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Enforcement of Non-Compete Clauses in Employment Agreements in China

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What is a Non-complete Clause – a Chinese Perspective

A non-compete clause is a term used in contract law under an employee agrees not to compete with the employer once s/he has left the employer's service, whether by working for a competitor, or by setting up a competing business. The non-compete clause is usually either found in the form of a separate document or included within the employment contract which is usually signed together with a confidentiality agreements.

It is common for foreign employers to require their employees to enter into

non-compete agreements when enter into the labor contract in order to limit the chance that private employer information or trade secrets are given to another company.

For example, years ago, Microsoft's global vice president Li Kaifu decided to leave Microsoft and joined Google company. This event immediately caused an uproar. Microsoft sued Google and Li to the court base on the ground of breach of non-compete agreement. The court later issued the temporary injunction against Li Laifu engaged in China's computer search industry related to search technology, business strategy, planning or development work; Besides, Li Kaifu was forbidden to disclose any Microsoft's trade secrets which acquired while working in Microsoft; the ruling also prohibited Li Kaifu encourage other employees quit from Microsoft to Google. This case is based on the non-compete system.

Non-compete clause in Labor Contract Law

The new Labour Contract Law came into effect from 1 January 2008 , and non-competition clauses are authorized by Articles 23 and 24 of the Labour Contract Law. The basic rules are as follows:

Under Article 23 of the Labour Contract Law : 1 An employment agreement may include provisions intended to protect the trade secrets of the employer. A non-competition agreement may be included in support of such protections; 2 The employer must pay reasonable compensation on a monthly basis to the employee during the term of the non-competition period. 3 Where the worker violates the competition restriction provisions, he/she shall pay liquidated damages to the employers as agreed.

There is no definition of “reasonable compensation.” Commentaries suggest employees should be compensated in a manner equivalent to their salary with the company. Others suggest that compensation is only required at the level of the current minimum wage in the relevant jurisdiction.

Under Article 24 of the Labour Contract Law, the personnel subject to competition restrictions shall be limited to the employer's senior management, senior technicians and other personnel who owe confidentiality obligations to the employer. The scope, geographic region and term of the competition restrictions shall be agreed upon by the employer and the worker and such agreement shall not violate the provisions of laws and regulations.

After the end or termination of the employment contract, the time limit of restrictive competition of the personnel prescribed in the preceding paragraph for working for other employers that manufacture or operate the same type of products or that engage

in the same type of business having a competitive relationship with the original employer, or for commencing its own business in manufacturing or operating the same type of products and engaging in the same type of business shall not exceed two years.

The enforcement of the Non-complete clause

There are some issues should be aware when sign the non-compete agreement and enforce the non-complete clauses:

1. Limited Employees bare the non-compete obligations

Article 24 of Labor Contract Law provide that the employees who will bare the non-compete obligations are limited to: a. senior management; b. senior technical personnel; or other personnel with the obligation of confidentiality.

2. The term of the non-compete obligations

Article 24 of Labor Contract Law also provide that the term of the non-compete obligations must not exceed 2 years, whether the former employee works for a competitor or runs his/her own competing business in a competing field which is a reduction from the maximum term of 3 years in most jurisdictions including Beijing, Shanghai and Shenzhen before.

3. The time period of the compensation for the non-compete obligations

It is stipulated by Article 23 of Labor Contract Law: Payment for non-compete obligations to former employees should be made from the date of termination of the employment contract and paid monthly over the term of the non-compete agreement.

Many cases which employer sue the employee breach the non-compete clause are filed, the main issue often is the employers failure to pay compensation to the employee during the non-competition period.

In the case Beijing Aptech Beida Jade Bird Information Technology Co., Ltd v Two Former (held by Beijing No. 1 Intermediate court on July, 2005), two former employees signed an employment agreement with Beida Jade Bird. Two years later, they left Beida Jade Bird company to work for a competitor. Beida Jade Bird sued these two employees for breach of there non-compete obligations, claiming compensation of RMB 500,000 and requesting termination of their employment with his new employer.

The Beijing Court upheld the validity of the employment and the non-disclosure

employments generally on April, 2007. However, Beida Jade Bird was unsuccessful in enforcing the non-compete and non-disclosure obligations. The court held that in order for an employer to enforce the non-compete obligations against its former employee, it must have compensated the former employee. The amount of compensation was to be no less than 50% of the last annual income. Beida Jade Bird was not able to show that it had compensated these two employees in this way and so neither employee was deemed to be bound by the non-compete agreements. Accordingly they were able to continue employment with their new employer.

Conclusion

From the case we can see that the law is very strict on time period of the compensation issue. Reasonable compensation must be paid on a monthly basis as provided by Article 23 of Labor Contract Law. Failure to pay or a delay payment voids the entire non-compete clause.