China Non-Compete and Trade Secrets Law: A Primer for U.S. In-House Counsel

Insights
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This is the second in our series on international non-compete and trade secrets law for U.S. corporate counsel. Today, we examine the law in the world's second largest economy, The Peoples Republic of China (PRC). The heated competition for qualified talent in the PRC makes non-compete protections a crucial topic. In a recent survey, members of the US-China Business Council reported that their #1 challenge doing business in China was "talent recruitment and retention":

Companies reported that it is becoming increasingly difficult to recruit and retain talented employees because the demand for such employees – by multinational corporations (MNCs) and, increasingly, Chinese employers – outstrips availability. In particular, companies noted difficulties in recruiting qualified managerial and technical talent.

USCBC 2011 China Business Environment Survey Results at p. 8. In another study, the MRI China Group surveyed more than 3,000 mid- to senior-level managers in China and Hong Kong, and found with respect to Mainland China respondents that:

- 64% had received offers in the prior 18 months, and 24% had received three or more offers
- 46% had moved to a new job with a compensation increase of 30% or more (another 46% received increases of 11 – 30%)
- 42% are not satisfied with their current compensation
- 24% had already determined to make a job change sometime in 2011

See MRI China 2011 Greater China Talent Environment Index at pp. 5-6.

All of this adds up to a very competitive and unstable market for key management and technical talent in an enormous and fast-growing economy. There is not much to do about the increasing spiral of salary levels in China, but at least companies are not left empty-handed when it comes to protecting competitive assets such as confidential business information and client relationships. It may come as a surprise to some that, with the advent in 2008 of the Labor Contract Law of the People's Republic of China (also known as the Employment Contract Law or ECL), the rules for employee contracts have been simplified and China's environment has emerged as more friendly to companies seeking to protect their interests than some US states.

Counsel who have been handling US domestic non-compete issues on a multi-state basis may note that, in some ways, the basic outline of non-compete law in PRC looks a bit like Colorado in that it permits covenants, but only for specified types of employees:

o Senior management
o Senior technicians
o Employees with access to trade secrets

See ECL Articles 23 & 24 (Cornell University Unofficial English translation). Compare Colo. Rev. Stat. 8-2-113(2)(d) (permitting non-competes only for "executive and management personnel" or "officers and employees who constitute professional staff to executive and management personnel"). The terms of any post-employment restrictive covenant must be contained in a written employment agreement. Indeed, all employment in the PRC must be by written agreement signed within one month of commencement of employment (ECL Art. 10). See generally To Write or Not to Write? International Laws on Employment Agreements (discussion by my colleague of written employment agreements internationally, including in PRC, on this blog).

Under the ECL, non-compete, non-solicitation and confidentiality agreements can be enforceable in the PRC if they meet the following requirements:

o Against one of the listed class of employees (ECL Arts. 23 & 24)
o Duration of no more than 2 years (ECL Art. 24)
o Reasonable geographic scope
o Compensation must be paid to employee monthly during the restriction term (ECL Art. 23); the amount varies by province (by way of example, it may range as high as 60% of prior compensation in Beijing)

The ECL specifically provides for an award of damages for violation of an otherwise enforceable non-compete agreement, and a specific liquidated damages clause may be advisable. See Art. 23 ("If the laborer breaches the non-competition provisions, he shall pay damages to the Unit as stipulated.").

Interestingly, the ECL statutorily provides for severability of unenforceable terms, employing a structure akin to US "blue pencil" states. The law stipulates that "if certain provisions of a labor contract are invalid and such invalidity does not affect the validity of the remaining provisions, then the remaining provisions shall still remain valid." ECL Art. 27.

In addition to the ability to impose contractual non-compete restrictions on the listed types of employees, the ECL also imposes a mandatory 30-day notice period for any employee who wishes to leave a job by dissolving his or her employment agreement (ECL Art. 37). This requirement gives the company a built-in de facto 30-day non-competition period against any employee who resigns. The only exception is if the employee seeks to dissolve the employment agreement for what in US law would be referred to as "good cause," the requirements for which are laid out in Article 38 and if satisfied would allow an employee to dissolve his or her agreement immediately and disregard the normal 30-day notice requirement.

In addition to the protections and requirements outlined in the ECL, it is worth noting that other sources of law in the PRC may offer protection for employers:

• The Company Law statutorily mandates a duty of loyalty (including a duty of non-competition and non-appropriation of corporate opportunities) during employment term for directors, supervisors and senior managers (Company Law § 6, Art. 148 & 149)

• Trade secrets are protected under the Ant-Unfair Competition Law (UCL), Article 10

o Requirements are substantially similar to Uniform Trade Secrets Act standards

o 2007 judicial interpretation makes clear that "client lists" can be trade secrets, although it suggests no violation if the employee can prove customers approached him or her on their own

Despite the potential protections of the UCL and the Company Law, the better approach for protecting confidential business information and ensuring non-competition during the term of employment is to have written covenants in employment agreements rather than relying solely on statutory provisions.

Next week, we will visit another fast-growing Asian economy, India, where the law on post-employment restrictive covenants looks quite different than it does in China.

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