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ASIA LIFE SCIENCES

Piloting Through The Pathways of Employment Law: An Essential Guide for Emerging Companies

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Today's agenda

- (1) Protecting Company Assets: Confidentiality, Invention Assignment, & Restrictive Covenant Agreements
- (2) Issues to Consider in the PRC
- (3) Issues to Consider in Japan
- (4) Q&A

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PROTECTING COMPANY ASSETS: CONFIDENTIALITY, INVENTION ASSIGNMENT, & RESTRICTIVE COVENANT AGREEMENTS

HOW TO PROTECT YOUR ASSETS FROM USE OR DISCLOSURE

CONFIDENTIALITY AGREEMENTS

INVENTION ASSIGNMENT AGREEMENTS

RESTRICTIVE COVENANT AGREEMENTS

INVENTION ASSIGNMENT AGREEMENTS

- **Legal contract that gives an employer certain rights to inventions created by an employee or consultant during the employment/consulting relationship**
  - **Require detailed disclosure of *prior* inventions**
  - **Define what future inventions will belong to employer**
    - **Require disclosure of future inventions**
    - **Require "assignment" (legal transfer) of ownership rights**
    - **Require cooperation in patent process**

CONFIDENTIALITY / NON-DISCLOSURE AGREEMENT ("NDA")

- **Legally binding contract that requires parties to keep confidentiality for a defined period of time**
  - Require applicants to execute
  - Condition of employment offers
  - Include in employment contracts
  - Require from third parties
    - Consultants
    - Vendors
    - Affiliates
    - Investors

ENFORCEABILITY OF NDAs

- **Must take steps to protect confidential information - Just defining "confidential" in NDA is not enough**
  - **Protocols - "CONFIDENTIAL," "TRADE SECRET," and "INTERNAL USE ONLY"**
  - **Passwords**
  - **Need-to-know access**
  - **Restrict USB drives, personal cloud storage, external email**
  - **Monitor downloads and files sent externally**
  - **Protocol for departing employees, consultants, interns**

- **Have counsel review NDAs periodically**
  - **Ensure NDA is broad enough but not overly broad**
  - **Ensure NDA is suitable for the circumstances**
  - **Do not overreach with applicant NDAs, consultant and other third party NDAs**

ENFORCEABILITY OF INVENTION ASSIGNMENT AGREEMENTS

- **You can require an employee or consultant to sign an invention assignment agreement as a condition of employment or engagement**
- **Some states limit the extent to which an employer can require an employee to give up rights**
- **Seek counsel on state law before you implement an invention assignment agreement that covers that state**
  - California invalidates invention assignment agreements to extent invention did not rely on use of employer's resources and was created during employee's personal time
    - Delaware, Illinois, Kansas, Minnesota, North Carolina, and Washington have similar laws
  - Nevada and Utah have unique invention assignment restrictions

RETRICTIVE COVENANT AGREEMENTS

- **Non-Solicits** – may limit solicitation of employees and/or customers
  - Legal contract an employee or consultant signs agreeing not to solicit employees and/or customers for the benefit of a competing business for a stated period of time after the relationship ends
  - **To be enforceable, non-solicits must be reasonable in scope and duration and tailored to protect legitimate business interests**

RETRICTIVE COVENANT AGREEMENTS

- **Non-Competes** - also known as covenant not to compete
  - Legal contract an employee or consultant signs agreeing not to start a competing business to work for a competitor for a stated period of time after the relationship ends
- **Federal Trade Commission's Proposed Rule Banning Noncompetes**
  - First "unfair methods of competition rule" in at least 55 years (arguably first ever)
  - FTC's authority to engage in "antitrust" rulemaking is untested and subject of debate

FTC's Proposed Noncompete Rule

- Proposed Rule Text:

> *Unfair methods of competition*. It is an unfair method of competition for an employer to enter into or attempt to enter into a non-compete clause with a worker; maintain with a worker a non-compete clause; or represent to a worker that the worker is subject to a non-compete clause where the employer has no good faith basis to believe that the worker is subject to an enforceable non-compete clause.

FTC's Proposed Noncompete Rule

- Proposed Rule Would:
  - **Ban noncompetes with "workers"**
    - Broad definition of "workers": any person "who works, whether paid or unpaid, for an employer"
    - Applies to explicit and *de facto* noncompetes
  - **Require rescission of existing noncompetes**, with notice to workers
  - Only **exception in connection with sale of business**, for noncompetes applicable to "substantial owners," which is defined to mean those owning more than 25% of business

Proposed Ban on "De Facto" Noncompetes

- (2) ***Functional test for whether a contractual term is a noncompete clause.*** The term noncompete clause includes a contractual term that is a *de facto* noncompete clause because it has the *effect of prohibiting the worker from seeking or accepting employment with a person or operating a business* after the conclusion of the worker's employment with the employer. For example, the following types of contractual terms, among others, may be *de facto* noncompete clauses:
  - i. **A non-disclosure agreement** between an employer and a worker that is written so broadly that it effectively precludes the worker from working in the same field after the conclusion of the worker's employment with the employer.
  - ii. **A contractual term between an employer and a worker that requires the worker to pay the employer or a third-party entity for training costs** if the worker's employment terminates within a specified time period, where the required payment is not reasonably related to the costs the employer incurred for training the worker.

Overly Broad Confidentiality Clauses Can Be De Facto Noncompete Clauses

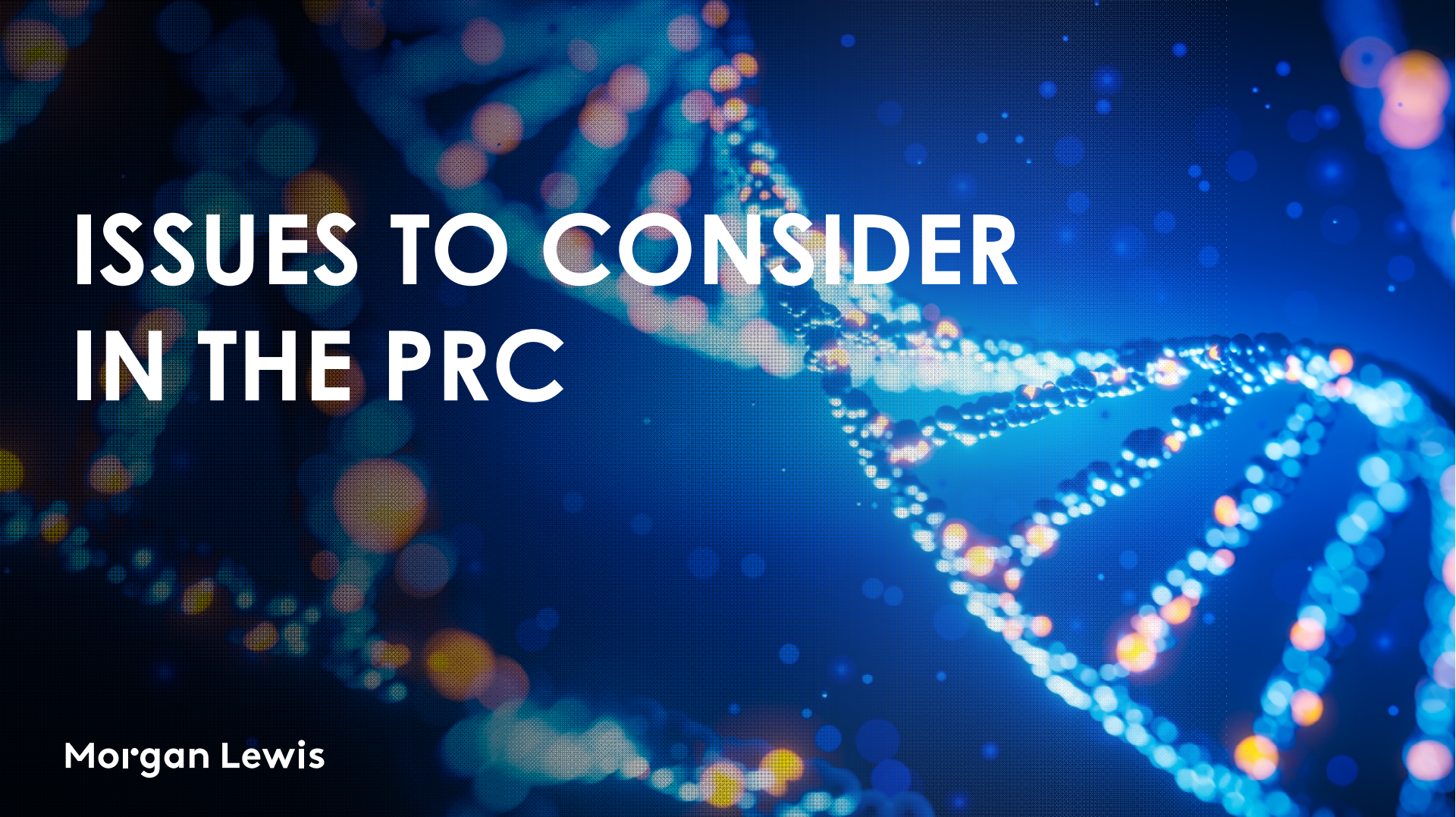
- Court will likely considerwhether the agreement has temporal and geographic limitations, and scrutinize the scope of the confidentiality clause to determine if the employer is precluding the former employee from using any of the following:
  - **Any and all** information received, encountered, or learned during the employment
  - **Any and all** information that is used or usable in; originated, developed, or acquired for use in; or about or relating to an entire industry
  - **General** knowledge, skill, or facility acquired through training or experience
  - Information that is **not in fact confidential, proprietary, or trade secret** information because it is public knowledge or readily accessible through legitimate means
  - Information properly provided to the former employee by **third-party sources** such as clients
- Courts may also analyze **how employers seek to enforce** confidentiality clauses by, for example, demanding the return of all information and materials received, encountered, or learned during the employment, in determining whether the confidentiality clause operates as a de facto noncompete.

What Should Employers Do?

- Do not panic or do anything drastic
- Take inventory of current agreements (including nondisclosure provisions)
  - Ensure no "de facto" noncompetes in the form of NDAs
- If Noncompetes Become Unavailable
  - Back-end loaded consideration through earnouts or staged purchases
  - Retained equity stakes in business post-departure with tail/sunset repurchases

CONCLUSION

- Employ protocols and other security measures to protect confidential and sensitive information
- Use appropriate confidentiality, invention assignment and restrictive covenant agreements
- Regularly review for enforceability and sufficient protections
- Prepare for Potential Ban on Non-Compete Agreements
- When unsure, contact **Morgan Lewis** for legal advice


ISSUES TO CONSIDER
IN THE PRC
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The Start of the Employment Relationship

- Offer letter
- Background check
- Employment contract: Local hire versus secondment
- Data protection consent form – for employee data
- Immigration considerations
- Export control considerations / restrictions – US and PRC
- Export of data considerations / restrictions - PRC
- Non-competition agreement
- Proprietary information and inventions agreement
- Reward and remuneration agreement for inventors

The Start: Offer Letter

- Not required, but often used
- Not binding, unless expressly incorporated into contract
- Include material terms and conditions:
  - Title
  - Remuneration
  - Benefits
  - Length of contract and probation period
  - Applicability of post-employment non-competition obligation
  - Requirement to sign proprietary information and inventions agreement
  - Requirement to sign reward and remuneration agreement

The Start: Structuring the relationship

- Direct Employment
  - Employment Contract:
    - Fixed term
    - Open ended
    - Duration of project / task-based
- No Independent Contractors
  - Risks: employment, social benefits, tax, immigration
- Indirect employment – labor dispatch
  - Restrictions on numbers
  - Restrictions on roles
  - Not legally compliant without a local entity in that location
  - "Equal pay for equal work"

The Start: Expatriates - Secondments

- Provide clear documentation for assignment:
  - Governing law
  - Secondment or dual contracts?
  - Home vs. host country benefits
- Secondee must have employment relationship with entity affiliated with the China entity

The Start: Expatriates

- Immigration issues
  - Nationality and permanent residency status matters (!)
  - Thresholds for eligibility
    - Faster, easier documentation process if Category A visa (Shanghai figures):
      - Monthly salary of > CNY50,000 (approx. US$7,100) and
      - Annual tax payment of > CNY120,000 (approx. US$17,000)
      - Notarization of diploma and "no criminal record" cert not required
- Work and residence permits no longer required for HMTs
- Immigration process: work and residence permits
  - Where will employee work on daily basis?
  - Where will employee and family live?

The Start: Labor Dispatch

- Not available for non-PRC nationals
- Limited to "temporary, auxiliary and substitute" positions
- Consultation required for auxiliary positions
- Limited to 10% of workforce of "user entity"
- "Equal pay for equal work" principle
- Lack of control over employment decisions – you are the "secondary" employer
- Staffing agencies
  - The actual employer, although liability may be joint and several
  - Little room for negotiation
  - Full indemnification

Protecting Company Interests – the Agreements

- Confidentiality Agreements
  - Reasonable time limit for maintaining confidentiality obligations
- Proprietary Information & Inventions Agreements
  - Locally enforceable with local entity
- Reward & Remuneration Agreements
  - Law applies to inventions during employment term and within 1 year of termination based on employee's work
  - Three types of employee inventions:
    1. Service inventions
    2. Service-related inventions
    3. Non-service inventions

Protecting Company Interests – the Agreements

Reward & Remuneration Agreements (cont'd) – statutory minimums *unless agreement otherwise*:

- Reward for patent inventions:
  - Payable within 3 months from the grant of the patent:
    - ≥ CNY 3,000 (approx. US$445) per invention patent; or
    - ≥ CNY 1,000 (around US$150) per utility model or design patent.
- Remuneration:
  - Payable annually throughout the validity period of the patent or by way of a corresponding lump-sum payment at no less than 2% of the operating profit generated from the exploitation of an invention or utility model patent; or
  - Payable at the time of licensing the patent at no less than 10% of the royalties generated.
- Reward for patent inventions:
  - ≥ 5% of the additional profit acquired from implementing the invention for three to five years consecutively; or
  - ≥ 20% of the net proceeds acquired from assigning the invention.

Protecting Company Interests – the Agreements

- Non-competition Agreements
  - Two-year limit
  - Scope and territory subject to agreement
  - Restraint can only restrict employee's right to work for an employer that produces the same type of products or is engaged in the same type of business, or from establishing a competitive business himself
  - Only enforceable against senior managers, senior technicians and those with access to trade secrets / confidential information
  - Requires financial consideration during the restraint period:
    - Jiangsu Province: 1/3 of average monthly salary
    - Shenzhen: 50% of average monthly salary
    - Shanghai: 20-50% of wages
  - PRC Law is silent regarding non-solicitation clauses

Protecting Your IP

- Protective measures
  - Identify confidential information
  - Identify and mark trade secrets
  - Physically and electronically protect the confidential information (entry and exit access system, remove software access to the product)
  - Providing regular internal training
  - Signing legal documents (employment handbook, confidentiality agreement, non-compete agreement, etc.)
  - Monitor the protection of IP in daily operations
  - Establish hotline/complaint channel for employees and third parties to report any violation
  - Preserve evidence and take disciplinary actions against employees who violate confidentiality obligation

Protecting Your IP

- Protective measures to consider:
  - Restricting printing function
  - Restricting downloading or copying to external device
  - Prohibiting or restricting use of social media to conduct business (WeChat)
    - Impact and overlap with compliance program
  - Metal detectors at entrance (similar to airport screening)
  - Mandatory check-in of smartphone or sticker over camera
  - Splitting access to trade secrets
  - Monitor employee download and access activity, particularly during notice period

Compensation and Benefits: Overtime

- Default is standard working hours system
  - 8 hours/day, 40 hours/workweek
  - Employee consent required for OT work
- District-level government approval generally needed for alternative working hours system
  - Flexible, comprehensive working hours systems
- Express consent needed
- Compensatory time off only available for OT on regularly scheduled rest day
- Penalty: unpaid overtime + penalties
- A release may not get you out of alleged OT claims

Unique China concerns

- Strict data protection laws – and potential trigger for new Anti-Espionage Law
  - employee data
  - third party personal and sensitive personal data, such as patient and clinical testing data
  - "important data" or data related to national security, such as data with respect to military hospitals

Unique China concerns

- Frequent interactions with HCPs / government officials
  - Generally, HCP in China = government official
  - *Anticorruption risks*: need robust policies and monitoring of conduct
  - Control of samples
  - Third party interactions – labs, testing centers, suppliers, etc.

Unique China concerns

- Equity is regulated
  - Requires filing and approval with State Administration of Foreign Exchange (SAFE)
  - Before a company is listed or if the equity plan is not filed and approved by SAFE, there is no effective and legally enforceable way to grant equity to Chinese nationals
  - Consider collecting wet signature to terms and conditions of equity awards
  - Courts are mixed: local employment dispute or a "foreign contractual dispute"


ISSUES TO CONSIDER
IN JAPAN
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No at-will employment

- No concept of at-will employment
- Unilateral termination of employment by employers always requires "objectively reasonable grounds", which in practice, is a very high hurdle
- Very high hurdle for employers, making it almost impossible to dismiss employees (e.g., for clear underperformance)
- Statutes and court precedents protecting employees' rights and benefits

Differences between (a) directors/independent contractors and (b) employees

- Directors/independent contractors - generally considered to be non-employees and not entitled to protection as employees
- Differences in dismissal
  - Employees cannot be dismissed without "objectively reasonable grounds". Tends to be difficult to amicably reach a separation agreement without generous severance packages.
  - Directors can be dismissed without cause by resolution at a shareholders meeting. However, if there is no justifiable ground, dismissed directors may be entitled to damages (i.e., compensation for the remaining period of directorship – normally, one year or two).
- Exception - a non-representative director may wear two hats: as a director and as an employee
- Independent contractors – can be terminated in accordance with the applicable service agreement, although there might be a risk that "independent contractors" are characterized as employees in light of various factors (e.g., manners of providing services).

Work rules and employment-related agreements

- Determined by:
  - Work rules
    - Need to specify working hours, wage system, causes for termination of employment
    - Need to put in place and file with the labor standards office, if 10 or more employees are retained.
  - Labor-management agreements with union (or employee representative)
    - Need to file certain labor-management agreement (e.g., overtime work agreement) with the labor standards inspection office.
  - Collective bargaining agreement with the union, if any
  - Employment agreements with individual employees
  - Statutory minimum requirements (e.g., annual paid leave, child care and family care leave, overtime payment, workers compensation)

Working hours, days-off and overtime work management

- Working hours and days-off are set forth in work rules
- Strict statutorily requirements on overtime work
  - Maximum overtime set forth in labor-management agreement with union or employee representatives
  - Failure of overtime payment may result in criminal sanctions and may result in court order to pay additional payment in amount equal to unpaid overtime pay
  - Narrow exemption from overtime work payment (e.g., employees in a position of supervision or management)
- Employers are required to manage and record working hours for all employees (including exempt employees) for the calculation of overtime payment and for the management of employees' heath conditions

Working hours, days-off and overtime work management

- Statutory requirements for annual paid leave, childcare leave and family care leave
  - Statutory annual paid leave – up to 20 days depending on the tenure
  - Childcare leave – up to age 2 of the child
  - Japanese employees tend not to take the annual paid leave in full
    - Employers are required to have them take at least five days of annual paid leave.
  - Many companies grant more generous leave, such as sick leave
- Many Japanese companies allow various days-off and general sick leave in their work rules

Restriction on negative change in employment terms and conditions

- Change in employment terms having negative impact on employees
  - Reduction of salary, reduction of number of paid leave days, reduction of pension benefits
- Generally, requires the affected individual employee's consent
- Severe requirements for negative changes in work rules without employee consent
  - change is reasonable
  - change is necessary
  - new terms are legally appropriate
  - well negotiated with labor union or employee rep
  - other circumstances (e.g., compensatory benefits)

Restriction on dismissal: Dismissal for underperformance/disciplinary actions

- Dismissal (termination by employer) requires "objectively reasonable grounds"
  - Very high hurdle for the employers – almost impossible to dismiss for underperformance
  - If a unilateral termination is held invalid,
    - required to reinstate the employee
    - pay back-pay from the date of termination, with a late payment charge or interest payment.
  - Union lawyers and/or plaintiff's counsel lawyers assist dismissed employees in negotiating and filing claims on wrongful dismissal
- Automatic termination of employment - mandatory retirement age
  - Age 60 or older
  - Need to retain until age 65 through "re-employment system" (e.g., annually renewable fixed term contract with less compensation) if employers so request
  - Being required to make efforts to raise the mandator retirement age, extend the end of re-employment or otherwise secure retention/employment up to age 70

Restriction on dismissal: Redundancy – four requirements

- "Objectively reasonable grounds" - four requirements for dismissal for redundancy pursuant to court precedents
  - (i) A strong need for the redundancy;
    - Typically, severely distressed employer
  - (ii) Employer will need to have made all efforts to avoid the redundancy;
    - reduction of all other costs, including management compensation
    - transfer or secondment of employees to affiliates or business partners
    - solicitation of voluntary resignation
  - (iii) Reasonable election of employees subject to the redundancy; and
  - (iv) Good-faith discussions with the union and/or employees.
- Difficult to predict court determination in advance.
- Collective protest by union or group of employees

Japan – Act on Protection of Personal Information

- Japan has stringent data privacy legislation, similar to the GDPR
- Employers are required to protect the personal information of employees in accordance with the Act on the Protection of Personal Information ("APPI"), which was significantly amended a few years ago.
- If a Japan employing entity needs to transfer any employee personal information outside of the company or Japan, including to affiliates of the employing entity, there are a number of alternative approaches to complying with the APPI.
- One approach is for companies to seek the specific consent of employees, but companies may also be required to provide information about the privacy laws of any countries to which information may be transferred.

Protecting Company Interests – the Agreements

Protective provisions for employers include:

1. Confidentiality provisions
2. Right to approve any concurrent employment
3. Prohibition against using or bringing any IP belonging to others
4. Work for Hire and assignment of invention provisions
5. Non-competes, non-solicits, non-disparagements

Can be documented in the employment agreement or in separate agreements.

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Lesli Ligorner has more than 25 years of experience serving clients on a wide range of labor and employment matters, with more than 15 of those years spent on the ground in China. She advises a broad range of financial services, telecommunications, media, technology, life sciences, and general manufacturing clients on the full suite of employment issues in China, including hiring and termination, discrimination and harassment policies, training, and investigations. Lesli is admitted to practice in New York and New Jersey.

Lesli leads the labor and employment practice in mainland China and handles cross-border employment matters and internal investigations across the Asia-Pacific region. She advises on global mobility and immigration, leaves of absence, wage and hour laws, intellectual property protection, and unionization and collective bargaining.

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Kimberley E. Lunetta has spent her legal career advising employers on labor and employment matters and defending employers in litigation in federal and state courts, FINRA and other arbitration forums, and administrative agencies. Kim defends and counsels clients facing a range of labor and employment issues, with a focus on the financial services, life sciences, and telecommunication industries. Kim specializes in employee medical leave and disability accommodations, and background, credit check, reproductive rights, and firearm laws. Kim also handles discrimination and harassment claims, reductions in force, enforcement of restrictive covenants, and misappropriation of trade secrets.

Kim works closely with clients to identify and address their workplace and employment concerns. When necessary, she conducts internal investigations into harassment and discrimination claims, and provides sexual harassment, antidiscrimination, internal investigation, reasonable accommodation, and other training for management and human resources personnel.

Biography

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Carol Tsuchida focuses her practice on investment funds and financial regulatory matters, as well as labor and employment. She helps clients establish, register, and license investment funds in Japan, and she assists with regulatory issues, including those pertaining to Japan's Financial Instruments and Exchange Law. Additionally, Carol counsels investors across many jurisdictions who are investing in infrastructure funds, hedge funds, and private equity funds throughout Asia.

Fluent in Japanese and English, Carol handles transactional and general corporate matters, including securities law compliance, investment funds, mergers and acquisitions, underwritten public offerings, private equity financings, and venture capital transactions. Prior to joining Morgan Lewis, Carol served as the assistant general counsel for a leading international financial institution that specializes in real estate investment funds.

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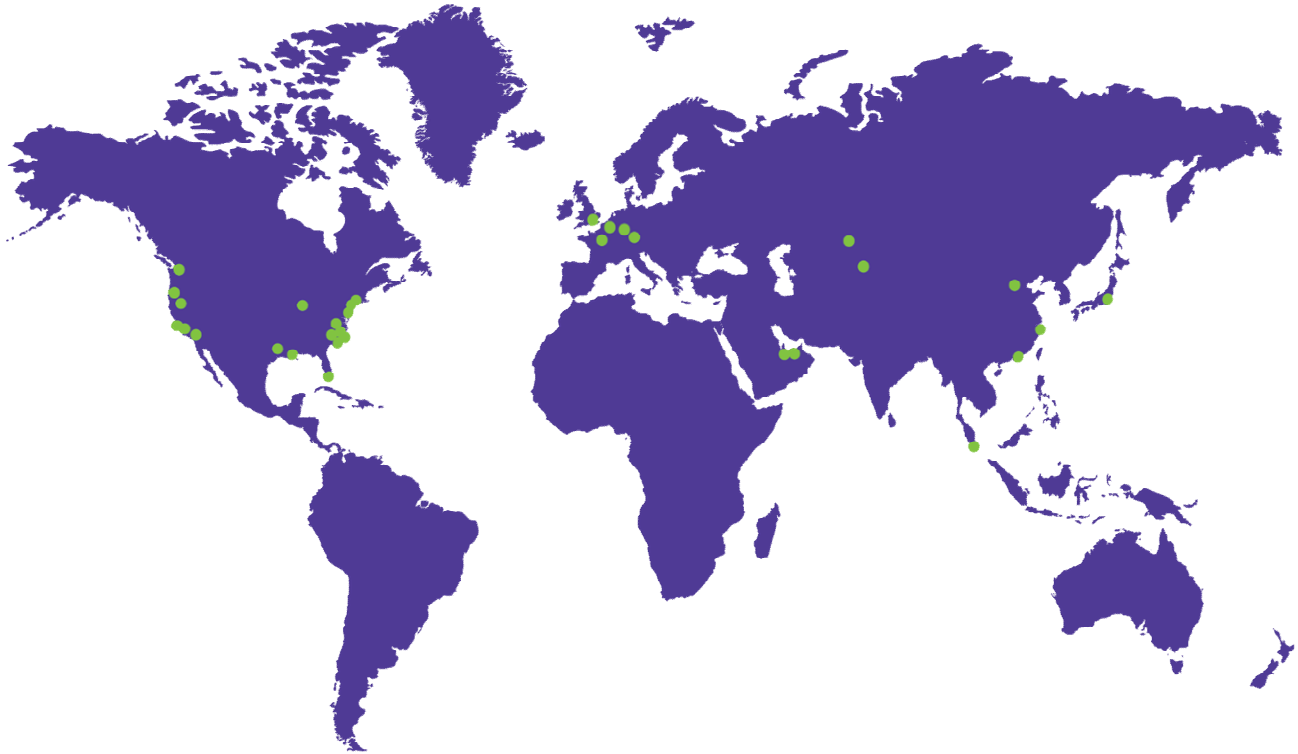

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