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Employment & Benefits Taiwan

How to make a post-termination restrictive covenant for non-competition legally binding

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A post-termination restrictive covenant for non-competition restricts an employee from joining the employer's competitor or conducting business in competition with the employer following termination of employment. The employee is usually required to provide such a covenant on being hired, making it difficult for him or her to decline.

Controversy

The legality of such a covenant for non-competition was controversial. Employers alleged that such covenants were necessary to protect their trade secrets and business interests, while employees argued that such a restriction limited their opportunity to find a new job when leaving their previous employer and affected their right to work. Since the Labour Standards Act provided no guidelines in this regard, many court precedents were generated in respect of this issue. In principle, the courts supported the legality of the post-termination restrictive covenant for non-competition and held that the employees should be bound by the restriction that they had agreed to as long as its scope is reasonable.

Guidelines

In 2003 the Ministry of Labour issued reference guidelines on post-termination restrictive covenants for non-competition, which suggested that such a covenant should:

- apply to employees who have access to company trade secrets or participate in research and development for the company;
- be valid for no more than two years;
- ensure that restrictions on the territory and scope of future employment are made in accordance with trade customs; and
- offer reasonable compensation (at least half of a month's salary before termination) for each month during the restricted period.

Should a post-termination restrictive covenant impose a default penalty, the penalty should be no more than the total remuneration (including salaries, incentives, allowance and bonuses) that the employee receives in the year preceding termination.

Although the guidelines are not legally binding, the courts have always considered them when reviewing the legality of a post-termination restrictive covenant. However, there are discrepancies among different court precedents regarding the criteria for making such a covenant legally binding.

Labour Standards Act

When the Labour Standards Act was revised in 2016, a new article was added to regulate the post-termination restrictive covenant for non-competition, which provides as follows:

- An employer may require an employee to agree to a post-termination restrictive covenant for non-competition only when:
 - o the employer has proper business interests that require protection;
 - o the employee's position or job entitles him or her to access or use the employer's trade secrets;
 - o the period, area, scope of occupational activities and prospective employers with respect to the restriction for non-competition do not exceed a reasonable range; and

- o the employer reasonably compensates employees subject to such a covenant for the losses incurred.
- Reasonable compensation should not include remuneration received by the employee during employment.
- Any restrictive covenant in violation of these conditions is null and void.
- The period of a restrictive covenant should not exceed two years. If such a period is more than two years, it will be shortened to two years.

The Enforcement Rules of the Labour Standards Act further provide the following guidance for implementing a restrictive covenant:

- The post-termination restrictive covenant for non-competition should be made in writing and specify the period, area, scope of occupational activities and prospective employers of the restriction and the compensation to be offered by the employer. The document should be signed by the employer and employee and each party should keep a copy.
- The period, area, scope of occupational activities and prospective employers of the restriction are subject to the followings requirements:
 - o the period of the restriction should not exceed the lifecycle of the trade secrets or technological information protected by the employer, up to a maximum of two years;
 - o the area of the restriction should be limited to the area in which the employer has actual business activities;
 - o the scope of occupational activities of the restriction should be concretely specified and identical or similar to the scope of the employee's occupational activities; and
 - o the prospective employer of the restriction should be concretely specified and have business activities that are identical or similar to and competitive with those of the employer.
- The reasonableness of the compensation to be offered by the employer should be evaluated based on the following:
 - o the amount of compensation per month should be no less than 50% of the employee's monthly average wage on termination;
 - o the amount of compensation should be sufficient to support the terminated employee during the period of the restriction;
 - o the amount of compensation should be equivalent to the loss incurred by the employee in compliance with the period, area, scope of occupational activities and prospective employer of the restriction; and
 - o other matters relevant to the evaluation of reasonable compensation criteria.
- The compensation should be paid to the employee in a lump sum on termination or on a monthly basis following termination.

Comment

Based on the legal provisions and guidance, a valid and legally binding post-termination restrictive covenant for non-competition must include a compensation mechanism to support the terminated employee during the restricted period and the compensation each month should be no less than 50% of the employee's monthly average wage on termination. In addition, the post-termination restrictive covenant for non-competition applies only to those employees who can access or use the employer's trade secrets during employment and the restriction period should be no more than two years.

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