Non-competition clauses in labour contracts

Swedish reporter: Judge Michaël Koch,
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1. What clauses, if any, are in your country’s constitution relating to covenants not to compete in labour contracts? Are there clauses relating to the freedom of occupation; protection of property (if so, does this include intellectual property and trade secrets); freedom of contract, etc. If there are such clauses, how are they applied relating to covenants not to compete? Which, if any, of the EU Directives relating to this subject are applied in your country?

The Swedish Constitution contains no provision concerning covenants not to compete in labour contracts. Similarly, there are no constitutional provisions relating to the freedom of occupation or protection of property. There are no EC Directives relating to covenants not to compete, but Art. 39 of the Rome Treaty contains provisions on the right of employees to free movement. These provisions have been applied in several cases by the European Court of Justice (i.a. cases Bosman, C-415/93, Kraus, C-19/92 and Lehtonen, C-176/96). In brief, the ECJ has held that provisions limiting the right to free movement are acceptable only if a) the provisions have a purpose in accordance with the Treaty b) this purpose is rightful for strong reasons of public interest c) the realization of the purpose is ensured by application of the pertinent provision and d) the application of the provision does not go beyond what is necessary for realization of the purpose.

2. Is there a statute in your country that governs the enforceability of covenants not to compete? Or, is the law governed solely by case law?

The 1915 Act on Contracts contains provisions relating i.a. to this field. Its section 38 is aimed directly on the enforceability of covenants not to compete. According to this section, a covenant not to compete (by economic actions of any kind, including employment in competing activities) is not binding to the extent that the covenant is stricter than can be deemed as reasonable.

If there is a statute, does the statute relate to specific professions or industries?

No, the aforementioned section 38 does not relate to specific professions or industries.

3. In general, are covenants not to compete in labour contracts enforceable in your country?

In Sweden covenants not to compete are always enforceable as far as ongoing employments are concerned. In fact, the employment is viewed as an automatic non-competition contract in itself, i.e. irrespective whether this undertaking is expressly stated in a contract or not. The debatable issue is to what extent a covenant is binding...
after ending the employment. In such situations, covenants are enforceable only under certain conditions and to a certain extent (see below).

4. What are the employer’s protected interests and how are they defined? What is the public’s interest in enforcing covenants not to compete? Is this a reason for statutes and case law?

According to what has been stated in the travaux préparatoirs behind the aforementioned section 38, that section should be applied with consideration to a 1969 collective bargaining agreement on non-competition clauses, signed by the central organizations on the private labour market. This agreement means that non-competitions are acceptable only among those employers which are depending on an independent development of products or methods and thus have acquired product secrets or comparable know-how. In summary, a covenant is not enforceable if its sole purpose is to retain an employee because of his special personal knowledge or experience.

5. If covenants not to compete are enforceable in your country: what must the plaintiff show to prove the existence of an enforceable covenant not to compete?

(a) Is a written contract required?

There is no requirement for a written contract. However, non-competition clauses are in practice for reasons of proof always in writing.

(b) Is a trade secret required to prove the employer’s case? If so, how is a trade secret defined? Does it include customer lists, price lists, systems of work?

The 1969 collective agreement further means that non-competition clauses are acceptable only for employees who during the employment have acquired knowledge about product secrets or comparable know-how and by education or experience have possibility to use this knowledge. In Swedish case law this agreement has been interpreted so that an employee’s personal skill, knowledge or experience is not covered by the concept of trade secret. In case law it has also been stated that non-competition clauses lying outside the scope of the 1969 collective agreement are indeed valid, but only under very strict conditions. Matters concerning trade secrets are also covered by the 1990 Act on Protection of Trade Secrets. In this act, trade secrets are defined as such information concerning trade or other business in an enterprise which is kept secret by the entrepreneur and the disclosing of which is likely to bring damage to the enterprise. The act gives protection for trade secrets only in rare cases where a former employee is concerned – hence the need for the employer to use a contractual non-competition clause.

(c) Does the employer need to give the employee consideration (in addition to a regular salary) as a condition for the covenant not to compete to be enforceable?

When judging whether a non-competition clause is reasonable in the sense of section 36 (see above), the total salary may be one factor among others. However, there is no need for a special, defined addition to the salary.

(d) Will geographical factors, time factors and the special characteristics of an industry be considered when deciding whether to enforce a covenant not to compete?

Yes, those factors are definitely relevant.
(e) Must the covenant not to compete meet a “reasonable test”? If so, who has the burden of proof? How, if at all, does your case law balance between such rights as freedom of contract, property rights and freedom of occupation?

As already has been explained, non-competition clauses are valid only to the extent that they are deemed to be reasonable. The burden of proof lies on the employer.

(f) May the new employer be sued for employing an employee who is violating the covenant not to compete in his labour contract with the former employer? If so, in which court? Is this hearing held jointly with the suit against the employee? Note: the new employer has no contract with the former employer and there is no employee-employer relation between them.

No, a new employer cannot be sued simply because he has hired a person who has signed a covenant. However, under the 1990 Act on Protection of Trade Secrets a new employer may be sued because he has used trade secrets pertaining to the former employer. The new employer may then have to pay damages, provided that he was conscious of the former employer’s right to the secret.

(g) If the employer terminates the labour contract, is the covenant not to compete enforceable? Does it matter what the reason for the dismissal is?

Generally, it has been held that the covenant is enforceable only when an employer wants to retain the employee in his business. The covenant is certainly not enforceable when the employee has been dismissed because of redundancy. However, in cases where an employee has been dismissed for other reasons – for instance a criminal offence against the employer – the legal situation is not quite clear.

7. If a covenant not to compete is held by a court in your country to be overly broad, will the court modify the covenant? What other flexibility do courts have relating to relief they can grant?

As indicated above, the court may adjust the covenant if this is deemed reasonable.

8. Do the courts issue preliminary (temporary) injunctions for violation of covenants not to compete in labour contracts?

This is possible, but does not occur very frequently.

9. What are the remedies which courts can and do grant when an employee has violated his/her covenant not to compete?

The usual remedy is an obligation for the employee to pay damages (or a sum stipulated in the covenant, possibly adjusted by the court).

10. Which court(s) in your country have jurisdiction over legal matters relating to covenants not to compete in labour contracts? (Labour Courts; Civil or Commercial Courts; Administrative Law Courts; Constitutional Court, etc.).

If the parties to the labour contract are bound by a collective bargaining agreement, the Labour Court has jurisdiction over the case. In other situations, only District Courts have jurisdiction (the Labour Court is in those cases second and last instance).

11. Are there any leading or illustrative judgments that you would like to describe relating to covenants not to compete in labour contracts?
One renowned decision was made by the Labour Court in 1991 in a case concerning an air pilot employed by the Swedish Defence Authorities. The pilot had signed a covenant which meant that he undertook to retain his employment during ten years and to pay a certain sum to the employer if he violated the covenant and, within three years after leaving the employment, entered into a new employment with other air pilot activities. The covenant was in accordance with a collective bargaining agreement signed by the state and the central trade unions in the public field. (The general reason for a covenant in these cases is that air pilots undergo very expensive education paid by the employer.) The pilot in this case had left his employment and entered into another air pilot employment. He was then asked to pay a sum equivalent to €70,000 to the former employer. The pilot argued, i.a., that the sum should be adjusted. The Labour Court found that the sum should be adjusted to €3,600.