SUMMARY

2015/49 Non-compete clause may limit cross-border activity (LU)

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For a non-competition clause in an employment contract to be valid under Luxembourg law, it cannot, inter alia, apply beyond national territory and it can only prohibit an independent activity identical or similar to that of the former employer. However, in a recent decision the Court of Appeal validated a non-competition clause that extended the prohibition against competing into France and prohibited an employed activity for a company competing with the former employer's company.

Facts

The plaintiff had brought a claim against his former employer for a payment for his having respected the non-competition clause included in his employment contract. According to the plaintiff's labour contract, he agreed to refrain, following the termination of his employment contract, from carrying out any employed activity on behalf of a company competing with the

activities of his former employer. In compensation for respecting this non-competition clause, the former employee would receive a payment equal to 25% of his last basic monthly salary.

The prohibition against competing lasted for one year and applied not only to the Grand Duchy of Luxembourg but also to several regions of France.

The employer claimed the non-competition clause was invalid because it went beyond Luxembourg's legal restrictions and therefore no compensation for complying with it was due.

Judgment

The Luxembourg Court of Appeal (Cour d'appel), confirming the judgment of the first instance court, the Labour Tribunal (tribunal du travail), stated that the non-competition clause was valid and consequently that the plaintiff could claim the payment. However, it reduced the geographical area originally covered by the clause, while accepting that it should still extend beyond Luxembourg and into Alsace-Lorraine.

The Court of Appeal pointed out that in order to maintain the validity of a non-competition clause and to balance the interests of the company and the freedom to work of the employee, the judge may correct imperfections and any undesirable effects of a non-competition clause. It also underlined that a non-competition clause would be abusive if it excessively restricted the freedom to work.

In this particular case the Court considered that the freedom to work was not excessively restricted because first, the employee was allowed to work within non-competing companies; secondly, the prohibition was limited in time; and thirdly, the prohibition was compensated for by a payment. Further, the Court reduced the geographic scope of the non-competition clause, whilst expressly retaining Alsace-Lorraine. In the Court's view, this did not restrict the employee's freedom to work excessively.

Consequently, the Court considered that a cross-border non-competition clause may be valid, provided the employee's freedom to work is preserved as far as possible, and the parties' mutual interests are sufficiently balanced.

Commentary

In terms of both Luxembourg's legislation and established case law, this judgment of the Luxembourg Court of Appeal is both extraordinary and rather surprising. It is interesting from various angles: first, from an internal point of view, because it is not in line with established Luxembourg case law; second, in comparison with other EU Member States; and third, from the point of view of EU law (in that non-competition clauses can be incompatible with EU

law).

In Luxembourg, non-competition clauses included in employment contracts are governed by Article L. 125-8 of the Luxembourg Labour Code. According to this provision, an employment contract may contain a non-competition clause by virtue of which the employee agrees that after leaving the company, he will refrain from setting up any independent business similar to that of his employer in order not to infringe the employer's interests. In other words, the law is silent on non-compete clauses that prohibit a former employee from working as an employee.

The same provision states that, in order to be valid, a non-competition clause must fulfil the following conditions: first, the clause must be in writing; second, it must refer to a specified professional sector and to activities similar to those of the employer; third, it must be limited to a period of time not exceeding 12 months from the end of the employment contract; and fourth, it must be restricted geographically to the territory of Luxembourg.

Further, the non-competition clause is only enforceable if the employee is earning a gross annual salary of at least EUR 52,843.89 or EUR 4,403.66 per month on the day he or she leaves the company.

Luxembourg non-competition clauses are therefore different from those of other countries (e.g. France and Belgium). In Luxembourg, non-competition clauses are only enforceable against employees taking up an independent activity or starting up their own business.

Closely linked to this is the fact that Luxembourg law does not make financial compensation a condition for the validity of a non-competition clause, although Luxembourg non-competition clauses often include payments.

Until this judgment, the Luxembourg courts used to rule that non-competition clauses prohibiting employees from taking up similar activities, directly or indirectly, as employees of a competitor were void.

The decision of the Court of Appeal derogates from this established case law as the non-competition clause in this case prohibited working for a competing company and not an independent business. The geographic area covered by the limitation, however, was considered too broad, so the Court chose to limit it. Nevertheless, it accepted that the geographical scope could go beyond national territory, which is clearly contrary to the wording of the law.

For the moment, we cannot tell whether the Court of Appeal's decision is a one-off or a turning point. We cannot predict whether the Luxembourg courts will from now on

automatically declare non-competition clauses that are too broad void or reduce their scope, to make them more proportionate. In this case, the Court of Appeal wanted to protect the employee. If it had declared the clause invalid, the employee would have been unable to claim the financial contribution. In another situation, of course, the Court of Appeal may have decided differently.

Only time will tell whether the Luxembourg courts will start to consider financial compensation a necessary condition for the validity of a non-competition clause as, for example, the French and Belgian courts do.

Another topic worth considering is that a non-competition clause may, under certain circumstances, be incompatible with EU law, in particular given that free movement of workers is enshrined in Article 45 of the Treaty on the Functioning of the European Union and private employers are obliged to respect this.

A non-competition clause that is not limited to national territory is not purely internal, but could have an effect in other Member States. In the Bosman case, the ECJ ruled that a restriction preventing or detering a national of a Member State from leaving his or her country of origin in order to exercise freedom of movement constitutes an obstacle to that freedom even if applied without regard to the nationality of the worker concerned (Bosman, C-415/93, point 96).

In this case, it seems that Article 45 of Treaty was not infringed, as the restriction was limited to a very precise region (Alsace-Lorraine). The restriction could be justified, for example, by the necessary protection of business secrets, and could be considered proportionate.

Comments from other jurisdictions

Austria (Martin Risak/Johanna Pinczolits): In Austria employees are only restricted in taking up a new job or in establishing their own business if their contracts include a non-competition clause. These clauses are subject to a number of statutory restrictions (i.e. §36 Act on White Collar Workers, §2c Act on the Adaption of Contractual Labour Law, Arbeitsvertragsrechtsanpassungsgesetz). For example, non-compete clauses may only be concluded for one year after termination and are only binding if the employee earned more than € 2,635 Euro per month (2015). Additionally, a non-competition clause may not unfairly impair the career prospects of an employee. On the other hand, under Austrian law the employee does not need to be compensated during the operation of the clause if the contract was terminated by the employee or if the employee was subject to summary dismissal.

In a similar case to the one at hand, the Austrian courts would most likely have considered the

clause valid and enforceable.

Germany (Dagmar Hellenkemper): In Germany, the decision reported above would not even have raised an eyebrow. An agreement between an employer and employee, limiting the trading activities of the latter following termination of the employment relationship is binding on the employee insofar as the restrictions imposed as to time, place, and the nature of trade do not inequitably restrict the professional career of the employee. Statutory provisions limit the timeframe to two years following termination and apply both to independent and dependent competing activities. Further, the employer can within reason choose the geographical scope of the prohibition. This might - depending on the field the former employee has been working in – involve regions of Germany, Germany as a whole, or additional countries. A worldwide ban on competition is possible but rarely applied. The employer would have to show in such a case that the market was very limited and any other kind of ban would be ineffective. An employee bound by a restraint of trade must be compensated at a rate of at least 50% of the former salary, including bonuses and other benefits. The rules for managing directors differ in theory but more often than not are the same in practice.

The Netherlands (Zef Even): In the Netherlands, non-competition clauses may both prevent the employee from entering into the service of a competitor, as well as from starting a competitive business himself. There are no statutory rules as to the duration and geographical limitations of a non-competition clause. Having said this, statute allows the court to limit and even nullify a non-competition clause, should it, balanced against the reasonable interests of the former employer, unreasonably hinder the employee following the termination of his employment agreement (a 'reasonableness test'). In practice, non-competition clauses often have a duration of up to 12 months, and a limited geographical scope. This geographical scope may expand to regions or countries outside the Netherlands, should this be necessary to protect the reasonable business interests of the employer.

I am not convinced that an employee can easily invoke article 45 of the Treaty when challenging the geographical scope of a non-competition clause. To my knowledge, this does not happen in the Netherlands, perhaps because the reasonableness test is broader and therefore more protective for an employee than having recourse to Article 45 of the Treaty.

Although Article 45 of the Treaty surely has horizontal effect vis-à-vis an individual employer (ECJ 6 June 2000, C-281/98, Angonese), it is as yet undecided whether that horizontal effect applies beyond the scope of discrimination on the grounds of nationality. In my view, it is therefore not certain whether the above-mentioned Bosman case could be applied to an individual employer. If so, such a hindrance could be permitted, applying the rule of reason. If

the employer can substantiate legitimate interests in concluding and enforcing such a non-competition clause, such as the reasonable protection of his business (which in essence is the aim of a non-competition clause), I would suppose such a clause to be enforceable under EU law.

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Parties: unknown

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