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The Dilemma and Improvement of the Statutory Non-competition Prohibition System in Company Law

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Abstract. As a crucial legal institution for protecting corporate trade secrets and maintaining fair competition order, the non-competition prohibition system has undergone new regulatory adjustments following the 2023 revision of the Company Law. However, issues concerning the scope of obligated subjects, standards for identifying competitive acts, and the allocation of remedial measures remain unresolved, necessitating a systematic examination from both institutional construction and judicial application perspectives. This paper focuses on the subject, conduct, and liability of statutory non-competition obligations, comprehensively employing normative analysis, case analysis, and literature review methods. The study reveals that the current system faces prominent problems: the statutory scope of subjects is too narrow and misaligned with practical needs; divergent standards exist in identifying "operating on one's own account or for the account of others" and "similar business"; and there are obstacles in exercising the disgorgement right alongside insufficient coordination between civil and criminal remedies. Accordingly, this paper proposes expanding the regulated subjects to include controlling shareholders and actual controllers who substantively perform functions, as well as shareholders with access to trade secrets; unifying the identification standards based on the Interest-Attribution Doctrine and substantive competitive relationships; and constructing a diversified remedial system integrating the disgorgement right, the right to claim cessation of infringement, and criminal liability pursuit.

Keywords: Non-Competition Prohibition, Obligated Subjects, Similar Business, Disgorgement Right, Remedial Measures

1. Introduction

The non-competition prohibition system is a vital mechanism in company law for balancing conflicts of interest, protecting trade secrets, and maintaining fair competition. The 2023 revision of the Company Law expanded the scope of obligated subjects to include supervisors and refined the exemption procedure for competitive conduct (transferring the decision-making authority from the shareholders' meeting to the board of directors or the shareholders' meeting as per the articles of association), reflecting a legislative response to governance needs. However, the underlying controversies remain unresolved. Regarding the subject of obligation, the statutory enumeration is too narrow to accommodate practical managerial demands, leaving the legal status of controlling

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shareholders, actual controllers, and departed employees ambiguous. Regarding conduct identification, the divergence between nominalism and the interest-attribution doctrine leads to inconsistent criteria for core concepts such as "operating on one's own account or for the account of others" and "similar business," while the application of the damage element also deviates. Regarding remedial measures, the exercise of the disgorgement right is hampered by unclear scope, proof difficulties, and ambiguous limitation periods; its concurrence with the claim for damages lacks clear rules; the right to claim cessation of infringement has not yet gained independent status; and coordination between civil and criminal remedies is fragmented. These issues result in inconsistent judicial standards and call for systematic responses. This paper employs normative analysis, case analysis, and literature review methods, adopting a "subject-conduct-remedy" framework to systematically examine the non-competition system. The research aims to reveal the inherent defects of the current system and provide theoretical references for reasonably defining the scope of obligated subjects, unifying identification standards, and constructing a diversified remedial system, thereby promoting the coordination and balance among corporate interests, shareholders' rights, and market order [1].

2. Deficiencies of the non-competition prohibition system under the current legal framework

Under the current legal framework, the non-competition prohibition system suffers from certain deficiencies, such as: unclear regulated subjects, inconsistent standards for identifying non-competition conduct, and inadequate remedial measures.

The lack of clarity as to the regulated subjects (i.e., obligated parties) is a core issue that perplexes both theorists and practitioners, and it is mainly reflected in the following three aspects.

First, there exists the contradiction between the overly narrow scope of statutory subjects and the demands of judicial practice. Some scholars point out that China's statutory obligated subjects for non-competition include the general manager and deputy general manager of Sino-foreign equity joint ventures, directors and managers of limited liability companies and joint-stock companies, the chairman, vice-chairman, directors, and managers of wholly state-owned companies, as well as all partners of partnerships [2]. However, such a statutory list "overlooks the senior management employed by partnerships and the responsible persons of collectively owned enterprises, thus narrowing the scope of obligated subjects and undermining the protection of enterprises' legitimate rights and interests" [2].

Second, there is a divergence between formal and substantive approaches in defining the scope of "senior management." Some scholars note that Article 216 of the Company Law adopts a closed list for senior management (managers, deputy managers, financial officers, secretaries to the board of listed companies, and other persons stipulated in the articles of association) [2]. However, it is observed that "with the emergence of various new types of companies and enterprises, the titles for senior management positions have also varied, such as CEO, CFO, CHO, President, Vice President, Principal, Vice Principal, etc. These titles differ from the scope of senior management specified in Article 216 of the Company Law." This variation creates "difficulties for the judiciary in accurately identifying the specific status of employees, and consequently in determining whether they fall within the scope of obligated subjects for directors and senior management under the non-competition rule" [2]. In determining director status, Wu Yingying advocates "substance over form," arguing that "in real life, it is common for limited liability companies to have incomplete procedures for the appointment and dismissal of directors. The existence of procedural formalities should not be the sole criterion for identifying a director" [3, 4].

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Third, the legal status of controlling shareholders, actual controllers, and resigned personnel is ambiguous. Some scholars point out that judicial practice holds different views on "whether controlling shareholders bear a statutory non-competition obligation to the company" and "whether directors, supervisors, and senior management of a parent company bear a statutory non-competition obligation to its subsidiary" [5]. Although Article 180 of the 2023 Company Law incorporates controlling shareholders and actual controllers who execute company affairs into the scope of fiduciary duties, the law itself does not automatically impose such an obligation on them. As scholars have argued, "controlling shareholders or actual controllers do not automatically owe a statutory non-competition obligation to the company solely by virtue of their status. If a controlling shareholder or actual controller substantively performs the functions of directors, supervisors, or senior management, becoming a de facto director, supervisor, or senior management... then they should be included within the scope of subjects subject to the company law non-competition obligation" [5]. Regarding resigned personnel, the current Company Law makes no explicit provision. In judicial practice, some courts have held that parties who have resigned are no longer bound by the Company Law's non-competition restrictions [6] , which fully demonstrates the institutional gap regarding post-resignation statutory non-competition obligations.

Significant disagreements exist in both theoretical and practical spheres over the criteria for identifying non-competition conduct, which are mainly reflected in three aspects: the standard for identifying "operating on one's own account or for the account of others," the standard for defining "similar business," and the applicable standard for the element of damage.

First, there is a dispute between the Nominalism Doctrine and the Interest-Attribution Doctrine regarding the identification of "operating on one's own account or for the account of others." The Nominalism Doctrine "requires the obligated subject to engage in competitive conduct in their own name or the name of others," and "it suffices that it is formally conducted in one's own name or as an agent for others, regardless of the ultimate destination of the benefits from the act" [7]. In contrast, the Interest-Attribution Doctrine holds that "regardless of whether directors or senior management use their own names or those of others, as long as these persons engage in competitive conduct and the economic benefits generated by the act ultimately accrue to themselves or others," such conduct constitutes a violation of the non-competition obligation [7]. Some scholars point out that "the Nominalism Doctrine limits 'operating on one's own account' to senior management conducting competitive business in their own name," while "the Interest-Attribution Doctrine transcends formal requirements, advocating that the ultimate destination of the benefits from the act serves as the basis for determination" [8]. Other scholars further reveal the practical difficulties of concealed competition, pointing out that "directors, supervisors, and senior management, as well as other subjects subject to fiduciary duties, often, due to their sensitive status, do not directly engage in competitive business activities in their own names, but utilize others (including but not limited to spouses, children, parents-in-law, friends, etc.) to do so" [5]. However, some courts "directly equate the business activities of a spouse with the personal business activities of the obligated subject, improperly expanding the scope of application of the company law non-competition obligation rules," which has led to inconsistent adjudicative standards [5]. For instance, in case Lu 13 Min Zhong No. 3381, where the spouse of a legal representative and senior manager served as the actual controller of a company engaged in similar business, the court found "insufficient evidence to determine" the breach, a finding that fully illustrates the difficulties in judicial identification of concealed competitive conduct.

Second, the definitional standard for "similar business" oscillates between formal and substantive criteria. Empirical analyses by some scholars reveal that some cases adopt the business scope

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standard, while others use the competitive relationship and conflict of interest standard, and this divergence leads to inconsistent adjudication [5]. The formal standard relies on the business scope recorded in the business license or articles of association—some courts hold that "the business scope for non-competition purposes should be based on the scope recorded in the business license, not merely on the actual business operations" [1]. The substantive standard examines "whether there is a substantive competitive relationship and conflict of interest," and courts make a comprehensive judgment from perspectives such as "business scope, product nature, product competition" or "business model, operational region, customer base" [5]. Judgments in some courts reflect this divergence; for example, case (2023) Zui Gao Fa Zhi Min Zhong No. 1568 found a breach based on "substantially identical business scope."

Third, the application of the damage element varies in practice. Some scholars explicitly point out that determining a director's breach of the non-competition obligation "does not require the company to have suffered actual economic loss, nor does it depend on whether the competitive activity resulted in a profit; it suffices that the activity is competitive and profit-seeking" [4]. However, they also criticize the current judicial practice: "Courts often focus on the existence of actual damage," which results in "a lower probability of plaintiff success" [4].

The inadequacy of remedial measures within the non-competition prohibition system is mainly reflected in four aspects: difficulties in exercising the disgorgement right, ambiguity in the concurrence relationship between the disgorgement right and the right to claim damages, legislative absence of the right to claim cessation of infringement, and insufficient coordination between civil and criminal remedies.

First, the exercise of the disgorgement right faces threefold obstacles: unclear scope, proof difficulties, and undefined limitation periods. Concerning the scope of disgorgement, scholars note that the standards for determining it are inconsistent: some courts determine it as "the pre-tax profits, distributable profits, or turnover of the competing company multiplied by the obligated subject's contribution ratio," others as "the operating income of the competing company and the appreciation of the equity held by the breaching subject," and still others "make discretionary judgments based on principles of fairness and the specific circumstances of the case" [5].

Second, the concurrence relationship between the disgorgement right and the right to claim damages lacks clear rules. Some scholars point out that "in disputes concerning liability for harming company interests, some plaintiff companies simultaneously exercise both the disgorgement right and the right to claim damages, and courts have expressed support; some courts hold that the plaintiff company may choose between exercising the disgorgement right and the right to claim damages; other courts believe the disgorgement right should take precedence." The coexistence of these three approaches leads to inconsistent judicial adjudication. Some scholars also note that the Company Law provides for a disgorgement right, while the Partnership Enterprise Law and the Sole Proprietorship Enterprise Law provide for rights to claim damages. "The inconsistency in liability methods" is a significant legislative flaw [5].

Third, the right to claim cessation of infringement is not explicitly stipulated as an independent remedial measure. The current Company Law does not list the right to claim cessation of infringement as an independent remedy.

Fourth, the coordinated civil-criminal remedial mechanism suffers from a significant gap. There is a "dual-track" system for the criminal liability of executives in state-owned versus non-state-owned enterprises: "When executives of state-owned companies use their positions to engage in competitive business activities, they not only bear civil liability but may also face criminal prosecution, whereas identical illegal conduct by executives of non-state-owned companies, even

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causing significant economic losses, due to the lack of criminal law provisions, merely results in civil compensation." Although Criminal Law Amendment (XII) has extended the scope of the crime of illegally operating a similar business to personnel of private enterprises, "conduct identified as breaching fiduciary duties in civil law may not be criminally punishable due to limitations on the subject of the offense or different filing standards, creating a fracture in the hierarchy of legal liability" [5].

3. Suggestions for improving the internal governance of trade secret protection

The author proposes improvements in the following aspects: 1. Clarifying the regulated subjects of non-competition prohibition; 2. Unifying the standards for identifying non-competition conduct; 3. Improving the remedial measures for non-competition prohibition.

Regarding the clarification of regulated subjects, the author believes two main aspects are crucial. First, partners, shareholders with access to trade secrets, and actual controllers should be included as regulated subjects. Some scholars point out that while current provisions list "all partners of a partnership enterprise" as obligated subjects, they "overlook the senior management employed by partnerships," advocating for "appropriately broadening the scope of obligated subjects under the non-competition rules" [2].

Second, shareholders with access to trade secrets should be included as regulated subjects. Such shareholders who "can easily access trade secrets in their work" should be added to the scope of subjects [9]. Some scholars believe that non-competition agreements "utilize this system for preemptively preventing presumed harm, transforming trade secret protection from post-event remedy to pre-event prevention" [1]. For shareholders who, although not holding director, supervisor, or senior management positions, have actual access to or potential access to trade secrets through participating in management, reviewing financial information, etc., the potential harm to company interests from their engaging in competing business is essentially no different from that posed by directors, supervisors, or senior management [5].

Third, the inclusion of actual controllers should be based on the criterion of "substantive performance of functions." Some scholars explicitly argue: "Controlling shareholders or actual controllers of a company do not automatically owe a statutory non-competition obligation to the company solely by virtue of their status. If a controlling shareholder or actual controller substantively performs the functions of directors, supervisors, or senior management, becoming a de facto director, supervisor, or senior management... then they should be included within the scope of subjects subject to the company law non-competition obligation" [5]. Furthermore, if formal evidence is insufficient to prove their director status, a substantive interpretation should be adopted, which examines whether they actually exercise the functions of a director [3].

To unify the standards for identifying non-competition conduct, coordinated efforts are needed in three dimensions: "operating on one's own account or for the account of others," "similar business," and the damage element. Regarding the identification of "operating on one's own account or for the account of others," using the attribution of benefits obtained by the obligated subject from competitive conduct as the determining standard better aligns with the overall purpose of the statutory non-competition system in company law. Some scholars argue that "the Interest-Attribution Doctrine transcends formal requirements, advocating that the ultimate destination of the benefits from the act serves as the basis for determination, meaning that regardless of whether the senior management uses their own name or that of others, as long as the conduct substantively serves their own interests or those of associated third parties, it should be subject to non-competition regulation" [8]. Furthermore, "operating on one's own account" should be defined as situations "where benefits

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accrue to the director or senior management themselves," while "operating for the account of others" should be defined as situations "where benefits accrue to persons other than the obligated subject" [10]. Other scholars further point out that "the key to determining business conduct lies in examining the interest relationship between the obligated subject and the competing company," and they assess "whether the obligated subject inevitably transferred skills honed in the original company or information derived from the original company to the competing company." They also clarify that "a mere equity investment in a competing company does not constitute operating a similar business," while "serving as a supervisor, member of the audit committee, or independent director of a competing company should be deemed as operating a similar business" [5]. For the identification of "similar business," some scholars advocate "adopting a model combining formal and substantive standards"—"at the formal standard level, refer to the business scope recorded in the company's industrial and commercial registration and articles of association"; "at the substantive standard level, examine whether there is a conflict of interest arising from a competitive relationship between the two companies," and this "includes not only current competitive relationships and conflicts of interest but also foreseeable future competitive relationships and conflicts of interest" [5]. They suggest "assessing from both the supply and demand sides, comprehensively examining factors such as the industry, business model, main products or services, target customer groups, geographical scope of operations, operational timeframe, and technologies utilized" by both parties [5]. Regarding the damage element, some scholars explicitly state that "determining a director's breach of the non-competition obligation does not require the company to have suffered actual economic loss, nor does it depend on whether the competitive activity resulted in a profit; it suffices that the activity is competitive and profit-seeking" [4]. The non-competition obligation "regulates potential conflicts of interest, serving a pre-risk-filtering function." To address the difficulties in proving the amount subject to disgorgement, rules for alleviating the burden of proof should apply, "which would reduce, to a certain extent, the plaintiff company's burden and standard of proof regarding the defendant's 'income,' with the defendant then contesting the plaintiff's evidence" [5]. Simultaneously, the "order to produce documents" system should be actively utilized, and "courts should proactively apply it as needed based on the circumstances" to resolve issues of evidence imbalance. These three dimensions of coordinated efforts can systematically unify the standards for identifying non-competition conduct.

The improvement of remedial measures for non-competition prohibition should be advanced in four dimensions: refinement of the disgorgement right system, optimization of evidentiary mechanisms, establishment of an independent right to claim cessation of infringement, and construction of a civil-criminal coordination framework.

Concerning the handling of the disgorgement right and the right to claim damages, a model where the disgorgement right takes precedence should be adopted. When the disgorgement right cannot fully compensate for the company's actual losses, the company should then be permitted to exercise the right to claim damages. This approach alleviates the company's burden of proving causation for losses while achieving sufficient sanction against the breaching party. The scope of disgorgement should be calculated based on "net benefits," and the calculation should distinguish between operating on one's own account and operating for the account of others [5]. In cases of self-operation, all net profits obtained by the breaching party from the business should be disgorged to the company; in cases of operating for others, the remuneration received should be disgorged. Human capital costs should not be deducted in the calculation, which means that the breaching party to bear the consequences of the breach themselves. Regarding the limitation period for exercising the disgorgement right, a prescriptive period should apply, drawing reference to the one-year period

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for revocation rights, commencing from when the company knew or should have known of the breach, with a maximum period not exceeding five years, to encourage timely exercise of rights by the company and avoid prolonged uncertainty [5].

To address difficulties in proving disgorgement amounts, rules for alleviating the burden of proof should apply. After the plaintiff preliminarily proves the total income, the defendant should provide rebuttal evidence. Simultaneously, the system of "order to produce documents" should be actively utilized, and courts should require the breaching party or third parties holding relevant financial information to submit corresponding documents. If they refuse to submit, the court may accept the plaintiff's claims. A supplementary calculation method could also be employed, referencing the average annual wage in the relevant industry in the province where the breaching party is located, multiplied by the duration of the competitive activity, providing an alternative path when the specific amount cannot be determined [5].

The right to claim cessation of infringement should be explicitly established as an independent remedial measure, and this establishment would enable the company to demand that the breaching party cease the infringement immediately upon discovering the competitive conduct, and thereby prevent further damage. Regarding civil-criminal coordination, under the guidance of the principle of unity in the legal order, the conceptual standards for identifying competitive conduct in civil and criminal regulations should be unified. An effective channel for the conversion of civil evidence to criminal proceedings should be established, and flexible modes of civil-criminal procedural coordination should be implemented. This allows the loss-prevention function of civil remedies and the deterrent function of criminal sanctions to complement each other, forming a comprehensive remedial system integrating the disgorgement right, the right to claim cessation of infringement, the right to claim damages, and criminal liability pursuit [5, 6].

4. Conclusion

Through this systematic review and reflection on the non-competition prohibition system, this paper draws the following main conclusions: First, the jurisprudential foundation of the non-competition prohibition system lies in the preemptive prevention of potential conflicts of interest. Its normative function encompasses both the maintenance of fiduciary duties and the protection of trade secrets. However, the current Company Law still exhibits a contradiction between the overly narrow statutory enumeration of obligated subjects and substantive needs. Although the 2023 revision included supervisors, the status of controlling shareholders, actual controllers, and resigned personnel regarding obligations remains ambiguous. Second, the standards for identifying non-competition conduct show significant divergence across three dimensions: "operating on one's own account or for the account of others," "similar business," and the damage element. In judicial adjudication, the Nominalism Doctrine and Interest-Attribution Doctrine coexist, as do formal and substantive standards. The misapplication of the damage element further weakens the deterrent effect of the system. Third, at the remedial level, the scope of exercise, evidentiary rules, and limitation periods for the disgorgement right require urgent refinement. The concurrence relationship between the disgorgement right and the right to claim damages lacks unified guidance. The independent status of the right to claim cessation of infringement has not yet been clearly established in legislation, and there are gaps in the coordination between civil and criminal liability.

This paper has three main limitations: the cross-application between the non-competition prohibition and the non-competition restriction under labor law is not fully explored; empirical data are confined to literature and published judgments, lacking field investigations; and comparative law analysis is relatively weak, with insufficient reference to foreign experience. Future research may

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introduce big-data empirical methods, deepen comparative law studies, and examine the challenges that new competitive forms in the digital and platform economy pose to traditional identification standards.

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