Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002

Legal Updates & News

Bulletins

U.S. and E.U. Non-Competition Agreements Compared and Contrasted

November 2007
by Ann Bevitt, La Tanya N. James

Employment Law Commentary, November 2007

PDF Version

With employers operating, and employees working, in the global economy, knowing whether non-competition agreements will be enforced in other jurisdictions is essential for both those seeking to enforce and those likely to be subject to enforcement action. Unfortunately, there is much variation not only in the United States itself, with different states adopting different stances on whether non-competition agreements may be enforced, but also across the European Union. This article will highlight some of those differences, both in the United States and in the European Union, and suggest how employers may prepare to meet the challenges of enforcing non-competition agreements in and across various jurisdictions. [1]

The United States

Range of the different schools of thought in the United States regarding the extent of the enforceability of non-competition agreements can be clearly seen from a brief review of the divergent approaches taken by the courts in Delaware, California, and Virginia.

Delaware's stance on the enforceability of non-competition agreements is consistent with that taken by the majority of states in the United States. Delaware's courts will closely scrutinize a non-competition agreement as restrictive of trade, but will generally enforce it if it is part of a valid agreement that is supported by consideration, is reasonable in time and scope, and serves to protect the employer's legitimate economic interests, [2] which generally include the employer's confidential information and goodwill developed through customer relationships. [3] Furthermore, Delaware courts have adopted the reasonable alteration approach, which means that if the non-competition agreement is overbroad and unenforceable as written, rather than finding the non-competition agreement to be completely unenforceable, the court may choose to enforce the non-competition agreement to the extent that it is reasonable to do so. [4]

California, on the other hand, has adopted a very different approach to non-competition agreements. The general rule in California is that non-competition agreements are unenforceable. California's Business and Professions Code Section 16600 declares that, with a few exceptions, "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." The general rationale for this prohibition on non-competition agreements is that "[t] he interests of the employee in his own mobility and betterment are deemed paramount to the competitive business interests of the employers." [5] However, there are general exceptions to the prohibition where non-competition agreements are connected to the sale of a business or partnership, dissolution of a partnership, or dissociation of a partner from a partnership. Further, California's courts have created an exception for agreements that are necessary to protect the employer's trade secrets. [6]

Somewhere in between the divergent positions taken by Delaware and California lies Virginia. Virginia courts consider restrictive covenants to be restraints on trade that are to be carefully examined and strictly construed. [7] Virginia courts have long disfavored the inclusion of non-competition agreements in employment contracts and construe them directly in favor of the employee. [8] However, generally, a Virginia court will enforce a non-competition agreement if an employer shows that the restraint, including the time and geographic restrictions,

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002
is no greater than necessary to protect some legitimate business interest; is not unduly harsh and oppressive in curtailing the employee's legitimate efforts to earn a livelihood; and is reasonable from the standpoint of a sound public policy. [9] Legitimate business interests include trade secrets or other confidential information, customer contacts, and knowledge of methods of operation. [10] A Virginia court will not modify a non-competition agreement that it determines is unenforceable as drafted. As a practical matter, this means that non-competition agreements that apply to employees in Virginia, as well as in other states that follow a similar stance, must be drafted with extreme care.

European Union

A similar difference in approach is evident in the various Member States of the European Union, as can clearly be seen from a brief review of the different approaches taken by the United Kingdom, France, Germany, and Italy.

United Kingdom
In the United Kingdom, non-competition agreements are commonly included in senior employees' employment contracts. As a preliminary comment, if an employer wishes to enforce such an agreement post-termination, it should ensure that it terminates the employee's employment in accordance with the employment contract; if the employer breaches the contract, for example by not giving the employee the contractually required notice of termination, the non-competition agreement will fall away and be unenforceable.

Non-competition agreements are prima facie against public policy and therefore unenforceable unless found to be reasonable in the interests of the contracting parties and of the public. There are two stages in assessing reasonableness. Firstly, the non-competition agreement must be drafted to protect only the legitimate proprietary interests of the ex-employer. [11] Legitimate interests include customer/client/supplier connections, trade secrets (or other information of a confidential nature), and the stability of the workforce. Secondly, the scope of the restraint must go no further than is necessary to give adequate protection to the ex-employer's legitimate interests. [12] "Scope" refers to geographical area, activities/subject-matter, and duration.

Of all the post-termination restraints placed on ex-employees, non-competition agreements are assumed to be the most onerous and are therefore scrutinized most carefully by the courts. Accordingly, they have generally been harder to enforce than other post-termination restrictions, although the courts have upheld non-competition agreements on the basis that a restriction on solicitation would be difficult to police and therefore might not effectively protect the employer's business interests. [13]

Non-competition agreement covenants were historically drafted by reference to a radius or geographical area from the employer's premises but are nowadays more usually drafted to cover a territory over which the employee had influence or to which the employee's activities related whilst in employment. The courts pay particular attention to the definition of the activities or businesses in which the covenant restrains the ex-employee from involvement. Covenants must be limited to activities or businesses which are in direct competition with the ex-employer's business and which relate to activities which the ex-employee carried out whilst employed by the ex-employer. Also, the more junior an ex-employee, the more reluctant the courts will be to enforce non-competition agreement covenants. Further, the duration of such covenants must be as short as possible. Covenants for periods up to six months will generally be held to be of reasonable duration; anything longer will be closely scrutinized, [14] and a duration of longer than 12 months will only be enforceable in exceptional circumstances and with clear documentary evidence regarding the rationale behind such a lengthy restraint period. Further, if an employee has spent any time on "garden leave" prior to termination of employment, it is advisable to reduce the duration of the covenant by an equivalent period.

In English law, the fact that the employer has provided the employee with payment for any period of restraint does not absolve the employer from having to demonstrate that the covenant does not offend the public interest. As the courts will not strike down the entire contract between the parties if one or more of the covenants in restraint are found to be unenforceable, it is common practice to expressly provide for the survival of each covenant separately from one another if one or more are found to be unreasonable and void. The courts may strike out sections of a covenant which are considered unreasonable, provided what is left has meaning in its own right and does not require the court to re-write any part of it. However, the courts will not alter the period of a restraint in order to make an unreasonably lengthy restraint reasonable as regards duration. Finally, employers should be aware of the contra proferentem rule whereby courts will construe any ambiguity against an employer who has been careless in drafting.

France
Non-competition agreements are common in employment contracts in France. They are not regulated by statute but by case law and collective bargaining agreements. They usually prohibit the employee from working for a competitor for a period of time, within a certain location. They must be limited in duration and

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002
may be reduced in ambit if considered to be unduly restrictive. Accordingly, in order to be enforceable, a non-competition agreement must:

a)be indispensable for the protection of the legitimate interests of the employer;

b)not totally preclude the employee from being employed in his field;

c)be limited in time and geographically; and

d)oblige the employer to provide consideration for the restrictive covenant.

The most important element in determining validity is whether in fact the non-competition agreement prevents the employee from working in his field. Thus, even if the legitimate interests of the employer justify the restriction, the courts will focus on whether the employee's right to work is in fact impeded.

The non-competition agreement cannot preclude the employee from performing an activity which is consistent with his education, professional training, and professional experience. The courts will take into account the employee's breadth of technical knowledge and the ease with which he could find a job in a different sector or industry.

In order for an employer to be deemed to have a legitimate interest in enforcing a non-competition agreement, the employer must be at risk of suffering damage as a result of the employee's violation of the clause. In making this determination, the courts look to see if the old employer and the new employer compete in the same industry or sector, and the extent to which the employee poses a genuine threat to his former employer. In assessing the latter, French courts look to the extent to which the employee, during his employment, had:

a)contact with customers;

b)access to sensitive company information; and

c)access to know-how ("savior faire") which is deemed to be the property of the employer.

Whilst there are no specific guidelines regarding the legally enforceable duration of a non-competition agreement, covenants limited to 12–24 months are generally upheld, but the assessment is made on a case-by-case basis. Further, French courts have not defined the permitted geographical scope of a restrictive covenant. Each case must be analyzed individually, considering whether the scope precludes the employee from finding another job in his field. The court has power to reduce the duration and geographical scope of a restrictive covenant.

A non-competition agreement is ineffective and unenforceable unless it includes an obligation on the employer's part to pay financial compensation in consideration of the employee's performance of the covenant. There is some uncertainty as to how this requirement is applied by the courts but the employer does not have to pay the employee the same level of remuneration that he or she was earning, for the whole of the non-competition agreement period. Some guidance may be obtained from collective agreements that govern the employment terms of most employees in France. One such agreement provides that 50% of the average monthly remuneration (including fringe benefits and bonus) must be paid. Another agreement provides that one-third of monthly remuneration is payable if only one manufacturing technique or product is concerned, two-thirds if more than one product or technique is concerned, and 100% for any period exceeding two years. An employer is unable to insert an obligation into the contract unilaterally to pay the consideration, or to render the non-competition agreement effective by paying the consideration voluntarily; the employee will have to agree to the change, and there can be no compulsion on him to do so.

Germany

In Germany, the following conditions must be met for competition restrictions to be valid:

a)The prohibition must serve to protect the legitimate business interest of the former employer. Normally, it can only give the employer protection in respect of that part of the business in which the employee was employed.

b)The prohibition may not unreasonably hinder the employee from making a living.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002

c)The prohibition is only binding if the employer undertakes to pay compensation for the duration of the prohibition of at least 50% of the income (including bonus and benefits) earned by the employee immediately prior to his or her employment ending (the obligation to pay compensation can be excluded in contracts with Managing Directors and Supervisory Board Members). If the contract specifies less than this, the employee can choose between taking the payment and being bound by the restrictive covenant or refusing payment, in which case the restrictive covenant is ineffective.

d)The prohibition may only be imposed for a maximum of two years. Any clause purporting to prohibit competition for more than two years can only be valid for the initial two-year period and is invalid for any period thereafter.

f) The contract must be in writing, and the employer has the burden of proving that the employee received a copy of the contract duly signed by the employee in original form.

The employer may at any time during the employment waive the covenant with 12 months' notice. Further, summary termination for an important reason by the employer gives the employer the right to declare within one month of termination that it will not enforce the restrictive covenant. The same applies vice versa: upon summary termination by the employee, the employee may notify the employer that he will not observe the covenant. If the employer dismisses the employee for operational reasons, the employee may also choose to declare within one month from termination that he will not observe the restrictive covenant. The employer can only avoid this result by paying the full salary at the date of termination for the duration of the restrictive covenant.

The 50% compensation will be set off against the employee's other income during the period of restriction, as far as such new income plus the compensation exceeds 110% of the employee's last income with the employer. Additional complications may arise if the employee is unemployed while the restrictive covenant applies, in that the employer will be obliged to reimburse to the employment office 30% of the unemployment benefit paid to the employee, this reimbursement being treated as if it were salary received by the employee for the purposes of any potential set off.

Italy
In Italy, non-competition agreements are only allowed if:

a)they are evidenced in writing;

b)compensation is paid to the employee; and

c)the restriction is confined within specified limits as to purpose, time, and location.

The duration of the restriction cannot be in excess of five years, in the case of executive personnel, and three years in other cases. If a longer duration is agreed upon, it is reduced to the length indicated above. [15]

The compensation in favor of the employee should not be symbolic, unfair, or lacking proportion in comparison to the concrete sacrifice of the employee. The amount depends on the following elements:

a)the duration of the non-competition agreement;

b)the geographic extension of the non-competition agreement;

c)the kind of activities carried out during the employment; and

d)the employee's salary.

The parties can agree that the compensation for the non-competition agreement clause shall be paid every month together with the salary during the course of the employment. In this case the compensation has the form of an additional percentage added to the salary. [16] There is no minimum amount of compensation.

The non-competition agreement can cover activities different from those that the employee carried out at the employer's company, as long as it does not prevent the employee from carrying out any working activity related to his previous experience.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002

Enforcement

From this brief survey of non-competition agreement practice in the jurisdictions referred to above, it is clear that the courts have developed (in common law jurisdictions such as the UK) or have in place (in codified jurisdictions such as France and Italy) comprehensive guidelines on the reasonableness and enforceability of non-competition agreements. However, these guidelines only function effectively where both employer and employee consider themselves bound by the same local law. To illustrate some of the problems which arise when one or both parties seek to rely on a foreign law, the difficulties of trying to enforce a foreign law non-competition agreement in California and in the UK are set forth below. This review concentrates on two aspects of such enforcement: whether the courts will respect and apply a foreign choice of law clause if themselves determining enforceability and how, if enforceability has been determined by a foreign court and judgment issued, that judgment can be enforced.

California

In the United States, the states vary on whether they will enforce a choice of law clause that requires that a non-competition agreement be interpreted under another state's law. Some states will enforce the choice of law provision as long as there is a sufficient connection to that other state to support the choice of that state's law and as long as that state's law would not violate the public policy of the forum state. Although this is generally the standard in California, California's strong public policy against restricting employee mobility requires that California courts generally disregard such choice of law clauses. [17] Further, based on this strong public policy, California courts have overridden a choice of law clause even though the employment contract containing the non-competition agreement was performed outside California by an employee who was not a California resident but who was subsequently recruited by a California employer for competitive "employment in California." [18]

The mobility of employees and the number of states that touch upon an employment relationship may lead to a "race to the courthouse" to enforce or invalidate a non-competition agreement. Whoever wins the race to the courthouse can affect which state's law is applied, irrespective of the agreement's choice of law. The race might also result in parallel legal proceedings in two for that result in different outcomes. [19] Despite California's strong interest in protecting its employees from non-competition agreements, the California Supreme Court has decided that it would be inappropriate for a California court to interfere with a parallel proceeding pending in another state's court even if that litigation was the later-filed litigation. The California Supreme Court has also determined that the parallel action would not divest California of jurisdiction unless and until it could be demonstrated that any judgment by the other court was binding on the parties.

If a former employer avoids a race to the courthouse, or wins the race without the need for parallel proceedings, the former employer may have to take additional steps to enforce any injunction that is awarded against an employee who is not a resident of the state in which the injunction was awarded. Generally, if the forum court had adjudicatory authority over the subject matter and persons governed by a judgment, then a final judgment in one state qualifies for recognition in all 50 states. [20] Therefore, all 50 states must recognize any final judgment finding that a non-competition agreement is enforceable and valid and has been violated. However, the other states do not have to enforce the injunction. [21] Such enforcement is a requirement only if the former employer takes the extra step of following the other state's procedural rules for domesticating the judgment or making it executory.

There is precedent for domesticating, and subsequently enforcing, a foreign injunction award in federal court in California by filing for and receiving an order and judgment of domestication. [22] However, this precedent precedes a decision of the Supreme Court providing that mechanisms for enforcing judgments do not travel with the sister state judgment.

United Kingdom

Although the English courts will generally treat a choice of law clause as definitive, where a contract is entirely domestic, i.e., where the employer, employee, and place of work are in the United Kingdom, the courts will not allow the parties to elect a foreign law as the applicable law. Also, choice of law will be restricted by the "mandatory rules of law" of the law of the country which would be applicable in the absence of a choice of law clause. Whether rules on restraint of trade which limit the extent of non-competition agreements are mandatory rules is unclear; if they are, then they would apply to any attempt at enforcement of a non-competition agreement where, for example, the employee habitually worked in the UK, regardless of any express choice of law. Further, the courts are entitled to refuse to apply foreign law where it is manifestly incompatible with English law public policy, although there has in practice been little reliance on this principle. [23]

The process for enforcing a foreign judgment in the United Kingdom depends upon which, if any, statutory regime applies. If the country where the judgment was obtained is a signatory to Council Regulation (EC) No 44/2001 of 22nd December on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002

Commercial Matters [24] or the Lugano Convention 1988 on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, [25] there are reciprocal arrangements in place whereby the recognition and enforcement of a judgment of one country in another country is simple and will not involve re-assessing the merits of the case. Given the number of countries who are signatories to these instruments, this is enormously useful for employers. However, a foreign judgment which is contrary to English public policy, or is incompatible with an English judgment, or is irreconcilable with an earlier judgment given in a signatory state involving the same causes of action and between the same parties will not be recognized. There is no time limit for making an application to enforce a judgment. Further, in uncontested claims the European Enforcement Order is available for enforcing judgments. This is a simplified method of enforcement and does not require registering the foreign judgment, and such judgments will be treated as if they were an English judgment.

Unfortunately, other statutory regimes are not as helpful. For example, judgments of countries with which the United Kingdom has bilateral conventions which are given effect by the Administration of Justice Act 1920 [26] will only be enforced if they are orders for the payment of a sum of money. Accordingly, the enforcement of a judgment for injunctive relief is not allowed. Similarly, judgments of countries covered by the Foreign Judgments (Reciprocal Enforcement) Act 1933 [27] will also only be enforced if they are orders for the payment of a sum of money. Judgments must be registered within 12 months of the date of the judgment under the 1920 Act and 6 years under the 1933 Act.

The position under common law is similarly unsatisfactory. Where the statutory regimes referred to above do not apply, a foreign judgment in personam can only be enforced via the common law. However, there are significant conditions and restrictions on such enforceability—in particular, that the foreign judgment must be for a debt or a definite sum of money; again, the enforcement of a judgment for injunctive relief is not allowed.

Conclusion

Although the legal systems in the jurisdictions surveyed have significant differences regarding non-competition agreement enforceability, such as whether or not financial consideration is required or preferred and the extent to which courts will rewrite otherwise unenforceable covenants, there are some common strands, like balancing legitimate interests and having regard to limiting factors like duration and restricted business areas. Accordingly, if employees are working, or it is thought that after termination of their employment they are likely to work, in more than one country, employers should consider the requirements for enforceability of non-competition agreements in all relevant jurisdictions, to maximize the chances of being able to enforce against employees should they in fact compete after termination of their employment. Finally, given the difficulties outlined above of enforcing injunctive relief across jurisdictions, employers may instead want to focus on obtaining and enforcing orders for damages for breach of non-competition agreements .

_____

Footnotes:

[1] This article only addresses non-competition agreements that impose post-employment restrictions. It does not address the enforceability of non-solicitation agreements or agreements that impose restrictions on competitive activities during employment.

[2] *Faw, Casson & Co. v. Cranston,* 375 A.2d 463, 466-67 (Del. Ch. 1977).

[3] *TriState Courier & Carriage, Inc. v. Berryman,* No. C.A. 20574-NC, 2004 WL 835886, at *10 (Del. Ch. Apr. 15, 2004).

[4] *Knowles-Zeswitz Music, Inc. v. Cara,* 260 A.2d 171, 175 (Del. Ch. 1969).

[5] *Diodes, Inc. v. Franzen,* 260 Cal. App. 2d 244, 255 (1968).

[6] *D'Sa, v. Playhut, Inc.,* 85 Cal. App. 4th at 935.

[7] *Northern Virginia Psychiatric Group, P.C. v. Halpern,* 19 Va. Cir. 279, 282 (1990) (non-solicitation agreement case); *Richardson v. Paxton Co.,* 203 Va. 790, 795 (1962).

[8] *Richardson,* 203 Va. at 795.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=d5bb690a-135c-4a53-b61e-0740d11d8002

[9] *Paramount Termite Control Co. v. Rector,* 238 Va. 171, 174 (1989).

[10] *Id.*at 175.

[11] *Stenhouse Ltd v. Phillips* [1974] AC 391.

[12] *Herbert Morris Ltd v. Saxelby* [1916] AC 688.

[13] *See, e.g., TFS Derivatives Ltd v. Morgan* [2004] EWCH 3181.

[14] *Thomas v. Farr plc & Hanover Park Commercial Ltd* [2007] EWCA Civ 118. In this case the Court rejected the previously well-accepted argument that, where an employer imposes non-competition agreements and non-solicitation clauses, the former should be shorter in duration than the latter (e.g., 6 months and 12 months respectively). A duration of 12 months for the non-competition agreement was held to be "a conservative estimate of the time for which [the employer's] confidential information would retain is currency" and therefore reasonable.

[15] Article 2125 of the Italian Civil Code.

[16] For example, it has been held that it was fair to provide an additional amount of 18% of the salary per month as compensation with regard to a six months non-competition agreement, geographically limited to the Region of Lombardy.

[17] *See Frame v. Merrill Lynch, Pierce, Fenner & Smith Inc.,* 20 Cal. App. 3d 668, 673 (1971); *Scott v. Snelling & Snelling, Inc.,* 732 F. Supp. 1034, 1039-40 (N.D. Cal. 1990).

[18] *See Application Group, Inc. v. Hunter Group, Inc.,* 61 Cal. App. 4th 881, 885 (1998).

[19] *Medtronic, Inc. v. Superior Court of Los Angeles County,* 29 Cal. 4th 697, 708 (2002).

[20] *Baker v. General Motors Corp.,* 522 U.S. 222, 232 (1998).

[21] *Id*. at 235.

[22] *Norrell Health Care, Inc. v. Redwood Empire Nurses of Sonoma County, Inc.,* No. CV-91-0021-MISC, 1991 U.S. Dist. LEXIS 6615, at *2-3 (N.D. Cal. May 6, 1991).

[23] *See, e.g., Apple Corporation Limited v. Apple Computer Incorporated* [1992] F.S.R. 431, where the proposition that public policy overrode the proper law of the contract was rejected.

[24] Signatories are Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the UK.

[25] Signatories are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, and the UK.

[26] Mainly former or current Commonwealth countries.

[27] Includes Crown states such as Isle of Man and Jersey.

© 1996-2007 Morrison & Foerster LLP. All rights reserved.