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General Report
NON-COMPETITION CLAUSES (covenants not to compete) IN LABOUR CONTRACTS

by

Judge Steve Adler,
President,
National Labour Court,
Israel

Thanks

- To those who patiently answered the questions in the questionnaire.
- Replies were received from Austria, Belgium, Finland, France, Germany, Ireland, Iceland, Italy, Malta, the Netherlands, Norway, Spain, Slovenia, Sweden and the United Kingdom.

Main issues

- **After conclusion of employee-employer relationship** – is a covenant not to compete enforceable? May an employee work for a competitor or in a related job, or open a competing business after he leaves his prior employer.
- **During the employee–employer relationship** – an employee may not work for his employer's competitor or in a related job, unless he has permission from his employer [all jurisdictions].
- What is the proper balance between the employers' right to property, freedom of contract and the workers' freedom of occupation?
- What are the social and economic factors involved in this balance?
- To what extent should social and economic considerations justify the non-enforcement of contractual provisions?

Constitutional and special status provisions

- No country reported the existence of a clause mentioning non-competition clauses in its Constitution.
- However, various constitutional rights relate to the issue of enforcing covenants not to compete, such as:
  - **Freedom of occupation** [**Austria, Iceland, Israel, Slovenia, Germany**, others]
    - **Right to work [Finland**, sec. 18; **Italy,** art. 4; **Norway,** sec. 110]
    - **The duty and right to work and earn a minimum income** [**Spain**]
    - **The protection of work** [**Italy,** art. 35]
  - **The property (and ownership) right, including intellectual property**, such as trade secrets (generally referred to as the employers' right, but do employees also have a property right in their workplace?) [**Slovenia**].
  - In some countries there are **constitutional rights to: freedom of trade and commerce; freedom of contracts; prohibition of unfair competition practices** [**Italy**, **Slovenia**]; also, autonomy of the individual.
  - ***Declaration des droits de l'homme et du citoyen (*Declaration of the rights of people and citizens**) of 1789: person free to do anything that does not harm another person; property basic right; freedom of occupation [**France**].
  - **Constitutional Council** – freedom of commerce and industry and freedom of contract are constitutional values [**France**].
  - Law governed by freedom of occupation, freedom of trade and industry and freedom of competition ("principles" not clear if in Constitution?) [**Belgium**].
  - Constitutional principles used by courts to interpret statutes [**Austria**, others].

EU treaties and directives

- No treaties or directives specifically mention covenants not to compete.
- **Treaty of Rome** – art. 39 relates to freedom of movement for employees).
- EU competition law – Directive v. December 18, 1986 (Abl. L382/17) limits the prohibition of competition for self-employed commercial agents. Parties to contract can only agree not to compete for two years.

Statutes

- Many statutes relate to covenants not to compete, directly or indirectly:
  - Most/all countries have laws protecting trade secrets.
  - Laws which relate to covenants not to compete:
    - **Germany** – sec. 60 of HBG (Commercial Code), extended by case law to apply to all employees; statutory restrictions on non-competition clauses which apply after end of labour contract: sec. 110 and 74 of Industrial Code, Const. Court judgment December 13, 1969 DB 1970.396; BGB, 242, good faith performance of contracts.
    - **Sweden** – sec. 38, covenants binding only if reasonable.
    - **Spain** – Workers Statute Act, good faith, **forbids unfair competition**, covenants not to compete enforceable only during the employment contract, maximum 2 years for professionals and 6 months for non-skilled workers.
    - **France** – *Code du travail* (labour code) prohibits restrictions on freedoms.
    - **Slovenia –** Employment Act, art. 37, 38-40; Employment Related Industrial Property Rights Act, art. 7, worker must protect employer's secrets.
    - **Finland** – Employment Contracts Act.
    - **Norway** – Act Relating to the Conclusion of Agreements, 1918, s. 38.
    - **Belgium** – Contract of Employment Act, 1978.
    - **Austria** – statutes relating to non-competition during employment contract and after its termination.
    - **Iceland** – restraints will not unfairly abridge employee's freedom of occupation.

Collective agreements

- Sweden – there is a collective agreement regarding airline pilots which restrict their right to work for competitor. See “cases”.

Court-made law

- In the countries which submitted reports many/most rules relating to the enforcement of non-competition clauses were court-made.
- Court-made law is based on statutes (if there are any), constitutional principles and policy considerations.

Two main theories why a covenant is not binding

1. **Protection of competition** – neo-liberal view; the worker is an instrument to further competition policy; the worker furthers the diffusion of information which is necessary for a competitive market.
2. **Protection of workers** – making covenants not binding protects workers and allows them to receive the best conditions which the market sets/they are offered.

Legal theories: when **Covenant is binding**

If reasonable = “**reasonableness test**” [**Austria, Germany, Ireland, Spain, Sweden, United Kingdom, Iceland, others**]. Below we discuss what is reasonable:

1. If there is a **legitimate employer economic interest**,
2. limited in time and space, proportional and includes proper economic compensation to the employee limited [**Austria, France, Germany, Italy, Spain**].
2. If a **written agreement**: court may limit binding character when employee interest unfairly prejudiced [**Netherlands**].
3. If a written agreement and employee does similar work and employee acquired **special knowledge** from prior work [**Belgium**].
4. If employee engaged in **unfair competition** [**Spain**], disloyal competition [**Belgium**].

Note: Some nations set maximum period for limitation of prohibiting worker from working (see page 25).

Legal theories: when **Covenant is not binding**

1. **Presumption that covenant is not binding**,
   a) unless: [many jurisdictions, **Germany, Israel**]
      (i) employee using trade secret of his former employer; or
      (ii) employee acting not in good faith;
      (iii) employee received special payment so that he should not compete; employee received special training or education paid by employer on condition he would not compete after finishing to work for that employer, unless employer has independent development of products or methods and employee has acquired trade secrets or special know-how [**Sweden**].
2. Unless necessary to protect employer's trade secret or "information" acquired while working for former employer. Unless reasonable and proportionate [**Norway**].
3. When there is fair competition [**Spain**].
4. When it is an inequitable obstacle to the worker's future career (**Austria, Germany**).
5. When the covenant is "overly broad" [**Germany**]. Court may restrict an overly broad covenant [**Austria, Iceland**]. Some jurisdictions say that a court may not modify a private agreement [**Italy**].
6. Not enforced in California under (almost) any circumstances [**California, USA**].
7. *The prevention of competition is not a legitimate interest. Public policy is to further competition, including competition of labour [many jurisdictions].*

“Reasonable test” – **covenant binding**: if it is “reasonable” (some jurisdictions)

- Factors for determining “reasonableness” of non-competition clause:
  - **Limited in time** – early labour court judgments: 3 years; later ones: 1–1½ years, according to circumstances. Reasonable test. Most jurisdictions set maximum times.
  - **Limited in area** – a reasonable area of the country [**Iceland, Ireland, Sweden, Norway, United Kingdom, most jurisdictions**].
  - **Special characteristics of an industry** - employers’ interest, employees’ interest, public policy? [**Austria, United Kingdom, Netherlands**: “public interest plays no explicit role”, but do/should judges take it into account?].
  - **Proportionality** – damage to employer v. damage to employee [**France**: *Code du travail*, art. L.120-2 – limitation must be proportionate to purpose of statue].
  - **Salary of employee** – when remuneration is less than set amount, the covenant not binding [**Belgium: €53,825 annually**].
- Whether employee is paid during the limitation period? When prohibited to work the employee receives money from employer who is limiting him [**Germany**?].

Factors to balance in determining extent of covenants being binding

1. **Property rights** of employer and employee.
2. **Individual freedoms**: freedom of occupation; Individual's freedom to determine how to lead his/her life.
3. **Freedom of commerce**; free movement of goods, capital, and labour. Competitive economy, globalization. Basic economic principles of EU.
4. **Freedom of contract**, enforcement of contracts and other commitments.
5. Labour law principles – overcome imbalance between worker and employer.
6. Public policy: encourage investments; encourage transfer of information.

All jurisdictions speak of balancing between employer and employee interests [**Netherlands** 5(d); to achieve proper balance, courts have developed tests and theories.

Following is a discussion of each factor.

I.1. The property right – of employers

- **Employer's property right** – (real and moveable property, intellectual property; our interest = **intellectual property**):
  - Non-competition clauses can be justified and enforced only when the former employer has a "legitimate interest" in preventing the employee from working at his competitor [**however, the prevention of competition is not a legitimate interest**]. Sometimes the clause can be justified when a former employee's working at a new workplace will cause prior employer economic harm. Employer interest can be the retaining of knowledge and skills of his employees within the enterprise; and retaining goodwill of customers [s. 4, Netherlands report]; preventing use of his trade secrets.
  - Employer has invested special money development, production, marketing, and training for the employee.
  - Employer protection "from insiders who leave the company looking for better economic conditions" [**Spain**, ques. 4] [unclear and seems to violate EU principles of freedom of movement].
- Balance between property rights of employers and employees; next, employees' rights.

I.2. The property right – of workers

- **Employees' property right –** knowledge, training, experience:
  - The employee has education and training prior to working for employer. This is the employee's "property", even though he has learned at workplace and even taken courses, etc. at employer's expense.
  - Employee's general education and training, including those received at a job, belongs to him and not the employer. Exception: (1) trade secrets; (2) agreement between employer and worker for finance of education or training on condition that worker continue to work for reasonable period.
  - Moreover, some specific workplace training might be considered belonging to the employer.

I.3. The property right – includes the protection of intellectual property

- **Patents** – registered and clear.
- **Trademarks** – registered and clear; Mickey Mouse has more protection than most workers.
- **Trade secrets** – most/all countries have laws protecting trade secrets. Generally trade secrets are not registered. Often not written.

  Definition of a "trade secret" to be discussed below. Trade secret protection is a small part of protection of intellectual property.

I.4. The property right – definition of “trade secret”

Illegal to use trade secret even when there is no covenant. However, relevant since a covenant not to compete will generally be enforced when the employee is using a trade secret of his former employer.

- **Interpretation of “trade secret”** determines the extent of limitation on freedom of worker to choose his workplace.
  - broad interpretation = more covenants binding
  - narrow interpretation = fewer covenants binding.
- ***“Trade”*** = must be information related to the employer’s business. Must have commercial value to the employer. Examples: production processes, customer information, product development. In **Ireland** there is a distinction between trade secret and confidential information, such as customer lists. This interest balanced against other interests and is not absolute [**Germany**].
  - the employer must have a real interest to protect the “secret”, not just an interest to cause damage to the employee (who left him). In **Germany** an employer’s interest in information about customers and suppliers is not enough to restrict competition.
- ***“Secret”*** = must be information which is secret. The employer must declare it secret and take reasonable steps to protect the secret. Example: information appearing in the employer’s internet site and telephone book is not a secret [**Israel**].
- Trade secrets protected by law [**Belgium, Israel, Sweden**] and there is no need for a written contract to protect them.

II. Individual freedoms

- **Freedom of occupation** is a constitutional right; basic law: freedom of occupation.
- Importance of the individual in modern society and law.
- **Human capital** – a worker’s knowledge and experience are his property. These are included in worker’s social right to work. Both human capital and financial capital are important.
- **Personal fulfillment** – workers spend a third of their day at the workplace, which is not only to earn a living but also to get satisfaction.
- A worker should be free to advance himself.

III. Freedom of commerce – free competitive economy

- **Free flow of goods, capital and labour/services** – basic principle of the EU and competitive market economy. Thus there should be as few restrictions on free flow of labour as possible.
- **Competition benefits the general public** – including competition over workers. One benefit of competition is to increase efficiency. However, in some jurisdictions the public interest in competition does not influence legal judgments [**Germany**].
- **Fair market wage** – restrictions on the free flow of labour prevent the market from setting fair compensation for workers. If a worker can receive a higher wage at another workplace, preventing him from changing jobs means he receives a lower wage than he can receive in a free market.

IV. Labour law principles

- Labour law assumes an unequal relationship between a worker and his employer. We prevent employers from using their superior power to limit employees rights.
- The employer is generally able to compel employees to agree to non-competition clause – but is it agreement from free will? When a worker signs such a clause he usually has no free choice, since signing is a condition of receiving the job.
- When an employer files a suit to prevent his former worker from working for his competitor he often wants to send a signal to his workers not to leave him. Also, court suits regarding enforcement of covenants not to compete are sometimes based on prior employer's vengeance against employee for leaving him or for another illegitimate reason.

V. Freedom of movement furthers economic growth

- **Economic growth is fueled by the transfer of information** (Hyde research and article: comparison of Route 128 in Massachusetts and the Silicon Valley in California). However, there is some recent literature which speaks of the revival of Route 128;
- Workers prevented from working in one state will go to another state to find work.
- New approach rules will not discourage investment since intellectual property is protected.
- Competition as best serving the public interest [**Norway**]. Employers must compete for workers.

Compensation for agreeing to covenant

- **Special compensation to worker for agreeing to non-competition clause**
  - Some jurisdictions do not require special consideration in the labour contract for worker's agreement to a non-competition covenant [**Iceland, Norway, United Kingdom**].
  - However, some jurisdictions require special compensation to be paid to the employee for his obligation not to compete, either in labour contract or after its termination [**Italy, Slovenia**]. Thus, some jurisdictions require the employer to pay the employee during the time he is prevented from working [**Belgium, Germany***:* **half gross remuneration; Slovenia: full compensation**].
  - Payment to worker for his agreement not to compete is a reason for upholding agreement [**Norway, Israel**].

Written contract requirement

- **Written contract is required** – some jurisdictions will enforce covenant only if there is a written clause in labour contract [**Germany, Italy**]; copy of prohibition rules must be given to worker. In **Norway** there must be a covenant, but it can be written or oral. **However, some jurisdictions have other restrictions** [**France**: however, even when a worker is allowed to work for a competitor, he is not allowed to reveal trade secrets].
- **No written contract requirement** – others imply the covenant not to compete into the labour contract [**Austria, Netherlands, Ireland Belgium, Slovenia, Israel, United Kingdom, Iceland**]. **Spain** and **Sweden** reported that there is no written contract requirement, but in practice the covenant is usually written. **Ireland** and **Israel** imply a covenant when employee is using trade secret or confidential information at his new job; **Israel** also implies a covenant when the employee is acting in bad faith.
- Covenant in collective agreement [**Sweden, France**].

  Note: No written contract is required to protect trade secrets; they are intellectual property of employer.

If the employer dismisses his worker, is the non-competition clause still binding?

- **Unfair dismissal** – covenant generally becomes not enforceable [**Iceland, Ireland, Slovenia, Sweden**]. When employer dismissed for unfair reason, it is not reasonable to enforce non-competition clause [some jurisdictions]. In some jurisdictions, employer must pay special compensation for it to be enforceable [**Austria**]. However, even if the dismissal is unfair, the non-competition clause is binding in some jurisdictions.
- **Fair dismissal** – when the worker is dismissed for a fair or reasonable reason, some jurisdictions hold the non-competition clause to be binding [**Norway**].
- **Fair dismissal** – employee can choose to be released from covenant; but if dismissal result of worker breach of contract then he does not have right to release himself [**Germany**].

Limits on length of time period that worker prohibited from working

- **Spain** – skilled workers: 2 years; unskilled: 6 months.
- **Ireland** – non-competition clause generally not enforced for more than 6 months.
- **Belgium** – 12 months. Exceptions when employer has own research services or an international business.
- **Germany, Slovenia** – 2 years.
- **Finland** – 6 months; 1 year when the employee received reasonable compensation.
- **Italy** – 5 years for managers; 3 years for all other workers.

Burden of proof

- **Burden of proof** – on plaintiff (employer) [**Ireland, Slovenia**].
- The burden of proof can be switched to worker only if he has the information.
- Is there an assumption that an employee will use trade secret?
  - Yes [**Ireland**].
  - No, employer must prove that worker is using trade secret or that it is reasonable that he is using it [**Israel**].

Remedies

- **Injunctions, damages** (these are the remedies available in all/most jurisdictions; also referred to as reimbursing former employer).
- **Only damages, no injunction** [**Belgium**, according to doctrine, but no court ruling yet, unless disloyal competition and then injunction can be issued].
- **Preliminary injunctions** – most labour courts can issue against employee violating covenant not to compete [**Austria, Germany Italy, Norway**, **Iceland**]. In **Sweden** this does not happen often. However, some courts do not issue preliminary injunctions [**Spain, Belgium**].
- **Seize order** – former employer may receive an order to seize his property, even at new workplace [**Ireland, Israel**].
- **Modify covenant** – when the covenant is “overly broad” [**Germany**]. Court may restrict an overly broad covenant [**Austria, Iceland**]. Some jurisdictions say that a court may not modify a private agreement [**Italy**].

Suit against new employer

- Former employer **can sue** the new employer, even though there is no contract between them. Legal theory: causing a breach of contract; for this the new employer must have procured or been a party to the breach of contract between the employee and the former employer [**Ireland, Israel**]. This is apparent when new employer benefits from trade secrets of former employer.
- In some jurisdictions the former employer **cannot sue** the new employer because he hired a worker who is violating his non- competition clause with the former employer [**Austria, Italy, United Kingdom, others**].
- Some jurisdictions say that a suit can be brought against new employer only if he is using trade secrets of former employer [**Germany, Sweden (Protection of Trade Secrets Act), Norway, Israel**].

Jurisdiction –

which courts have jurisdiction to hear cases relating to covenants not to compete?

- **Labour courts have jurisdiction over suits against both worker and new employer** [**Belgium, Israel Italy**]. To do this the court must expand the standing rules, since the new employer is not an "employer" in a suit between the worker and prior employer.
- **Ordinary courts – everything** [**Netherlands, Norway, Ireland, Finland, Iceland**].
- Divided between labour courts and general courts –
    - **suit against employee – labour courts**
    - **suit against new employer – civil court**

      [**Austria, France, Spain, Sweden, Slovenia**?]
- **Constitutional court** – when there is an issue in their jurisdiction.

Proposed changes in laws

- Netherlands – amendment to art. 7:653 of Civil Code: covenant not valid unless contains exact description of prohibited work; employer will pay compensation when employee prohibited from working.

Cases

- **France** – window cleaner case: clause not binding, since no legitimate employer interest.
- **France** – the small person (dwarf) case: freedom of occupation v. human dignity.
- **Ireland** – chicken salesman case: set up rival business, took half of former employer’s workers, direct competition, no express agreement; no order given and former employer’s case dismissed.
- **Sweden**: – air pilot case: contract clause which required pilot to work 10 years and pay.
- **Germany** – taxi driver case: contract that he could not be taxi driver in another company for 6 months after leaving employer. Held that this not binding.

New Israeli approach
[Frumer – Checkpoint; Saar-AES]

- CNTC will not be enforced unless the prior employer proves that:
  (1) his former worker is using his trade secret at new job;
  (2) the worker received special payment for not working at a competitor;
  (3) the worker was not acting in good faith [Girit];
  (4) the CNTC protects employer's interests which are proven to be legitimate and real [AES-Saar].
- Trade secret defined narrowly: (1) must be a secret; (2) has significant commercial value.

THE END

Thank you for your attention.