Focus on enforcement and remedy of non-compete issues in China (Part I)

In early 2013 the Supreme Court of China issued the Judicial Interpretation regarding labor disputes (IV) (Judicial Interpretation IV), which provided certain guidance in relation to the validity and enforcement of non-compete clauses, as well as the level of compensation required from employers and the possible remedies for employers when employees breach.

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Specifically, Judicial Interpretation IV provides that where the parties include a non-compete clause in the labor contract or separate agreement without stipulating the amount of economic compensation which must be paid to the employee on termination or expiry of the employment, and provided that the employee has fulfilled his/her non-compete obligations, the People's Court will uphold an employee's request for payment of economic compensation. Such compensation must be at least 30% of the employee's average monthly remuneration during the 12 months prior to termination for each month of the restricted period. This amount must not, however, be less than the minimum wage set in the place of employment.

This is also helpful for employers because it means that a non-compete provision will not be considered void or unenforceable because the original agreement does not specify an exact amount of compensation. In other words, provided that the employer provides compensation (subject to the minimum amount stated above) an employee in principle is bound by the restriction.

In addition, Judicial Interpretation IV further states that where an employee violates a non-compete agreement and is therefore required to pay the relevant liquidated damages stated in the underlying agreement to the employer, the People's Court will support the employer's request to also require the employee to perform the ongoing non-competition obligations. As such, Judicial Interpretation IV makes it clear that it is possible for an employer both to receive liquidated damages and also to have specific performance as a remedy for a specific violation of a non-compete obligation.

Despite the relative clarity brought by Judicial Interpretation IV, in practice there remain a number of challenges for employers in relation to the enforcement of non-compete provisions and achieving an adequate and timely remedy. These series of articles focus on those issues and what employers need to be aware of.

Enforcement of non-compete clauses in China

There are several practical problems in China which make the enforcement of non-compete provisions relatively difficult.

In particular, employers face a challenge in order to obtain and provide sufficient evidence that a former employee is in fact competing and therefore in breach of his/her obligations. The burden of proof is on the former employer to do so.

Firstly, the company needs to establish that an ex-employee now works for a competitor. Some companies require the individual to provide certain documents confirming that he/she is not working for a competitor. However, this could not be easily achieved without the cooperation of the former employee. Accordingly, in most cases, the company must make its own enquiries in order to establish this.

Some companies list key competitors in their non-compete agreement so that employees are clear as to future employers who are considered off-limits during the restricted period. The former employer can also notify a competitor of the employee's existing non-compete obligations if the company becomes aware that the individual has or is due to join the competitor. This can be effective, especially if the competitor is worried that the former employer may bring a claim against it on the basis of anti-competitive behavior.

In practice, however, it is often hard to obtain information or to force an employee to provide information. Large companies may have many subsidiaries and branches operating under different names or with complicated onshore or offshore shareholder structures. As a result, it can be difficult to establish the de facto or legal employer.

Further, some companies still use a dispatch model to hire certain staff. Under this model a dispatch agency signs the employment contract with and makes social insurance payment for the employee, but dispatches or assigns the employee to work for the host entity. Technically therefore, from a legal perspective, the dispatch agency is the legal employer of the individual, not the host entity "competitor". As such, it can be difficult to prove that the former employee is in fact working for a competitor without cooperation from the dispatch agency or confirmation from clients or customers of the plaintiff company that the former employee is working with a competitor and has dealings with or is seeking to have dealings with such clients or customers.

In addition to issues around the identity of a new employer, there is also the question of the nature and scope of the former employee's work in his/her new role. When hearing non-compete cases, a PRC labor court will typically compare the business scopes of the former and current employer in order to determine whether the two entities are competitors or not. This can present difficulties because company registrations and the way of describing the business scope can vary from place to place. For example, in some locations a company may receive an approved business scope with an extreme broad or generic description, such as "to engage in any business operations that are legal, except for those which by law require additional approvals or licenses." Accordingly, it can be difficult to show and to convince a judge that the business of the new employer is in fact competitive with that of the former employer. In such instances, a plaintiff company may need to show more specific or detailed evidence of competition.

Titles of employees can also blur the picture. For example, an individual holding the title "sales manager" with a trading company could move to a management positon at a new employer, such as a company headquarters, where there is no obvious sales or trading designation, even tho' in reality the individual engages in predominantly the same activities as previously.

These practical problems can make it quite difficult or costly to collect sufficient direct evidence to prove that an former employee works for a competitor and is engaging in the same type of work as previously. Companies wishing to enforce non-compete obligations need to be aware of this and consider what evidence they can obtain and whether, for example, they can gather a coherent body of indirect evidence which as a whole demonstrates that their claim is justified. This may include witness statements or video evidence. However, in any event, it is important that all evidence is collected by legal means; otherwise, the company may not just lose the non-compete case, but also have to deal with

ensuing counterclaims filed by the defendants regarding infringement of rights.

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