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Research on Legal Application Issues of the Non-Competition System

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Abstract

The non-competition system, stipulated in the Labor Contract Law, is a legal system that protects the trade secrets of employers, balances the freedom of oc-cupation choice and market order by restricting the post-employment non-compete behaviors of workers. It faces three predicaments in practice: first, the generalization of the applicable subjects, leading to the random inclusion of ordinary positions; second, the formalization of trade secret review, where judi-cial practice focuses on the form of agreement signing, neglects the substantive verification of the "three attributes" (secrecy, value, and confidentiality) of trade secrets, and publicly known information is often misidentified; third, the imbalance in the economic compensation system, with significant differences in standards across regions.Based on this, first, legislation should refine the ele-ments for "other personnel" to have substantial access to trade secrets, exclud-ing non-secret-related positions; second, judicially, a substantive review stand-ard for the "three attributes" of trade secrets should be established, requiring employers to provide evidence; finally, it is necessary to unify the national minimum standard for economic compensation to balance protection and fair-ness.

Keywords

Labor Contract Law; Non-competition; Scope of applicability; Trade secrets; Fi-nancial compensation

Introduction

As a crucial arrangement to balance the protection of employers' trade secrets and employees' freedom of employment, the non-competition system presents diverse forms in global legal practice. In recent years, with the intensification of labor mobility and market competition, issues of its over-generalized application and blurred boundaries have aroused widespread concern. In September 2024, the U.S. Federal Trade Commission (FTC) adopted the Non-Compete Clause Rule, which, in principle, comprehensively prohibits non-compete agreements, retaining only exceptions such as existing agreements for senior executives and business sales. This has triggered controversies over administrative authority, constitutionality, and impacts on the labor market. Regions like California have long held a stance of strict restriction, highlighting the system's profound influence on labor mobility, innovation, and competition.China also faces practical challenges. In April 2025, the Ministry of Human Resources and Social Security and the Supreme People's Court jointly released a typical case. In the case, a security company entered into a non-compete clause with its security guard Li. After Li resigned and joined a competing company, the security company claimed damages for breach of contract. The arbitration commission held that Li's position barely allowed access to trade secrets, making him an ineligible subject, thus ruling the non-compete clause invalid and dismissing the claim. This case warns employers against abusive restrictions and emphasizes that arbitration and judicial authorities should balance the rights and interests of employers and employees, responding to the problem of employers' abuse of restrictions.Both domestic and foreign cases reflect that the system has issues of blurred boundaries, value conflicts, and practical divergences in legal application. In-depth research on core issues such as its scope of application, subject qualification, and determination of validity is of great significance for improving legislation, unifying judicial standards, balancing the rights and interests of employers and employees, and promoting fair market competition.

1. Overview of the Non-Competition System

1.1. Concept of the Non-Competition System

The non-competition system refers to a legal system where an employer and an employee agree that, within a certain period after the dissolution or termination of the labor relationship, the employee shall not operate independently, operate on behalf of others any business that competes with the original employer, or take up employment with other employers having a competitive relationship, so as to protect the employer’s trade secrets and competitive advantages.Articles 23 and 24 of China’s Labor Contract Law clearly define the statutory framework of this system: the subjects of application include senior management personnel, senior technical personnel, and "other personnel with confidentiality obligations"; the scope of restriction must involve a competitive relationship with the original employer in "producing or marketing similar products or engaging in similar business"; the maximum duration shall not exceed 2 years; and economic compensation shall be paid monthly during the non-compete period.

1.2. Theoretical Foundations of the Non-Competition System

(1) Theory of Trade Secret Protection: This theory emphasizes that the legitimate rights and interests of employers in trade secrets constitute the foundation for the legitimacy of the system. Without protectable interests, restricting employees’ right

to choose a career would lose its reasonableness.
(2) Theory of Tilted Protection of Labor Rights: The principle of tilted protection in labor law requires that system design should take into account employees' right to subsistence. The mandatory provisions on economic compensation embody this principle, preventing employers from depriving employees of employment opportunities under the pretext of protecting trade secrets.
(3) Theory of Maintaining Market Competition Order: Reasonable non-competition can prevent unfair competition, while excessive restrictions hinder talent mobility and technological innovation. By defining the criteria for identifying "competitive relationships," the system avoids employers' monopolization of talents.

1.3. Types of the Non-Competition System

(1) Statutory vs. Contractual Non-Competition: Statutory non-competition, based on direct legal provisions, apply to specific subjects and are mandatory. Contractual non-competition are established through agreements, apply to "other personnel with confidentiality obligations," and must meet requirements such as subject qualification, reasonable content, and clear compensation.
(2) On-the-Job vs. Post-Employment Non-Competition: On-the-job non-competition derive from employees' duty of loyalty and do not require economic compensation. Post-employment non-competition, with compensation as consideration, are the main type of disputes, and their duration and scope must comply with legal provisions.
(3) Trade Secret Protection-Oriented vs. Business Interest Protection-Oriented: The former takes trade secrets that meet the criteria of "secrecy, value, and confidentiality" as the objects of protection; the latter extends to non-secret business interests such as customer resources and goodwill.
(4) Total vs. Partial Non-Competition: Total restrictions cover the entire industry or all businesses of the original employer, with a broad scope. Partial restrictions only target specific businesses, technologies, or customer resources that the employee has access to, making them more targeted.

2. Current Legal Application Status of the Non-Compete Obligation System

2.1. Legislative Status of the Non-Competition System

China's non-compete obligation system is primarily established under the Labor Contract Law. Articles 23 and 24 define its fundamental framework: applicable subjects are limited to senior management personnel, senior technical personnel, and other personnel bound by confidentiality obligations; the maximum restriction period shall not exceed two years; employers are required to pay monthly economic compensation during the non-compete period. At the local level, jurisdictions have issued differentiated regulations based on practical circumstances. For instance, some regions specify minimum thresholds for economic compensation as a certain proportion of wages, forming a multi-level regulatory framework characterized by "central legislation supplemented by local provisions."

2.2. Judicial Status of the Non-Compete Obligation System

In judicial practice, multiple controversies exist in resolving non-compete disputes. Significant divergence exists regarding subject qualification. Most courts adopt a "formal review" approach, presuming subject eligibility based on the execution of the agreement or job title, leading to the overbroad inclusion of ordinary employees. Although a trend toward "substantive review" has emerged in recent years (e.g., Supreme People's Court Guiding Cases requiring assessment based on actual business functions), a unified standard has not yet crystallized, with some courts still upholding validity based on "voluntary agreement." Review of trade secrets tends to be formalistic. Courts apply lenient scrutiny to the three constitutive elements of trade secrets—"confidentiality, value, and protective measures"—often deeming the employer's protective measures satisfied merely by the "existence of a confidentiality agreement," neglecting the substantive secrecy of the information. Some judgments extend protection to non-secret interests such as customer resources and goodwill, blurring the boundary between non-compete obligations and trade secret protection. Determination of the restricted scope exhibits "form-over-substance" characteristics. Geographically, broad stipulations like "nationwide" or "global" are generally upheld, even if the employer operates only provincially. Regarding industry scope, competitive relationships are frequently determined based on business license scopes, diverging from the "substantive business relevance" review approach, reflecting disparate interpretations of "restriction necessity."

Significant regional disparities exist in adjudicating economic compensation and liquidated damages. The validity of agreements lacking compensation clauses is inconsistently recognized: some jurisdictions uphold validity and supplement compensation based on statutory standards, while others directly invalidate them. Liquidated damages adjustments lack a uniform scale; although most courts exercise discretion to reduce penalties, the reduction ratios vary widely, with only a minority invoking the Civil Code's unconscionability clause to intervene in agreements featuring "low compensation but disproportionately high penalties." Difficulties arise in determining performance and liability. Employers' claims for "specific performance" are often difficult to enforce as they may involve compelled resignation, and the "one arbitration plus two trials" procedure duration may exceed the non-compete period. Divergent approaches exist regarding the liability of new employers: some courts support joint liability, while most deny it based on the principle of privity of contract, increasing the legal risks for relevant parties.

3. Dilemmas in the Legal Application of the Non-Competition System

3.1. Lack of a Mechanism to Narrow Down Catch-All Clauses

The core cause of the generalization of subjects applicable to non-competition lies in the ambiguity in the legal system's definition of obligated subjects, enabling employers to arbitrarily expand the scope of restrictions through legislative loopholes. From the perspective of legal provisions, the catch-all clause "other personnel with confidentiality obligations" in Article 24 of the Labor Contract Law lacks clear definition standards. This directly leads employers to extend non-competition to ordinary workers, such as customer service representatives, junior sales staff, and cleaning personnel, who have never accessed trade secrets. In practice, some enterprises, aiming to strengthen internal management, adopt a one-size-fits-all approach by having all incoming employees sign non-compete agreements, and even include employees' close relatives in the restrictions through contractual stipulations, breaching the principle of privity of contract.

The legal system fails to clarify the necessary connection between "confidentiality obligations" and "the possibility of accessing trade secrets," further exacerbating the generalization of subjects. Legislation does not require "other personnel with confidentiality obligations" to actually access trade secrets, relying only on the vague expression "bearing confidentiality obligations." As a result, employers can arbitrarily include ordinary positions in restrictions. Even if an employee's work involves only basic tasks, they are deemed eligible subjects once they sign the agreement, causing non-competition to degenerate from "a special means to protect trade secrets" into "a universal tool to restrict talent mobility," deviating from the original purpose of the system.

Additionally, the ambiguous legal definition of "trade secrets" has also contributed to the generalization of subjects. The Labor Contract Law does not specify the scope of trade secrets, and in practice, employers often claim ordinary business information or even publicly known industry information as trade secrets, thereby expanding the scope of subjects subject to non-competition.

3.2. Vague Standards for Reviewing Non-Compete Agreements

In judicial practice, the lack of unified standards for reviewing non-compete agreements has led to frequent occurrences of inconsistent judgments in similar cases. Firstly, there is a significant formalistic tendency in the identification of trade secrets. Courts' reviews of the three elements of trade secrets—"secrecy, value, and confidentiality"—are mostly superficial. Employers are deemed to have taken confidentiality measures merely by stipulating "confidentiality obligations" through standard terms, without needing to prove the actual secrecy of the information. Some courts include publicly known industry information or ordinary business information in trade secret protection, and even recognize information without substantive confidentiality measures, resulting in the loss of control over the boundaries of trade secret protection.

There are fundamental divergences in the criteria for defining competitive relationships. One review approach is based on the business scope registered in the business license, identifying a competitive relationship as long as there is an overlap in business scopes. The other approach requires reviewing the actual business content, emphasizing the substantive judgment of "business overlap." Such divergences lead to contradictory rulings in similar cases, undermining judicial credibility.

There is no unified standard for reviewing the reasonableness of the restriction scope. In terms of geographical scope, vague agreements such as "national" or "global" are generally recognized. Even if an employer operates only in a certain province, courts mostly uphold the validity of such agreements on the grounds of "autonomy of will," with only a few cases where the geographical scope is deemed unreasonable as it far exceeds the employer's actual business area. In terms of industry scope, some courts expand the restriction scope to the entire industry based on the vague expression "related to the original employer's business," essentially depriving employees of the freedom to choose employment in related fields.

3.3. Imperfections in the Economic Compensation System

The imperfection of the economic compensation system is another prominent dilemma in the operation of non-competition. Firstly, there are significant regional disparities in compensation standards, lacking unified national regulations. Local requirements for the minimum proportion of economic compensation vary greatly, leading to contradictory rulings in cross-regional cases and violating the principle of uniformity in legal application. Secondly, there are fundamental divergences in determining the validity of agreements without stipulated economic compensation, exacerbating the uncertainty in the operation of the system. Whether economic compensation is a validity requirement for non-compete agreements remains controversial. These divergences result in three outcomes—"valid," "invalid," and "optional"—for similar cases in different regions, increasing the legal risks for both employees and employers.

Irregularities in payment methods have further intensified disputes. In practice, some employers pay "non-compete compensation" during the employee's tenure and merge it with wages, leading to confusion between compensation and labor remuneration. Courts hold divergent views on the validity of such payment methods. This chaos allows employers to evade compensation obligations through "on-the-job payment," making it difficult to protect employees' rights and interests.Moreover, the imbalance between liquidated damages and economic compensation is prominent, with frequent occurrences of obvious unfairness. Employers often use their dominant position to stipulate "low compensation and high liquidated damages." In judicial practice, courts lack a unified standard for adjusting liquidated damages, and such arbitrary discretion results in employees facing huge compensation for minor breaches, while employers bear extremely low liability for breach, seriously deviating from the principle of fairness.

Finally, the lack of a payment guarantee mechanism for economic compensation leads to widespread delays in compensation payments by employers. Employees need to safeguard their rights through arbitration or litigation, but the rights protection cycle often exceeds the non-compete period, resulting in employees winning cases but failing to obtain actual compensation. This has seriously questioned the fairness of the non-competition system.

4. Suggestions for Improving the Legal Application of the Non-Competition System

4.1. Clarifying the Constituent Elements of "Other Personnel with Confidentiality Obligations"

To address the issue of the generalization of subjects applicable to non-competition, it is necessary to clarify the constituent elements of "other personnel with confidentiality obligations" and curb the expansion of the scope from the source.

Firstly, define them as "workers who actually access the employer's trade secrets and such secrets have protectable value," and specify three core elements: first, the position is directly related to trade secrets; second, the employer must provide evidence of the specific content of the trade secrets that the worker has actually accessed; third, reasonable confidentiality measures have been taken for the secrets. At the same time, clearly exclude positions that do not involve trade secrets and prohibit such personnel from being included in the agreement.

Secondly, it is necessary to clarify that "close relatives are not subjects of non-competition," negate the validity of agreements where employers include third parties such as the worker's spouse and parents in the restrictions, and return to the principle of privity of contract. Regarding the "generalization of job titles," stipulate that courts must conduct a substantive review of job content, not relying on titles such as "manager" or "assistant" for identification, but combining job responsibilities and the type of information accessed for judgment. For example, for a "sales assistant," it is necessary to verify whether they participate in core customer negotiations or master unpublicized quotations, rather than merely presuming based on the title.

In addition, implement a "trade secret access list" system: when an employer signs a contract with a secret-related position, it must list the types, scope of secrets that the worker may access, and confidentiality responsibilities, as the basis for determining "bearing confidentiality obligations." In judicial practice, courts take this list as key evidence; if the employer cannot provide it or the list is irrelevant to the position, the subject is deemed ineligible. This system can guide employers to accurately define secret-related personnel, provide standards for judicial review, and avoid "one-size-fits-all" contracting.

4.2. Improving the Review Standards for Non-Compete Agreements

To solve the problem of vague review standards for non-compete agreements, it is necessary to construct a three-stage review system of "substantive identification of trade secrets + substantive judgment of competitive relationships + reasonableness verification of restriction scope." Firstly, the review of trade secrets should strengthen substantive judgment, strictly verify "secrecy, value, and confidentiality," requiring employers to prove that the information is "not known to the public" (which can be supported by industry practices and expert opinions), can bring competitive advantages, and that specific confidentiality measures have been taken (not merely standard terms). The Supreme People's Court can issue typical cases, clarify the negative list for trade secret identification, and unify standards.

Secondly, the identification of competitive relationships should focus on "substantive business overlap": replacing the formal review of business licenses, judging from three aspects — direct substitutability of products/services (e.g., production of similar chips constitutes competition, while production of chips and car seats does not), overlap of target customers, and intersection of market regions. Clearly require affiliated companies to prove business overlap, avoiding expanding restrictions through affiliated relationships.

Finally, the restriction scope must be verified for reasonableness. The geographical scope should be consistent with the employer's actual business area, prohibiting vague agreements such as "national/global"; the industry scope is limited to the field involved in the worker's original position (e.g., software engineers are restricted to "research and development of similar software"). Legislation should list situations of "excessive restriction" and empower courts with the right to take initiative to adjust, avoiding excessive deprivation of the right to choose employment.

4.3. Optimizing the Economic Compensation System

To address the imperfection of the economic compensation system, firstly, unify the national minimum standard for economic compensation, establish a unified national minimum standard for economic compensation, and clarify that "average salary" includes bonuses, allowances, and other income. For workers whose salary is lower than the minimum wage standard, payment shall be made in accordance with a certain proportion of the minimum wage standard to ensure the basic living of low-income groups. Localities can formulate higher standards on the basis of national standards, but they shall not be lower than the national bottom line. In addition, the calculation base of compensation should be clarified.

Secondly, clarify the validity of agreements without stipulated compensation. At the same time, it is necessary to clarify the calculation method of the "statutory standard" to prevent rights imbalance caused by differences in local discretion. Also, standardize the payment method of compensation, prohibiting employers from merging it with wages during the employee's tenure. For agreements with "on-the-job payment of compensation," the relevant amount shall be directly deemed as labor remuneration, not regarded as non-compete compensation, and the employer shall still make re-payment after the employee's departure. Employers should provide records of compensation payment as evidence of performance, and employees do not need to prove non-receipt of compensation, reducing the burden of rights protection.

In balancing the proportional relationship between liquidated damages and compensation, it is necessary to prevent unfair agreements of "low compensation and high liquidated damages." For the excess part, courts can take initiative to adjust ex officio; if the compensation is not fully paid, the liquidated damages shall be reduced proportionally according to the amount already paid. At the same time, stipulate that if the employer defaults on compensation, the worker has the right to request a reduction or exemption of liquidated damages; if the default period exceeds the time limit, the liquidated damages automatically decrease to the corresponding proportion.

Moreover, introduce a "compensation escrow system," requiring employers to, within a certain period after the non-compete agreement takes effect, deposit all compensation in a lump sum with a third-party institution, which shall pay it to the worker on a monthly basis. Failure to make the deposit shall be deemed as no agreed compensation, and the worker may not be bound by the agreement.

Conclusion

Against the backdrop of increasingly fierce innovation-driven development and talent competition, the non-competition system, as an arrangement to balance the protection of employers' trade secrets and employees' freedom of career choice, bears on market order and labor allocation. China has formed a regulatory system with the Labor Contract Law as its core, yet in practice, it faces dilemmas such as the generalization of subjects, vague review standards, and imbalance in the compensation mechanism. The root causes lie in ambiguous legislation and inconsistent judicial standards.

This paper sorts out its theories and types, analyzes prominent issues, and puts forward targeted suggestions: clarify the elements of "other personnel with confidentiality obligations" to curb the generalization of subjects; establish a system of "substantive identification of trade secrets + substantive judgment of competitive relationships + reasonableness verification of restriction scope" to unify judicial standards; optimize the compensation system to rectify rights imbalance.

These suggestions aim to return to the original purpose of the system, balance protection and freedom, achieve dynamic equilibrium, and make it a legal cornerstone for maintaining market fairness and promoting innovation, thereby providing support for high-quality development.

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