

20/06/2019

The employee's non-competition obligation during the execution of his labor contract

Case Presentation:

Mr. Zhang joined Company A as project manager in 2011 and resigned in 2016. The business scope of Company A includes investment consulting.

It is stipulated in Mr. ZHANG's labor contract that in case he is engaged in a competing business during the execution of his labor contract and causes damages to Company A, Company A is entitled to dismiss him without any payment of economic compensation.

Company B was established in 2009, the legal representative and shareholder of which is Mr. ZHANG. Company B extended its business scopes in 2014, one of which is investment consulting.

After Mr. ZHANG has left Company A, the latter produced evidences proving that he poached the customers of Company A when he was still the employee of Company A thus causing damages to Company A. As such, Company A considered that Mr. ZHANG violated his non-competition obligation when he was still the employee of Company A, so after his resignation, it sued Mr. ZHANG to the court and claimed that he shall (1) Compensate the loss suffered by Company A amounting to RMB 720,000, (2) apologize publicly in the newspapers, (3) pay Company A liquidated damage for carrying out the competitive business with Company A during the execution of his labor contract.

On his side, Mr. ZHANG argued that (1) according to the law, employees are only subject to non-competition obligation after the termination of their labor contract; in addition (2) when he was still the employee of Company A, he did not hold the position of senior executive, and he did not receive any compensation related to non-competition obligation. Under these circumstances, the provision in his labor contract about non-competition obligation during its execution of employment should be deemed invalid.

Viewpoint of the Judge:

Several key questions in dispute have been dealt with during the trial of this case,

- Was Mr. ZHANG bound by the non-competition obligation during the execution of the employment with Company A?

The court considers that such obligation comes from the *honest credit principle of the employee* which is a statutory obligation of the employee, and furthermore, once the employee violates his non-competition obligation during the execution of his labor contract, the subjective culpability of the mind and influence to the employer are worse than the case that the employee violates this obligation after the labor contract is terminated. Consequently, the court confirms that the employee is subject to such obligation during the

execution of his labor contract, and simultaneously, the employer is not required to pay the relevant compensation during such period.

- Has Mr. ZHANG violated his non-competition obligation?
The court considers that the evidences submitted by Company A are sufficient to prove that Mr. ZHANG simultaneously held the position of legal representative of Company B during the execution of the labor contract with Company A. Furthermore, the Company B engaged in competing activities with Company A. Under these circumstances, the court considered that Mr. ZHANG violated his non-competition obligation.
- Does Mr. ZHANG have to pay the liquidated damage in violation of non-competition obligation during the execution of the labor contract?
The court considers that the payment of liquidated damage is not a statutory responsibility, but a contractual responsibility. Since there is no provision about the liquidated damage between Company A and Mr. ZHANG, there is no legal basis to request Mr. ZHANG to pay it.
- Does Mr. ZHANG have to compensate the damage suffered by Company A?
The court considers that there exists a causality between Mr. ZHANG's violation of non-competition obligation and the occurrence of loss suffered by Company A, thus he shall compensate this damage.

Consequently, and given the impossibility to calculate the real amount of the losses, the court took into account on the one hand, Mr. ZHANG's income derived from being engaged in a competing business with Company A and, on the other hand, his salary received from Company A during the period of violation of non-competition obligation. Under these principles, the amount that Mr. ZHANG shall compensate to Company A is RMB 300,000. The court rejected the other claims of Company A.

DS Comment:

Whether an employee is automatically subject to the non-competition obligation during the execution of his labor contract is not expressly stipulated in legal provisions. There is also no consensus on this point in the judicial practice. Via today's case, it is relatively clear that in Beijing, the judges consider that the employee is subject to non-competition obligation during the execution of his labor contract. Other jurisdictions, for example the courts in Shanghai, took opposite decisions in the past.

On the contrary, Chinese law provisions clearly indicate the possibility to stipulate a non competition obligation after the termination of the labor contract. The employer may request some of his employees to comply with non-competition obligation for a particular activity, within a specific territory and during a specific period (up to two years) after the termination of the labor contract. In return, the employer shall pay the employee an economic compensation on a regular basis or in one lump sum during the period of non-competition. If the employee violates the provisions in the non-competition agreement, and renders services for a competitor or runs a competitive business during such period, he shall pay the liquidated damage as provided by the non-competition agreement, and compensate the employer for the loss incurred.

If the employer and the employee have agreed on a non-competition obligation clause/agreement, at the time of termination of the labor contract, the employer may decide to relieve the employee of his non-competition obligation. If this is the case, it must then clearly state this in the termination documents of the labor contract. Otherwise, the non-competition clause will automatically be considered valid. Under these conditions, if the employee complies with this obligation, he may then demand payment of the compensation provided for in the clause/agreement from the employer. If

the amount of compensation is not explicitly provided for in the clause/agreement, the employee is entitled, during the entire non-competition period, to a monthly compensation equal to 30% of his average salary during the 12 months preceding the end of the labor contract.

Tips for DS Clients:

In order to improve the protection of the employer, we suggest specifying clearly in each labor contract and company's internal rules/employees handbook, that employees are subject to non competition obligation during the execution of the labor contract and/or after its termination. For example, the following article could be added in the labor contract template to provide the non-competition obligation during the execution of the labor contract:

"During the whole execution of its labor contract, the Employee shall not, directly or indirectly, engage in any other employment, consulting occupation or any other business activity or have a director position, directly or indirectly, related to business in which the Employer and its subsidiaries are involved in or become involved during the employment. In case he violates such obligation during the employment, it will be considered as serious violation of internal rules and his labor contract will be terminated. Moreover, the employee shall pay the Employer RMB XXX as a liquidated damage and compensate the Employer for its loss suffered as consequence of this violation. "

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