# Confidentiality and enforcing post-termination restrictions across Europe

17 March 2015

# Agenda

- Are restrictive covenants enforceable?
- What immediate steps should be taken to protect your business when a threat is identified?
- When should injunctive action be taken, and what compensation can be recovered?



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# Case Study

- One of your best employees, John, has just handed in his notice. He has an employment agreement which contains some post termination restrictions. You hear on the grapevine that John is intending to join your fiercest rival, Competitor A Limited. You are immediately concerned that John may provide Competitor A Limited with your confidential information so as to gain a commercial advantage. You are also worried that John will poach customers and persuade other valuable employees to join Competitor A Limited. You ask HR to look into this further and consider what can be done to prevent John from damaging your business.

**What steps should you take next?**

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# United Kingdom

# The United Kingdom

- The usual post-termination restrictions, which in practice must be agreed in a written document, will prevent a departing employee from:
  - Competing in another organisation (including a new business);
  - Soliciting (approaching) customers, clients and introducers of business;
  - Doing business with them (even if they make the approach);
  - Approaching members of the team to leave and join him.

# Restraint of trade

- The UK Courts will refuse to enforce these restrictions (covenants) unless an employer can prove that they are necessary to protect its:
  - confidential information; or
  - customer/client connections; or
  - the stability of its workforce; and
- The restriction in question is drafted so as to be no more restrictive than the minimum necessary to protect those vital interests.
- If the employer fails to do this, the Court will refuse to enforce the restriction. It will **NOT** rewrite it for the employer.

# Common drafting errors

- Duration – restrictions last too long.
- Scope e.g. prevents solicitation of or dealing with every customer, not limited to those with which employees had recent contact.

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However, if the covenants are well drafted the UK Courts will usually enforce them.

# how are restrictions enforced?

- Injunctions – employee ordered not to compete/solicit/ deal etc. for the duration of the restriction.
- Injunctions often granted on an interim basis, to maintain position until trial (typically 3 to 4 months).
- And/or claims for damages: but often difficult to prove loss.

# Garden leave clauses

- An expensive but effective alternative:
  - Employee sent home for all or part of notice period and required not to work, contact clients and/or staff – but must be paid as normal;
  - Must be agreed in writing in the contract;
  - Courts can refuse to enforce if too restrictive but can in effect rewrite it (unlike covenants).
  - Contracts usually provide for time spent on garden leave to reduce the length of any restrictive covenants.

# International aspects

- Even if the parties have expressly chosen foreign law, the UK Courts will refuse to enforce restrictions which would not be enforceable under UK law.
- Employees located in the UK must be sued in the UK, irrespective of any choice of jurisdiction clause.



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# Partnerships, stock options etc.

- If restrictions are imposed in return for the grant of shares and other property rights, the Courts are much more likely to enforce them.

# Practical points

- Many departing employees make the mistake of soliciting/dealing/competing BEFORE the termination of employment.
- That is almost always unlawful, and it is usually easier to find evidence against them e.g. on the IT system.
- Where a group of employees leaves as a team, it becomes more difficult to avoid committing some unlawful act. The team and the organisation recruiting them should take specialist advice at an early stage.

# Germany

# Implied terms in employment contracts

**Employee's duty of loyalty, confidentiality and diligence**

- Under German law employees are subject to a general duty of loyalty, confidentiality and diligence
- This includes such aspects as
  - having to keep confidential the employer's trade and business secrets,
  - not being permitted to compete with the employer during the employment and
  - a duty to protect the employer from harm where possible



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# Garden leave, Payment in lieu

- General right to work for employee
- Garden leave only based on prior agreement - even after serving notice
- In practice, use of garden leave common after serving notice for high ranking employees
- Payment in lieu is not permitted unless employee agrees

# Non-solicitation agreements (“non-poaching clauses”)

- Non-solicitation agreements (“non-poaching clauses”, intended to hinder former employees to poach workers for new company), which are supposed to apply (also) in case of a later self-employment of the former employee, fall under sec. 74 et seq. HGB (Commercial Code) and are valid only in combination with an appropriate compensation payment.
- At least, this rule applies in case that the former staff member disposes over specific expertise, and therefore the non-solicitation agreement would significantly restrict the employee in building up a new competing company.
- In case the former employee is only restricted with view to poaching former colleagues for his new employer, it has to be decided in the individual case at hand whether the agreement falls under sec. 74 et seq. HGB. In case the caused restrictions are economically negligible sec. 74 et seq. HGB might not apply. In this case such agreements can be valid without any compensation payment.
- Non-poaching clauses only have little practical relevance in Germany.
- Enforcement:
  - Through contractual penalty
  - Note: Not possible to hinder the solicited employee to work for his new employer in case the solicited employee did not breach contractual duties.

# Restrictive covenants – general requirements

- Compliance with very strict framework conditions in order to be valid and binding:

  - Written form (sec. 74 para. 1 HGB).
  - Justification by a legitimate interest of the employer with regard to the **temporal**, **geographical** and **factual** scope of the post contractual non-compete agreement.
  - The simple desire to prohibit an employee from competing with the employer for a certain period after the end of the employment contract as such not sufficient.
  - Restricted period of up to **two years** permissible (sec. 74 a para. 1 HGB)

⇒ Note: Whether a non-compete agreement is legally effective always depends on the individual case at hand!

# Restrictive covenants – legitimate interest

- **Geographical** scope: Appropriate limitation according to the services historically rendered by the employee to be made.
- **Factual** scope: Requirement of close link between the former professional activities of the employee on the one hand side and the field of application of the non-compete restriction on the other hand side.

- **Compensation**:
  - Obligation by the employer to pay compensation for the duration of the restrictive covenant in the agreement.
  - Amount to at least 50% of the last contractual remuneration and benefits (sec. 74 para. 2 HGB).

⇒ Note: Calculating compensation: Accounting for not only the fixed salary but also bonus payments, company cars and further elements of the employee’s remuneration!

# Restrictive covenants – consequences of incorrect non-compete clauses

## 1. Post contractual non-compete agreements being null and void

- Agreements not in writing
- Agreements not providing for compensation to the employee during the term of the restriction

## 2. Post contractual non-compete agreements being non-binding for employees

- Insufficient amount of compensation
- No legitimate interest of employer for being protected by a post contractual non-compete agreement
- Target of the agreement to limit the professional advancement of the employee in an unreasonable manner

# Restrictive covenants – enforcement and alternative approach

- **Enforcement**
  - Injunctions – employee ordered not to compete/solicit/ deal etc. for the duration of the restriction
  - And/or claims for damages: but often difficult to prove loss.
- **Alternative approach**
  - Agreeing upon **longer notice periods** with key employees
    - Even though obligation to pay full salary, interesting approach due to prohibition of competition during notice period
    - Explicit definition of the temporal, geographical and factual scope thus not required
  - Possibility for employer to remove employee from operational business by **sending employee on garden leave.**
    - During the notice period and the garden leave time it would be the employer's task to approach clients of the employee in order to build up new, and to strengthen existing personal relationships with these clients.

# Take away

- Post contractual non-compete agreements have to be tailor-made to each single case. There is no “one size fits all solution”.
- Strict rules for non-compete agreements regarding the temporal, geographical and factual scope have to be kept in mind.
- For post contractual non-compete clauses that shall apply in several countries it has to be examined whether a legitimate interest of the employer for such extensive scope can be proved.
- Even if a post contractual non-compete agreement governed by a foreign legal system is definitely legally effective under this legal system it might end up having no bite in Germany.



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# France

# Check if a non-compete clause exists and if employer hasn't released employee therefrom upon termination

- The former employer should check if the employee had a post-termination restriction clause in his/her employment agreement and if this clause is still enforceable
  - Post-termination restriction clause would need to be in writing
    - Provided expressly in the employment agreement or by a contract amendment
    - Otherwise, if the applicable collective agreement requires such a clause and the employee was informed thereof
  - ➢ Clause distinct from general duty of loyalty to which employee is bound during the period of employment, which prevents him/her from competing with the employer
  - Enforcement of the clause should not have been waived by employer upon termination
    - Since non-competes must be indemnified, employers quite often release employees from non-competes upon termination
      - Usually very tight timeframe to do so: upon termination or within 8-15 days

# Conditions of validity of the non-compete clause

The non-compete must:

- be essential for the protection of the company's legitimate interests
- be limited in time and in space
  - *e.g.*, usually up to two years, limit in geographic or professional scope
- provide for a financial indemnification
  - Mandatory since 2002
- whilst taking into account the characteristics of the employee's job
  - Clause can't prevent the employee from working in his/her field of expertise

➢ Extensive interpretation of non-compete clauses by French courts

- Customer, customer protection or non-solicitation clauses often assimilated to non-competes

# Financial compensation of non-compete

- Minimum amount sometimes provided by the applicable collective labor agreement
- Compensation granted, regardless of reasons for termination and who initiated termination and whether the employer suffers any damage
- Lump-sum amount granted, not a penalty clause
  - Judge can't increase or decrease it
- – Monthly payment
  - Can't be paid in advance during the period of employment, paid monthly as from the employee's effective departure
- – Considered as salary
  - Subject to social charges and to paid vacation

# Sanctions of invalid clause

- If the non-compete clause does not comply with requirements, clause is null and void
  - Only the employee can invoke this nullity
  - Employer can't invoke the nullity of the nullity to avoid paying the non-compete indemnity
    - Employer can only refuse to pay if it can prove the employee didn't comply with the clause
    - Employee is entitled to damages if s/he can prove s/he complied with the clause
- French judge may intervene and rectify duration, scope of clause or employee post-contractual obligation
  - But judge may not increase or decrease financial compensation

# Possible release from clause upon termination

- Unilateral release of the non-compete is possible upon termination
  - Needs to be provided in the clause
    - If no release period is provided in clause, employer may only waive at the time of the termination
  - Regardless of a release period, employer must waive enforcement of the clause <u>at the latest</u> at the date of the effective departure of the employee, if the employee is exempted from working during his/her notice period
    - If the release is notified to the employee too late, employer will have to pay all of the financial compensation
  - Sometimes, even if release is timely, collective labor agreement provides that non-compete indemnity would be owed for several months

# Drafting suggestions for non-competes

- Provide for a penalty clause in the non-compete to prevent employee from violating the clause
- Draft the clause so that it becomes applicable as from the date of the employee's effective departure
  - Otherwise, if the employee is exempted from working his/her notice period, s/he could compete during the notice period
  - Provide for the payment of the non-compete indemnity only as from the date of termination of the employment so that the employer not be required to pay the employee's salary + non-compete indemnity during the notice period
- Provide that the non-compete indemnity includes the paid vacation indemnity
  - If collective labor agreement permits this (*e.g.*, metallurgy CCN)

# If employer has released the employee from the non-compete upon termination or if there is no non-compete

The employer would not be completely powerless:

- Duty of loyalty still exists, even after termination
  - Employee may work for a competing company or set up a competing business
  - BUT s/he must carry out his/her activity in a fair manner
    - S/he cannot act so as to disorganize the business of his/her former employer, or cause commercial disruption or a confusion in the consumer's mind
      - Such wrongdoings would be faulty, even if there is no fraud on the employee's behalf
- Possible unfair competition claim against the former employee or the new employer

# Unfair competition claim against employee and/or new employer

- Competent court: first instance civil court (*Tribunal de Grande Instance – TGI*) or commercial court if former employer and employee are both merchants
  - If unfair competition started during the performance of the employment, labor court competent
- Possible summary proceedings procedure
- Possible unfair competition action against new employer



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# Proof of wrongdoing

- Burden of proof on the former employer
  - Need to prove fault, damage and causal link
  - Wrongdoings evaluated according to the company's actual activity and to the employee's actual work
  - Proof sometimes difficult to obtain
    - The employer may request the judge to order specific investigation measures (in particular in summary proceedings), based on Article 145 of French Civil Procedure Code, to obtain proof before filing the dispute

# Joint liability of the new employer

- Joint liability of new employer (Article L1237-3 of the French Labor Code) if:
  - It is proven that it intervened in the poaching of the employee
  - It hired the employee whilst knowing he was tied to another employer
  - It continued to keep the employee even after having learnt the employee was still bound to another employer by an employment agreement



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# Non-compete undertaking agreed upon by settlement agreement

- A non-compete clause may be agreed upon after the termination of the employment in a settlement agreement.

# Italy

# Loyalty obligation and post-termination restrictions

- Section 2105 of the Italian Civil Code - loyalty obligation - No competition during the execution of the employment agreement;
- Section 2125 of the Italian Civil Code – post-termination restrictions – Non-compete provision;
- Elements for the validity of the non-compete provision: (a) must be in writing (to be included in the employment agreement or as an attachment); (b) consideration (must be a meaningful proportion of the entire salary); (c) subject matters of the non-compete provision; (d) territory; and (e) duration (maximum of 5 years for managers and 3 years for employees);

# Loyalty obligation and post-termination restrictions

- Subject matters of non-compete provision: e.g. no activities in competition with those of the prior employer (both as an employee and as consultant); No work for competing entities (in the same or a different role); No work for suppliers or customers of the prior employer; No disclosures of confidential information pertaining to the prior employer and its organization (e.g. prices, products, customers/supplier list, discounts, etc.); No solicitation on behalf of the new employer towards the prior employer's supplier, customers or employees.
- Territory: Limited to certain countries (to be avoided: "All of Europe", "Worldwide" and the like).

# Garden leave

- No specific provisions about garden leave;
- It is not lawful in Italy to attempt to restrain someone from performing any working activities during any given period; however, specific non-competition obligations will apply in such cases (see above).

# Actions in case of breach of non- compete provision

- Injunctive relief pursuant to Section 700 of the Italian Code of Civil Procedure; (a) "*Fumus bonis iuris*" (appearance of a valid cause of action for the current or former employer), and (b) "*periculum in mora*" (actual risk of additional damages if the unlawful behaviour is allowed to continue); Aim: Judicial restraint order to stop the damaging activities of the employee.
- Full civil action for restoration of damages (Section 1453 of the Italian Civil Code), including any pre-liquidated contractual penalty (Section 1382 of the Italian Civil Code).



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# Important evidence – practical advice

- Search for incriminating evidence through e-mail correspondence must be previously authorized in writing by the affected employee(s), under strict Italian laws for the protection of personal data (“Privacy”).

# Questions?

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# CPD POINTS

- For CPD points please email:

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# Case Study

- One of your best employees, John, has just handed in his notice. He has an employment agreement which contains some post termination restrictions. You hear on the grapevine that John is intending to join your fiercest rival, Competitor A Limited. You are immediately concerned that John may provide Competitor A Limited with your confidential information so as to gain a commercial advantage. You are also worried that John will poach customers and persuade other valuable employees to join Competitor A Limited. You ask HR to look into this further and consider what can be done to prevent John from damaging your business.

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  - Judge can't increase or decrease it
- Monthly payment
  - Can't be paid in advance during the period of employment, paid monthly as from the employee's effective departure
- Considered as salary
  - Subject to social charges and to paid vacation

# Sanctions of invalid clause

- If the non-compete clause does not comply with requirements, clause is null and void
  - Only the employee can invoke this nullity
  - Employer can't invoke the nullity of the nullity to avoid paying the non-compete indemnity
    - Employer can only refuse to pay if it can prove the employee didn't comply with the clause
    - Employee is entitled to damages if s/he can prove s/he complied with the clause
- French judge may intervene and rectify duration, scope of clause or employee post-contractual obligation
  - But judge may not increase or decrease financial compensation

# Possible release from clause upon termination

- Unilateral release of the non-compete is possible upon termination
  - Needs to be provided in the clause
    - If no release period is provided in clause, employer may only waive at the time of the termination
  - Regardless of a release period, employer must waive enforcement of the clause at the latest at the date of the effective departure of the employee, if the employee is exempted from working during his/her notice period
    - If the release is notified to the employee too late, employer will have to pay all of the financial compensation
  - Sometimes, even if release is timely, collective labor agreement provides that non-compete indemnity would be owed for several months

# Drafting suggestions for non-competes

- Provide for a penalty clause in the non-compete to prevent employee from violating the clause
- Draft the clause so that it becomes applicable as from the date of the employee's effective departure
  - Otherwise, if the employee is exempted from working his/her notice period, s/he could compete during the notice period
  - Provide for the payment of the non-compete indemnity only as from the date of termination of the employment so that the employer not be required to pay the employee's salary + non-compete indemnity during the notice period
- Provide that the non-compete indemnity includes the paid vacation indemnity
  - If collective labor agreement permits this (*e.g.*, metallurgy CCN)

# If employer has released the employee from the non-compete upon termination or if there is no non-compete

The employer would not be completely powerless:

- Duty of loyalty still exists, even after termination
  - Employee may work for a competing company or set up a competing business
  - BUT s/he must carry out his/her activity in a fair manner
    - S/he cannot act so as to disorganize the business of his/her former employer, or cause commercial disruption or a confusion in the consumer's mind
      - Such wrongdoings would be faulty, even if there is no fraud on the employee's behalf
- Possible unfair competition claim against the former employee or the new employer

# Unfair competition claim against employee and/or new employer

- Competent court: first instance civil court (*Tribunal de Grande Instance – TGI*) or commercial court if former employer and employee are both merchants
  - If unfair competition started during the performance of the employment, labor court competent
- Possible summary proceedings procedure
- Possible unfair competition action against new employer



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# Proof of wrongdoing

- Burden of proof on the former employer
  - Need to prove fault, damage and causal link
  - Wrongdoings evaluated according to the company's actual activity and to the employee's actual work
  - Proof sometimes difficult to obtain
    - The employer may request the judge to order specific investigation measures (in particular in summary proceedings), based on Article 145 of French Civil Procedure Code, to obtain proof before filing the dispute

# Joint liability of the new employer

- Joint liability of new employer (Article L1237-3 of the French Labor Code) if:
  - It is proven that it intervened in the poaching of the employee
  - It hired the employee whilst knowing he was tied to another employer
  - It continued to keep the employee even after having learnt the employee was still bound to another employer by an employment agreement

# Non-compete undertaking agreed upon by settlement agreement

- A non-compete clause may be agreed upon after the termination of the employment in a settlement agreement.

# Italy

# Loyalty obligation and post-termination restrictions

- Section 2105 of the Italian Civil Code - loyalty obligation - No competition during the execution of the employment agreement;
- Section 2125 of the Italian Civil Code – post-termination restrictions – Non-compete provision;
- Elements for the validity of the non-compete provision: (a) must be in writing (to be included in the employment agreement or as an attachment); (b) consideration (must be a meaningful proportion of the entire salary); (c) subject matters of the non-compete provision; (d) territory; and (e) duration (maximum of 5 years for managers and 3 years for employees);

# Loyalty obligation and post-termination restrictions

- Subject matters of non-compete provision: e.g. no activities in competition with those of the prior employer (both as an employee and as consultant); No work for competing entities (in the same or a different role); No work for suppliers or customers of the prior employer; No disclosures of confidential information pertaining to the prior employer and its organization (e.g. prices, products, customers/supplier list, discounts, etc.); No solicitation on behalf of the new employer towards the prior employer's supplier, customers or employees.
- Territory: Limited to certain countries (to be avoided: "All of Europe", "Worldwide" and the like).

# Garden leave

- No specific provisions about garden leave;
- It is not lawful in Italy to attempt to restrain someone from performing any working activities during any given period; however, specific non-competition obligations will apply in such cases (see above).

# Actions in case of breach of non- compete provision

- Injunctive relief pursuant to Section 700 of the Italian Code of Civil Procedure; (a) "*Fumus bonis iuris*" (appearance of a valid cause of action for the current or former employer), and (b) "*periculum in mora*" (actual risk of additional damages if the unlawful behaviour is allowed to continue); Aim: Judicial restraint order to stop the damaging activities of the employee.
- Full civil action for restoration of damages (Section 1453 of the Italian Civil Code), including any pre-liquidated contractual penalty (Section 1382 of the Italian Civil Code).

# Important evidence – practical advice

- Search for incriminating evidence through e-mail correspondence must be previously authorized in writing by the affected employee(s), under strict Italian laws for the protection of personal data (“Privacy”).

# Questions?

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# CPD POINTS

- For CPD points please email:

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