

The Expansion of the Scope of Non-Competition and Its Judicial Countermeasures

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Abstract

At present, there are expansion issues of the non-competition system in practice, especially the expansion of the scope of the non-competition agreement and the abuse of the system by the employer, which has brought many adverse effects. In essence, the rationality of the system lies in the maintenance of labor ethics with capital, with the dual nature of labor relations and civil relations, and its system design is more beneficial to employers, which leads to excessive autonomy and arbitrariness of employers. Drawing on foreign experience and other departmental laws, at the judicial level, attention should be paid to introducing the concept of “relevant market” and initiation of joint and several liability reviews on new employers to limit the scope of non-competition and to curb the abuse of non-competition by employers.

Keywords: non-competition, expansion of scope, relevant market, joint and several liabilities

1. Statement of the Issue

The non-competition is that the employer restricts certain employees to engage in similar products or businesses that compete with the employer within a certain period to protect its business secrets. During the period, the employer shall pay compensation to the employee as consideration, and the employee who violates the non-competition shall pay a penalty for breach of contract. In the context of China, non-competition may generally be initiated based on a written contract between the parties. In practice, an employee generally signs a non-competition agreement at the same time signing a labor contract. It is up to the employer to decide whether to activate non-competition at the time when the labor relation is terminated.

With the deepening of labor marketization and employee job-hopping more and more common, the contradiction between the reasonable flow of talents and the protection of business secrets has become more prominent. According to “Opinions of the Supreme People’s Court on Strengthening the Trial of Cases Involving Intellectual Property Rights in the New Era to Provide Effective Judicial Services and Support for Building China into an Intellectual Property Rights Power” issued in September 2021, efforts shall be made to properly handle the relationship between the protection of business secrets and freedom to choose jobs as well as the relationship between the not-to-compete restraints and the reasonable flow of talents, to protect the business secrets of enterprises while safeguarding the lawful rights and interests of employees in employment and business startup, ensure the innovation and development of enterprises, and promote the reasonable flow of talented personnel. The non-competition, as an important method for balancing the above-mentioned interests, has been paid more and more attention by all aspects of society.

1.1 The Scope of Non-Competition Is Way Too Broad

The scope of non-competition refers to the scope of competing enterprises stipulated in the non-competition agreement. When we mention the scope, referring to the territory is inevitable because they are tied up. Article 24 of the “Labor Contract Law of the People’s Republic of China” (hereinafter the “Labor Contract Law”) stipulates that the employers and employees shall agree on the scope and territory of the non-competition, and the criteria for judging the scope of the competition relationship is generally put forward in paragraph 2.

However, in practice, this article seems to be in name only, and the agreement on the scope of non-competition is too broad. Internet companies, in particular, usually list almost all companies in the industry in detail when listing their own competing companies in the non-competition agreement, including not only all well-known

domestic Internet giants and their holding companies and affiliated companies, but also including all the companies in the same industry in the world such as Facebook, Twitter, Amazon, etc. Once the non-competition agreement is activated for employees, they will not be allowed to work in the same industry globally within the agreed period. In addition, some companies have adopted relatively vague and general terms, directly citing general terms such as “business of the same category”, “products of the same category”, and “competitive relationship” in the Labor Contract Law. By doing so they try to expand the boundaries of competitive relationships and strive for more power of interpretation in defining the scope of non-competition.

In judicial practice, judges are not unified enough on the examination of the rationality of the scope of competing enterprises. Some judges have more lenient standards and consider whether the business scope of the business registration of enterprises overlap as the basis for determining whether there is a competitive relationship. While some judges have substantively examined the actual business operations of the enterprise and the businesses engaged in by workers, and then make scrutiny more stringently. And the former has the upper hand in numbers. However, in today's increasingly refined division of labor, it is difficult to accurately identify whether there is a real competitive relationship with lenient standards.

The absence of public power leads to the loss of employees' interests. Under normal circumstances, when signing a non-competition agreement, the laborer, as a natural weaker party, has personal dependence and has no bargaining power or room for free negotiation facing the employer. And the intervention of public power is often needed to protect their rights and interests. Therefore, if the judge adopts a lenient standard to scrutinize the rationality of the scope of “competing companies” in the non-competition agreement, it will allow the employer to expand the scope under the guise of equal negotiation, which is not conducive to the establishment of substantive equality. From a macro perspective, the expansion of the scope of non-competition is not conducive to the free flow of talents in the market and the cultivation of specialized skills, which are precisely the important factors to promote national innovation and development. From a micro perspective, in the absence of the current collective negotiation mechanism in China, most of the employees can only passively accept the expanded scope of non-competition, which will encourage employers to abuse the clauses of non-competition and its “discourse hegemony”, jeopardizing the legitimate rights of employees and the fair competition order of society.

1.2 The Abuse of Non-Competition Agreements by Employers

Based on the expansion of the scope of non-competition, it is obvious that the abuse of non-competition agreements by employers is becoming more and more serious. Take the Internet industry as an example. On the one hand, the company asks all its employees to sign a non-competition agreement, and expands the scope of the competing company to all Internet companies in the world, strictly restricting the competition of the company's employees, on the other hand, it continues to hire new employees from other companies with non-competition agreements and finds ways to protect them from the non-competition agreements of the previous companies. For new employees who are subject to non-competition, the employer will usually help avoid violating non-competition by signing supplementary agreements or labor contracts with outsourcing service companies. At the same time, it will also instruct employees to pay attention to using pseudonyms, covering their faces in public, and not connecting to the company's wireless network in the short term and other details. For resigned employees who signed the non-competition agreement, some employers will monitor their movements by matching mobile phone device IDs and IP addresses, sending anonymous couriers, candid video, and other methods to monitor their movements, and fix evidence to prove that the employees violated the non-competition clauses. In the widely concerned case of Tencent v. Xiao's non-competition dispute, Tencent used the candid video as evidence to prove that although Xiao had signed a labor contract with an outsourcing company, she had indeed worked for a competing company, Byte Dance. Another example is the Pinduoduo company. On the one hand, its regulations on resigned employees with non-competition are very strict, on the other hand, it has repeatedly poached Alibaba's programmers and sales personnel, and even offered sky-high salaries.

Such a phenomenon is bound to raise more legal issues. First of all, from the perspective of ethics and legal basis, while the employer requires its employees to abide by the foundation on which the non-competition agreement is built: the obligations of fidelity, the principle of good faith, and the contractual obligation not to do “competitive behavior”, it asks newly-hoped employees to leave them behind and quickly use their accumulated work experience or business information to create value for the company. By doing so, the employer regards laws and talents as tools for profit-grabbing and vicious competition, which is a double trampling of ethics and legal principles and is also objectifying the worker. Secondly, once the employee with non-competition signs an outsourcing contract in the new company to evade non-competition, there will be obvious ambiguity between the employer and the labor relation, which may lay hidden dangers for future labor disputes, which will be detrimental to employees; meanwhile, the former company's various monitoring methods to employees have

undoubtedly caused serious violations of workers' privacy rights. Thirdly, in judicial practice, non-competition disputes often end up with employees paying the penalty for breach of contract, while the new employer's infringement liability is often ignored, which is also unfair. In addition, excessive abuse of the non-competition agreement has brought great restrictions on the legitimate rights of employees, which often arouses the resistance of employees, causing the phenomenon of violation of the non-competition agreement emerging in an endless flow, and further weakening people's willingness to comply with the non-competition.

2. The Nature of the Non-Competition Agreement and Cause of the Issue

2.1 The Nature of the Non-Competition Agreement

To better understand the causes of the above issues, it is necessary to make a qualitative analysis of non-competition and clarify its theoretical basis, rights and obligations, and institutional tendency.

2.1.1 The Duality of Labor Relations and Civil Relations

The non-competition agreement, as a civil contract, is an agreement between the employer and the employee to protect the employer's business secrets, maintain its competitive advantage in the market, and reduce the losses caused by employee turnover. Given this, the employer pays certain compensation as a consideration in exchange for the behavior of the employee not to compete with the same industry within a certain period, that is, "no action". There are different theories about what kind of rights employees have transferred themselves, including but not limited to "Labor Rights", "Job Selection Rights", and "Equal Employment Rights". Although the non-competition agreement restrained the "Job Selection Right" in the same industry, However, from the perspective of the content, form, and purpose of the non-competition agreement, what the employer wants the employee to transfer should be civil or economic rights of the non-competition act, without involving the restriction on labor rights. In other words, it can also be considered that the "no action" of the employee on the premise that the employer pays the compensation is also a kind of "employment". It can be seen that the legal basis for the non-competition agreement is the autonomy of will and the restriction of private rights: both parties form a contract out of mutual consent, agreeing to transfer or limit their own economic and civil rights, to achieve their respective goals.

However, in the analysis of the nature of the non-competition agreement, its labor relation attribute cannot be ignored but must be taken as the premise. It is generally believed that the ethical basis of the non-competition is mainly the principle of good faith and the obligations of fidelity. The principle of good faith requires that while pursuing one's interests, the public and others' interests cannot be harmed. The non-competition is the specific legal application of this principle. As far as the obligations of fidelity are concerned, different law systems have their theoretical origins. The common law system believes that the duty of loyalty from common law and the fiduciary duty and good stewardship duty required by the law of equity to the trustee in the fiduciary relation derives the obligations of fidelity between the company and the directors with fiduciary relations; civil law system believes that the agency or appointment relationship between the director and the company is the basis of the generation of the obligations of fidelity. Based on the obligations of fidelity, the employee's obligation of confidentiality to the employer has naturally evolved, that is, regardless of whether there is an agreement or not, the employee has a natural and absolute obligation of confidentiality to the employer during his employment, which is the legal non-competition. Even after the labor relation is terminated, the employee still has the obligation of fidelity and confidentiality to a certain extent. It is precisely out of the transitive maintenance of the labor ethics of the principle of good faith and the obligations of fidelity and confidentiality that the employer's entering into the non-competition agreement in the form of dual obligations has its rational basis. In other words, a non-competition agreement not only has the attributes of equal negotiation and freedom of contract in civil relations but also has the attributes of identity subordination and organizational ethics in labor relations.

In short, from the perspective of legal nature, it is a system with the duality of labor relation and civil relation, which is centered on the labor ethics of maintaining the principle of good faith and the obligations of fidelity and is covered by the civil contract with the autonomy of private law and limitation of rights.

2.1.2 The Design of Non-Competition Is More Inclined to Safeguard the Interests of Employers

As mentioned above, in essence, the institutional basis of non-competition is to maintain the ethical order of labor with the capital. From the point of view of practical purpose, the premise and purpose of its existence are to protect the business secrets of enterprises. In modern society, with the advancement of science and technology and the development of the market-oriented economy, business secrets have increasingly become intangible assets and important rights that affect the competitiveness and development of enterprises. Because business secrets would be permanently lost once they were disclosed, the disclosure would cause irreparable loss of

profits to the enterprise and even cause the loss of the overall interests of all employees represented by the enterprise. Thus, it is necessary to protect business secrets. The development of this protection has gone from the stage of keeping things secret, to the stage of restricting the disclosure of business secrets through the control of people, which generates the non-competition system.

From the point of view of legal effect, the design of this system is undoubtedly more beneficial to the employer. First of all, although the purpose of the employer is not to limit the labor rights, the right to choose a job or the employment right, but to limit the employees' competition action in the same industry by paying them economic compensation and other consideration, to achieve the purpose of maintaining their business secrets. However, during the implementation process of this system, employees cannot engage in work in their previous professional fields within a certain period and within a certain territory, which inevitably results in the restriction of their labor rights or job selection rights, and even endangers their basic constitutional rights such as the right to subsistence and that of their family. As a legal interest, business secrets represent the economic rights of enterprises, and their value rank is far less than that of labor rights and the right to subsistence behind them. Secondly, job-hopping generally means better development opportunities. Compared with the benefits of improving labor skills, career development opportunities, and income that can be obtained by continuing to work in the same industry, the compensation received by employees following non-competition agreements is far less than the above benefits. In the end, the only thing in exchange is a "possibility" that the enterprise's business secrets will not be disclosed and its competitive advantage not lost, which is not worth the loss to employees. Finally, from the perspective of legislation, the existing law tends to impose greater restrictions on employees. For example, the employer generally holds the right to initiate and terminate on the non-competition. If the employee wants to remove the non-competition, it must meet the precondition of "non-payment of economic indemnity for three months for reasons attributable to the employer" (The rule has been repealed since 2021); there is no upper limit for the penalty for breach of the contract, which makes the employer having too much of autonomy. In short, both in terms of theory and system design, to protect labor ethics and the economic interests of enterprises, employees often lose more and are subject to more restrictions.

To sum up, from the perspective of essential attributes, the non-competition agreement is to maintain the labor ethics with capital. From the perspective of interest protection, the design of this system is more inclined to protect the interests of employers. Despite there is the apparent equality of employees and employers in the form of autonomy of will, the original intention of the legislation did not pay attention to the protection of the subordinate and disadvantaged employees, which aggravated the substantial inequality and contributed to the fundamental causes of the aforementioned problems.

2.2 Employers Have Too Much Autonomy and Arbitrariness

The non-competition agreement is premised on labor relations. Therefore, like labor relations, it is an unequal relationship in subordination and it differs from the relationship between two equal parties in civil relations. The employee obtains the necessary materials for life from the employer, and at the same time has the obligation of obedience to it. As a kind of labor contract, a non-competition agreement also has subordination, and its establishment must be based on the existence of labor relations. Although the legal basis of the non-competition agreement is the autonomy of private law, and the conclusion of the contract needs to be based on the free and equal negotiation between the parties, it is difficult for the subordinate employee to do substantially equal negotiation with the dominant employer in the whole process. Due to the huge gap in economic resources and status, as well as due to pressures on getting employed and money, or due to lack of experience, employees are often forced to sign non-competition agreements. As mentioned above, while signing the non-competition agreement, the employer generally attaches the non-competition agreement with the labor contract when the employee enters the job and decides whether to activate the non-competition agreement to the employee when the labor relationship is terminated. It has absolute control over the content of the non-competition agreement and whether to activate it or not. For employees, who sign non-competition when there is no other choice, after the termination of the labor contract, they often find themselves "involuntarily": they have to completely listen to the "former employer" on whether they are in non-competition, how to re-employ, and even the amount of compensation. As the disadvantaged party, this will even lead it to be in a more disadvantageous position, which contradicts the principles of the legal value of fairness, freedom, and integrity, and inevitably constitutes a blatant unfairness.

As mentioned above, because labor law has the characteristic of the combination of voluntary and compulsory standards, to avoid employers abusing their dominant position when signing labor contracts with employees and resulting in a situation of formal equality but substantial inequality, public power is often required to intervene and to reconcile. To protect the rights and interests of disadvantaged employees, it is necessary not only to

formulate mandatory clauses in legislation but also to make strict judgments in the judiciary and conduct a substantive examination of the non-competition agreements. However, the fundamental nature and institutional tendencies of the non-competition system tend to protect the interests of the employer, and in legislation, the ambiguous meanings of clauses with unclear boundaries such as “other employees who have the obligation to keep secrets”, “products and business of the same category” also leave too much room for employers to make a decision. Thus, the clauses that should be mandatory cannot achieve the effect of constraining dominant employers, nor can they provide clear guidance for judicial judgments. This further leads to that in judicial practice, the judge often evades the obligation of substantive review, only carries on the formal review, or adopts the lenient standard in the substantive review: The judge does not examine whether the scope of the non-competition agreement is reasonable or whether the agreement is invalid in violation of mandatory provisions of law, but only makes a judgment according to the non-competition agreement signed by both parties. The absence of public power in a disguised manner makes the initiative of non-competition arbitrarily controlled by the employer, resulting in the over-expansion of the application of the scope of non-competition, and the abuse of the non-competition system by the employer.

3. The Judicial Countermeasures: Pay Attention to the Examination for the Rationality

Based on perfecting legislation, attention should be paid to a reasonable review of issues related to non-competition at the judicial level. For example, about the definition of business secrets in non-competition clauses, the German Commercial Code stipulates that non-competition must be aimed at protecting the legitimate business interests of employers, otherwise, it will be invalid. In British precedents, the premise of determining the validity of non-competition is that the employer proves that it has reasonable commercial interests to protect, and non-competition clauses should first comply with the “Industry Restriction Rules”, that is unless their “rationality” is reviewed and approved, relevant non-competition clauses are invalid. It can be concluded that, in addition to the requirement of rationality and legitimacy for business secrets, it’s the employer who needs to prove it. Since non-competition hinders the free flow of talents and restricts the legitimate rights and interests of employees, it is necessary to put forward higher requirements for the legitimacy and rationality of the employer’s interests to protect, which can also help establish the value orientation and standards of judicial judgment and help address the issues raised in this paper.

3.1 The Concept of “Relevant Market” Should Be Introduced to Assist the Review

Regarding the issue that the scope of the non-competition agreement is too broad, the expression of “products in the same category”, “business in the same category” and “competitive relationship” in the legal text is rather vague and difficult to understand accurately. When employers draft the non-competition clauses, they make the scope of “competing companies” either too detailed, listing all companies in the same industry in the whole world, or too vague, copying the original text in the labor contract law, and own the right to interpret it. It is worth mentioning that the rationality review of the British courts usually does not support the excessively broad clauses in the non-competition agreement. In the relevant precedents, because the employer’s agreement on the scope of the non-competition is too broad, the relevant clauses are directly determined to be invalid by the judge. A similar situation in China can be directly determined invalid by referring to the practice experience of British courts. In reality, as summarized above, judges in our country either review the rationality of the scope with a lenient standard, based on the business scope registered in the employer’s business license, and if there is some overlap between the two entities, it is considered as a competitive relationship. Or they review through a strict and substantial rationality standard for the competitive relationship, based on whether the actual business scopes overlap. The unreasonableness of the former is obvious: the registration of business scope in the business license is relatively broad, and enterprises have greater flexibility and autonomy to choose their business scopes to be registered, which are generally far beyond their actual business scopes. As for the latter, how to determine whether there is a competitive relationship when conducting a strict and substantial rationality review requires further standards. At this time, the concept of “relevant market” in competition law can be appropriately borrowed and introduced.

The definition of a “relevant market” is generally the starting point for any type of competitive relationship analysis. The so-called “relevant market” refers to the commodity scope or territorial scope within which the business operators compete against each other during a certain period of time for specific commodities or services. Market competition occurs between specific products of specific business operators, rather than between any business operators. In anti-monopoly investigations, government departments generally use the concept of “relevant market” to judge the impact of market players’ behavior and then determine whether they have monopolistic behaviors. The purpose of borrowing the concept of “relevant market” is to better understand “products and business in the same category” and “competitive relationship” in order to clarify the scope of

non-competition. Generally speaking, “relevant market” includes relevant product market, relevant territorial market, relevant time market, relevant technology market, and other markets. Here, we will only briefly elaborate on the relevant product market, relevant territorial market, and relevant technology market, which is more useful to solve issues in this paper.

A relevant product market is the sum of competing products. Enterprises supply products to those in demand in the market, and many products in the market can meet the needs of the demanders. Because the product functions and product prices are similar for the demanders, they can be substituted for each other, which constitutes the reasonable “demand substitution”. And once the price of a certain product is too high, other suppliers can enter the certain market with demand substitution at a reasonable cost, and this generates “supply substitution”. Demand substitution and supply substitution constitute two competitive constraint factors for analyzing the relevant product market. The relevant territorial market emphasizes the homogeneity of the competitive conditions. If the competitive conditions of a certain territory are sufficient and homogeneous and can be clearly distinguished from the competitive conditions of the adjacent territories, then it constitutes a relevant territory market. Similarly, reasonable “demand substitution” and “supply substitution” can also be used to analyze the relevant territory market. The relevant technology market includes licensed intellectual property and its approximate substitutes. Even if the specific behavior has no adverse competitive impact in the relevant product market, if it has an adverse impact on the technology market, it will be judged as a violation of anti-monopoly law. With the help of the above-mentioned three relevant markets, it can help to understand what is a real “competitive relationship” and help judges to identify whether the scope of non-competition is justified and necessary when conducting a rational review on it.

3.2 Review the Joint and Several Liabilities of the Employer

Regarding the abuse of non-competition agreements by employers, employers on the one hand impose non-competition on resigned employees, and on the other hand help new hires who are in non-competition to get rid of the restrictions, and then make profits for themselves, commonly known as “poaching a wall”. Obviously, this is wanton destruction of the principle of good faith, and it will also cause many legal problems, which have been elaborated on in the previous article and will not be repeated here. From the perspective of legal responsibility, the non-competition agreement is a contract between the employer and the employee, and employees who violate the non-competition should be liable for the breach of contract, which has been stipulated by article 23 of the Labor Contract Law. At the same time, the new employer’s recruiting of employees with non-competition may also constitute an infringement of the business secrets of the original employer. Therefore, violating the non-competition restriction may trigger concurrent liability for breach of contract and liability for infringement. Concerning Article 91 of the Labor Contract Law, “Where an employer hires any employee whose labor contract with another employer has not been dissolved or terminated yet if any loss is caused to the employer mentioned later, the employer first mentioned shall bear joint and several liabilities of compensation.” If the employee infringes on the business secret of the original employer, the new employer, as a joint actor with vested interests, shall bear joint and several liabilities.

The problem is that non-competition is a system of presumptive damage and prevention in advance, and the infringement of the business secret of the original employer by the new employer and the employee is only a possibility and does not actually cause damage. Under such circumstances, there is room for discussion on whether the new employer should bear joint and several liabilities. Some scholars believe that the violation of non-competition violates the stability and security of business secrets and exposes them to the risk of being leaked. Other scholars believe that this behavior also violates the “labor credit” of the original employer. Starting from the concept of social standard of labor law, making new employers bear joint and several liabilities can reduce the economic burden of penalty for breach of contract on employees, and can effectively curb the abuse of non-competition agreements and violations of the principle of good faith by employers, and guide a good market competition order. Therefore, in the trial of non-competition disputes, it is of more legal and social benefits to initiating a joint and several liability reviews of the new employer.

4. Conclusion

The non-competition agreement has the dual nature of civil law and labor law. It tends to protect enterprises from the very beginning, and employees have become the weaker party by nature. As a typical system of the interest balance attribute of the labor law department, it is necessary to balance the interests of multiple parties, for example, among the economic rights of the employer such as business secret confidentiality, and the employees’ basic rights to labor and survive, and the public interests like the flow of talents, free competition and social innovation; and coordinate the value between maintaining the ethical order of labor and capital and

protecting the rights and interests of disadvantaged employees. How to deal with the above relations, judges need to learn from foreign laws and other department laws and introduce new judicial countermeasures, to strive to achieve a win-win situation for the society, enterprises, and individuals.

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