SUMMARY

2015/48 Supreme Court clarifies definition and scope of ‘customer protection’ clause (FR)

<p>A clause preventing a former employee, for a fixed period of time, from dealing directly or indirectly, with his former employer’s clients is a non-compete clause and must, therefore, meet certain requirements established by French case law, in order to be valid. A former employee who refrains from competing against his former employer on account of an invalid non-compete obligation, believing it to be valid, is entitled to compensation.</p>

Facts

The French Labour Code is silent on restrictive covenants, i.e. provisions in a contract between an employer and an employee that prevent the latter from competing against his or her (former) employer during or after termination of the employment relationship, or restrict the employee in his freedom to compete. However, the courts have developed a body of judge-made law regulating restrictive covenants. This case law is based on Article L. 1121-1 of the Labour Code. It forms part of a section of the Labour Code headed “droits et libertés dans l’enterprise”. Article L.1121-1 provides that no one may restrict the rights of individuals or restrict individual or collective freedoms unless such a restriction is justified by the nature of the task to be carried out and is proportionate to the required purpose. This principle is applied by judges when analysing the provisions of restrictive covenants.

Under the said case law, in order to be valid and enforceable, a non-compete clause must meet

certain requirements. One is that the restriction is limited in time and geographically. Another is that the former employee must be paid compensation (contrepartie) for the duration of his or her compliance with the non-compete undertaking. There are no hard and fast rules in respect of the amount of compensation, but compensation that may be inadequate in the eyes of the court risks being considered invalid. Compensation equal to 30-35% of the last-earned base salary is typical.

In the case at stake, the employment contract of an employee included a clause entitled "customer protection". It provided that, upon termination of the employment contract and for 24 months thereafter, the employee undertook not to contact directly or indirectly, by any means, any clients of the company with whom he had been in contact while performing his duties. The contract did not make mention of any compensation.

Following termination of his contract, the employee filed an action before the Labour Court, claiming that the so-called "customer protection" clause had to be considered as a non-compete clause and that, as such, he should have been compensated. He claimed damages. The main issue was whether a clause limiting an employee's right to liaise with clients of his former employer is to be treated as a non-compete clause, in which case the clause should have satisfied the requirements outlined above.

The Labour Court of Annecy held that the customer protection clause was not a non-compete clause and therefore dismissed the employee's claim.

The employee appealed the decision before the Chambéry Court of Appeal. That court ruled that the clause was not a non-compete clause and that the restriction included in the customer protection clause was strictly limited, since it only prevented the employee from liaising with clients of the company and did not aim to prevent him from performing similar duties at a competitor's. Further, the Court of Appeal recalled that the clause did not provide any geographical restriction and that, accordingly, the employee was free to carry on a similar activity. Therefore, the Court of appeal rejected the employee's claim.

The employee appealed to the Supreme Court.

Judgment

The Supreme Court overturned the Court of appeal's decision. It ruled that a clause preventing a (former) employee from contacting, directly or indirectly, within a certain defined period of time, the clients of his former employer, is a non-compete clause. The Supreme Court recalled that, in order to be valid, such a clause must 1) be necessary for the protection of the company's legitimate interests, 2) be limited in time and in space, 3) take into account the

specific nature and peculiarities of the employee's job and 4) provide for financial compensation.

Commentary

Article L.1121-1 of the French Labour Code is extremely broad. Courts rely on it whenever they consider a right or freedom to require protection. It is hardly an exaggeration to say that courts can use Article L.1121-1 to achieve almost any outcome they deem desirable. They strive, on a case-by-case basis, to protect the interests that are at stake in the dispute before them. Article L.1121-1 has been used, for instance, to reach decisions in disputes concerning professional equality, discrimination and employee monitoring.

As of the end of 2014, the French Supreme Court had rendered no fewer than six decisions relating to non-compete clauses. In 2002, it regulated the use of non-compete clauses. According to a series of decisions rendered in July and September of that year, to be valid and enforceable, a non-compete clause must:

be necessary for the protection of the company's legitimate interests;
be limited in time;
be limited in space;
take into account the specificities of the employee's job;
provide the former employee with financial compensation1.

In the event of failure to comply with the above mentioned criteria, the employee - and the employee only - is entitled to claim the non-compete clause to be void. If successful, the clause will not be enforceable against the employee. Moreover, the courts may modify a non-compete clause that is valid, for instance, reducing its duration or scope. However, judges may not 'blue-pencil' the provision in a non-compete clause that specifies the amount of compensation.

An employee who has complied with a non-compete clause, and who has not engaged in any unfair competition[2], can ask for payment of damages. The court will then estimate the loss suffered. Interestingly enough, the Supreme Court considers that having a void non-compete clause in an employment contract necessarily causes prejudice to the employee, even if the employee was hired by a new employer at the point of termination of the former employment

contract. In other words, the employee does not have to demonstrate the existence of any specific prejudice in order to be awarded an indemnity. The Supreme Court indemnifies the mere existence of a void non-compete clause. A number of Courts of Appeal have tried to oppose the position of the Supreme Court on this and have rejected employees' claims in cases where the employee has not complied with a non-compete obligation[3] and has not produced evidence of prejudice suffered.[4]

In practice - and in order to avoid application of the above-mentioned regime - employers used to insert a clause in employment contracts preventing them from liaising with clients, without going as far as to prevent them from working for a competitor. This was done on the assumption that this did not qualify as a non-compete clause. They were wrong. In a decision made in 2008[5], the Supreme Court decided that a clause entitled "non-diversion of clientele" in practice prevented the employee from performing an activity consistent with his professional training and experience. The clause was therefore to be considered as a non-compete clause and should have followed the relevants rules.

In 2009[6], the French Supreme Court held that a clause prohibiting the employee against contacting the employer's clients, directly or indirectly, even if it was the clients who made the decision to liaise with the employee, constituted a non-compete clause. Since the clause was neither providing for financial compensation nor was limited in time and space, it had been declared void.

In a decision of 15 October 2014, the French Supreme Court considered that a confidentiality clause does not constitute a restrictive covenant[7]. In this matter, a dismissed employee brought an action before a labour court arguing that the confidentiality clause in his employment contract was a non-compete clause. He claimed compensation. The Supreme Court confirmed the decision of the Court of Appeal, which had ruled that the clause did not prevent the employee from performing an activity and that it was only aimed at protecting the confidential information provided to him in the course of his employment relationship. The clause was not a non-compete clause and, consequently, did not require the payment of financial compensation.

Although the Supreme Court had made it clear that it is not possible to provide different financial compensation depending on the reason for termination, trial judges have sometimes been reluctant to follow this position. In a decision of 9 April 2015[8], the Supreme Court reiterated that a clause in which the amount of compensation depended on the reason for termination was void. Thus, whether the employee was dismissed or resigned, the effect on his or her freedom to work was the same and should be compensated in the same way. Moreover, variable compensation is not sanctioned by the the clause being declared void. In

that situation, the employee would be entitled to the maximum compensation specified in the clause.

Case-law recognises the employer's right to unilaterally release the employee from a non-compete obligation. However, this option has been strictly regulated by case law in order to protect both parties' interests. The Supreme Court ruled on 11 March 2015[9] that, unless otherwise agreed by the parties, the employer may not unilaterally waive a non-compete clause before the employment has ended. In the case at hand, a non-compete clause provided that the employer could waive the non-compete obligation provided that it was done by registered letter no later than eight days following notice of termination. On 7 April 2010, the employer released the employee from the non-compete obligation. On 28 June 2010, the employee was dismissed. The court of appeal had ruled that a requirement to waive no later than eight days following notice of termination implies that the employer may waive any time before termination. The Supreme Court quashed this decision, as it considered that the clause provided for a withdrawal period starting ont the date of termination. This meant that the employer could not withdraw the non-compete obligation during the course of the employment contract, except where expressly otherwise provided.

Another issue is to work out when an employer should waive a non-compete clause if it decides to release the employee from the notice period. The Supreme Court decided, in a decision dated 21 January 2015[10], that the starting date of the non-compete obligation is the date of actual departure of the employee from the company. The effect of this is that the employer should waive the non-compete clause at the point when it informs the employee of exemption from the notice period.

In practice, the decisions of the Supreme Court illustrate the difficulties in dealing with restrictive covenants. Identifying a non-compete clause is not straightforward and the wording of these clauses may not be clear. With the decision reported above, the French Supreme Court continues to clarify the definition and the scope of these clauses.

Today, employers have a tendency to include non-solicitation of clients in non-compete clauses in order to avoid issues about how it should be treated. When will the Supreme Court provide clear and reliable guidance on the appropriate amount of financial compensation in such cases?

Comments from other jurisdictions

Germany (Dagmar Hellenkemper): In Germany, 'client protection clauses' are regularly seen as non-competition clauses and are handled as such. Statutory provisions limit the time frame to two years following the employment and apply to both independent and dependent

competing activities. Any further restraint would interfere with the employee's occupational freedom, as guaranteed by the Constitution. Further, the employer can within reason choose the geographical scope of the prohibition. An employee bound by a non-compete clause must be compensated at a rate of least 50% of his or her former salary including bonuses and other benefits. The employer cannot argue it has no obligation to pay the compensation because the clause is invalid. It can inform the employee that it does not uphold the non-compete clause, but this only exempts it from paying compensation, at the earliest, one year after the waiver. The only other way to avoid a non-compete clause – and the resulting obligation to pay - is to mutually agree to waive it.

Romania (Andreea Suciu): Non-compete clauses are expressly regulated in the Romanian Labour Code. The parties may negotiate and include a non-compete clause into the employment contract that expressly states that the employee is required not to compete against his or her employer for a maximum of two years following termination of the employment contract. In return for this obligation, the employer must pay the employee monthly compensation of least 50% of the average gross salary throughout the non-compete period. Moreover, a non-competition clause is not effective unless, inter alia, it expressly describes the activities prohibited to the employee. This may include prohibiting the former employee from liaising, directly or indirectly, with former clients for a gvien period of time.

In the case of breach of a non-compete clause, the employee may be obliged to reimburse the compensation and, where appropriate, pay damages for loss incurred to the employer. However, the employer must prove that it suffered harm as a result of the actions of the employee in breach of the clause. If such evidence cannot be provided, the employer may only claim reimbursement of the non-compete compensation in court. The parties may not agree a clause saying that the employee is required to pay a sum of money in the event of non-compliance.

In cases of breach of a non-compete clause, a former employee could also be sanctioned - or could be criminally liable - for competing with a former employer under Competition Law no. 11/1991 on combating unfair competition.

Depending on the seriousness of the offence, the provisions of Competition Law no. 21/1996 may be used in conjunction with the Criminal Code to the effect that the perpetrator may be liable for crimes such as breach of professional secrecy, negligence at work etc.

Although, non-compete clauses might appear to have limited practical value for employers, in that the effect of breach is simply that the employee has to pay back the compensation, in practice, they tend to act as a useful deterrent.

EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

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