



Non-Competition Agreement under Chinese Employment Law Regime

Nowadays all competition is essentially a battle for talent. In practice, however, it is very tough to strike a balance between the legitimate interests of employers to protect their competitiveness on the one side, and the freedom of employees to choose/change their jobs. Based on his relevant experience the author summarizes below some basic issues for reference when drafting or negotiating a non-competition agreement under Chinese employment law regime.

I. Definition of non-competition agreement

- An employer may conclude a **written non-competition agreement** with an employee under a duty of confidentiality such that after the termination of his/her employment contract the employee shall
 - neither work for another employer who produces or operates the same kind of products or engages in the same kind of business as his/her former employer in a competitive manner,
 - nor start his/her own business to produce or operate the same kind of products or engage in the same kind of business.

II. Qualified employees

- An employer may only enter into a non-competition agreement with its **senior managers, senior technicians and other employees under a duty of confidentiality**.
- As the Chinese laws and regulations rarely define the qualified employees in individual cases, the employer has to save the relevant evidence to prove that the employee concerned is a qualified employee with whom a non-competition agreement may be concluded. As evidence the employer may for instance consider providing the employee's labor contract with his/her job description, company's organization chart, registration record (if applicable) and/or any confidentiality, IP, training agreement or commitment signed by the employee.

III. Scope of non-competition

- The scope, geographical region and duration of the non-competition covenant can be agreed upon by and between the employer and the employee. They shall also be in line with law, fairness and reasonableness.
- According to Guiding Case No. 190 published by China's Supreme People's Court, in dispute the competent court should examine whether the employee's self-employment or new employer form **a real competitive relationship** with his/her former employer. The court should not limit its examination to the overlap of the registered business scope of both entities, but also consider the overlap of their actual business content, customers (including potential customers), and the corresponding market.

IV. Non-competition period

- The maximum non-competition period amounts to **2 years** after the termination of the employment contract of the employee concerned.
- In Guiding Case No. 184 published by China's Supreme People's Court, the employer and the employee agreed in the non-compete clause that the period for applying for arbitration or litigation would not be included in the non-compete period. Such agreement, on the one hand, limited the employee's right to judicial remedies to a certain extent as it reduced the employee to a dilemma where if he/she seeks judicial remedies, the non-compete period would be extended, and if he/she does not seek judicial remedies, the employee's rights and interests would be damaged. On the other hand, such agreement allowed the employer to unilaterally and disguisedly extend the employee's non-compete period by filing arbitration or litigation, relieving itself of its statutory liability to a certain extent. Therefore, the trial court found that this agreement was prohibited by law as it exempted the employer from its legal liabilities and excluded the employee's rights, and should be null and void.

V. Non-competition compensation

- In exchange for the employee's complying with the non-competition covenant, the employer shall pay him/her **a compensation on a monthly basis during the non-competition period**. The minimum amount of such compensation varies by location.
- According to a judicial interpretation of China's Supreme People's Court, if there is no agreement regarding the non-competition compensation and the employee has complied with the covenant, the employee may demand a non-competition compensation amounting to **30% of his/her average salary over last 12 months** or the local minimum monthly wage, whichever is higher. To be on the safe side, it is advisable to use this 30% rate as the minimum non-competition compensation to be agreed upon, unless the applicable local rules provide for a higher rate (e.g.

in Province Jiangsu the non-competition compensation shall be at least 1/3 of the employee's average salary over last 12 months).

- In practice, it is not easy to supervise and control whether the employee has complied with the non-competition covenant. Therefore, for check and verify by the employer and also for evidentiary purpose, it is advisable to agree on an obligation of the employee to regularly report his/her new employment/business activities by submitting written reports with supporting documents. This **reporting obligation** may even become a condition precedent to the payment of the monthly non-compete compensation if both parties agree.

VI. Liquidated damages

- It is explicitly allowed by the Chinese Labor Contract Law and also strongly advisable to agree with the employee on **liquidated damages for breaching the non-competition covenant by the employee**. Should the agreed liquidated damages be lower than the actual damages caused, the employer may ask the labor arbitral tribunal or the court to make a corresponding increase. Should the agreed liquidated damages be extraordinarily higher than the actual damages caused, the employee may ask the labor arbitral tribunal or the court to make an appropriate decrease.
- If the employee claims that the agreed non-competition liquidated damages are too high and requests an appropriate reduction by providing the relevant prima facie evidence, the labor tribunal or the court would decide by considering the actual loss and the expected benefits (to be substantially proven by the employer), the performance of the contract, the degree of fault of the parties, and other comprehensive factors in line with the principle of fairness and good faith. If the liquidated damages amount exceeds the actual damages by 30%, in general it could be treated as “excessively higher than the actual damages caused”.
- Where the employee breaches the non-competition covenant and thus pays the liquidated damages to the employer, the employer is still entitled to requesting the employee to continue the performance of the non-competition covenant in accordance with their agreement.

VII. Termination of non-competition agreement

- The employer may unilaterally rescind the non-competition agreement during the post-employment non-competition period. However, the employee is entitled to claim for another 3-months' non-competition compensation from the employer. Therefore, if the rescission of the post-employment non-competition agreement is wished by the employer, such **rescission should be declared or agreed upon before or at the same time when terminating the employment contract** in order to avoid the payment of any further non-competition compensation.
- The employee may also unilaterally rescind the non-competition agreement if the employer for its own reasons has failed to pay the non-competition compensation for (at least) 3 months.

VIII. Non-competition agreement not as a standalone measure

- Pursuant to the Chinese Labor Contract Law, apart from a non-competition agreement an employer and an employee may among others also enter into
 - a written **confidentiality agreement** on the protection of the employer's trade secrets,
 - a written **agreement on intellectual property matters** (e.g. retaining, assigning, licensing inventions developed by the employee and relevant incentives), and
 - a written **agreement on special training** provided/financed by the employer to the employee (including certain service period after the training and the liquidated damages for the employee's breach of such service period agreement).
- It is advisable to effectively combine above-mentioned measures to protect the employer's know-how and draw a legitimate red line for the employee when exercising his/her freedom to choose/change jobs. When a dispute arises, such measures can also be used to support each other. For instance, the confidentiality, IP and training agreements with the employee could evidence the employee's key position with the employer and the severe impact on the employer if the employee works for the employer's competitor by breaching the non-competition agreement.

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