner is allowed to calculate the amount either according to his or her loss or the infringer's benefits. Such model must be more effective for relieving and protecting right-owners' interests.

At the third layer, there is the breach disgorgement damage system, with the least influence from public law. Among legal subject matters of private law, contract law can most sufficiently present traits of private autonomy and discretion of private law. Therefore liability of breach damage in contract law is the most typical compensatory one. In general, the amount of compensation is based on the non-breaching party's loss. Only in very rare exceptional cases, the counting method based on the delinquent party' benefits is adopted, if such loss could not be proved or determined, or if it would be unfair not to give relief to the non-breaching party. Certainly, the method of breach disgorgement damages is applied in contract law only if three terms is satisfied. Firstly, normal damages would not be adequate.

²⁷Wagner (2006), 96 et seq.

Secondly, the breach is willful. Thirdly, such breach is for seeking benefits, which accords with intonation of opportunistic breach stipulated in Restatement (Third) of Restitution and Unjust Enrichment.

Strengthening the System of Proving Gains

The difficulty of proving gains is an important reason why China's disgorgement damages system is rarely employed and is difficult to operate effectively. It is necessary for us to improve the possibility of proving gains in two aspects.

Firstly, the burden of providing information on gains should be imposed on the infringer or the breaching party. The greatest obstacle for practicing disgorgement damages system is that the right-owner could not prove gains of the infringer. To overcome this difficulty, this paper suggests that the infringer shall assume the responsibility of providing information about his or her gains or the burden of proof.

Let's revisit the above mentioned "Case No. 1 of patent infringement in China". The judgment of trial court held that the industrial and commercial facts of SELV could be used to calculate the profit of SELV from the infringement, since SELV does not provide the cost book; the amount of damages is determined to be RMB 355,939, 206. 25 on account of the operating profit of SELV from August 2, 2004 until July 31, 2006; since the amount is higher than that claimed by Chint which is RMB 334,867, finally RMB 334, 869, 872 Yuan was awarded. The act of Wenzhou Intermediate People's Court offers a positive protection for right-owners' interests. What is more, in the newly amended Trademark Law, a new section is added to provide "in determining the amount of compensation, the People's Court may, in the event the right owner has taken every effort to produce evidence but the account books and materials relating to the infringing activities are in the possession of the infringer, order the infringer to provide such account books and materials; if the infringer refuses or provides false account books or materials, the People's Court may decide the amount of compensation according to the claim of the right owner and the evidence provided thereby." It can be regarded as a push for the proving-the-gain system. This rule can introduced to other fields, including other intellectual property infringement, personal right infringement, harming a corporation's interest and breach of contract.

Secondly, we should allow assumed gains in specific situations. If the infringer's actual gains were small or there were no gains, could the law then go beyond actual gains and allow assumed gains? Here, assumed gains refer to "assumed license fees", i.e. fees which should be paid to the injured party if the infringer gets right to use after consultation with the victim. The answer to the above question should consider the value goal and the function orientation of disgorgement damages. If we still insist on the "actual gains" damages, the goal of protecting the injured party's right would not be achieved. Since the usage of many personal rights with property traits have ready markets and property interests are easy to calculate, "assumed gains" can be calculated with substantial certainty.

In France, this method has been employed in some cases.²⁸ In a case of right to portrait dispute, *Cecilia Cheung v Jiangsu Tayoi Cosmetics Co., Ltd.*,²⁹ the court also applied the method of assumed gains and ordered damages of over RMB 300,000 to the injured party, Cecelia Cheung. The court's comments are as follows. Zhuhai Tayoi concluded with Cheung a contract worth RMB 2.7 million, such contract covers advertisements, buyout of right to portrait, performance remuneration and remuneration for press conferences. Without any contract with Cheung about right to portrait, Jiangsu Tayoi, in order to make more profits, arbitrarily used and thus infringed Cheung's right to portrait. In consequence, RMB 300,000 is awarded, with reference to the contract between Zhuhai Tayoi and Cecilia Cheung. It is an exact application of the assumed gains method.

In Patent Law and Trademark Law, there are provisions such as "if it is difficult to determine the losses which the patentee has suffered or the profits which the infringer has earned, the amount may be assessed by reference to the appropriate multiple of the amount of the exploitation fee of that patent (the exploitation fee of that trademark) under contractual license". These expressions are also presentation of assumed gains method.

Shifting from National Confiscation System to Party Centered System

Though the Chinese disgorgement damage system, to certain extent, punishes the wrong-doer and discourages law-breaking, its main aim is to protect lawful rights and interests of private subjects, which closely relates to private law traits of the system. Presently, the national confiscation system, which generally exists in the current disgorgement damage system, indeed departs from private law traits of the system and does not adequately protect interests of private subjects in civil and commercial field. Consequently, we should limit acts such as confiscation which represents national public power, recognize that the system is part of private law, and put the parties concerned at the center of this system.

Take Article 209 of Securities Law for example. It provides that "all the illegitimate incomes and fines lawfully confiscated and collected from issuing and trading securities against the law shall be delivered to the national treasury." It is reasonable and acceptable for fines to be delivered to the national treasury. The reasons are as follows. Firstly, the fine, with public law traits, increases wrong-doers' cost of breaking the law and meanwhile warns other people. Secondly, it is not from investors, who thus have no right of recourse. However, it is not the same with illegal gains. Though the administrative order is made by China Securities Regulatory Commission, the gains are collected from investors. Therefore, the

²⁸Sun (2009), 12.

²⁹Hefei High-Tech Development Zone People's Court (2003) Hegaoxingminyichuzi No. 137, Judgment.

investor may reclaim these gains over anyone else. Illegal gains should not be turned over to the state? In today's global securities market, the development trend is to compensate the investors' loss with fines as well as restitutions of illegitimate gains.³⁰ So article 209 of Securities law shall be revised to be "illegitimate incomes confiscated shall be used to compensate for investors' loss". The current provision is not consistent with economic justice. It hurts the party's interests. It does not correspond to values and thoughts of putting the parties in the center of the system.

Conclusion

Recognizing the disgorgement damages system has been a new trend in the law of damages. China by now has learned about the relevant advanced rules and systems from other countries. At least for basic legal expression, China has kept pace with this global trend of law development. What is exciting is that we can always find cases where Chinese courts have cited rules or jurisprudential basis of disgorgement damage to recover the damage of the injured parties in some of their opinions. This reflects that such provisions have been to some degree implemented in China's legal practice and become an important instrument for private relief and compensation in practice. However, it is a pity that the legal practice of the system has lagged behind the expression of the law itself. We do not have a general legal basis for the system. Besides, existing rules in intellectual property, torts and securities law only play a supplementary role. Without practical application, they are just printed words in the law, which means there are no practical values. To fully develop the functions of Chinese disgorgement system, we need to unify a general theoretical basis, establish an internal structure with rich layers, strengthen practice criteria for proving the gains, and return to the idea of putting the parties at the center of the system, as required in private law. Only in this way our legal system can be an efficient one when it comes to disgorgement of unlawful profits by private mechanisms.

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³⁰Liu (2013), 80.

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