EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

SUMMARY

2015/29 Employer may not unilaterally waive non-competition clause (PT)

<p>The employer, having announced to the employee its decision not to comply with the non-competition clause the parties had entered into five years before, refused to abide by it when the employment contract ended. The employee brought the matter before court, demanding payment of the sum specified in the clause in return for one-year’s noncompetition. The first instance court upheld the employer’s position, but the Court of Appeal of Lisbon overturned it, in a ruling that was later confirmed by the Supreme Court of Justice. Both higher court decisions denied the employer the right to cancel a non-competition clause, given the employee’s legitimate expectations.</p>

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The employer, having announced to the employee its decision not to comply with the non-competition clause the parties had entered into five years before, refused to abide by it when the employment contract ended. The employee brought the matter before court, demanding payment of the sum specified in the clause in return for one-year's noncompetition. The first instance court upheld the employer's position, but the Court of Appeal of Lisbon overturned it, in a ruling that was later confirmed by the Supreme Court of Justice. Both higher court decisions denied the employer the right to cancel a non-competition clause, given the employee's legitimate expectations.

Facts

The defendant in this case was an advertising agency. The claimant was the head of its graphic production department. Four years after the claimant was hired the parties entered into an agreement that included a non-compete clause. It bound the employee to abstain from performing any sort of professional activity in entities competing with the employer for a one-year period following the employment contract´s termination. In consideration of this obligation, the employer was bound to pay the employee, for the duration of the non-compete obligation, monthly compensation equal to his last-earned salary.

Five years later, the employer announced that it had "waived" the noncompete clause, by which it meant that it had cancelled the clause. The employee expressed disagreement and responded that he considered the cancellation unlawful. The employer replied by claiming to be the clause's sole beneficiary and, as such, to be entitled to waive it unilaterally. This statement was rejected by the employee. Six letters were exchanged in which the parties stuck to their respective standpoints.

When, shortly afterwards, the employment contract was terminated, the employee kept to his side of the agreement by refraining from any sort of competitive activity. He urged the employer to keep to its side of the agreement by paying him as provided in the contract. Faced with the employer's refusal, the employee brought the case to court seeking to have the "waiver" declared void.

The court of first instance ruled in favour of the employer, holding that the aim of non-compete clause was exclusively to serve the employer's interests, and that it had therefore been legitimately waived. This judgment was overturned by the Court of Appeal of Lisbon, in a ruling later confirmed by the Supreme Court of Justice, as described below.

Judgment

The question submitted to the Court of Appeal of Lisbon was whether an employer can unilaterally cancel a non-competition clause entered into prior to the termination of the employment contract, the argument being that, until the contract is terminated, the clause operates to the exclusive benefit of the employer. In this view, a non-compete clause does not affect the employee's position until the employment contract has ended. It is then that the clause becomes effective and enforceable.

The Court began by observing that non-compete clauses are usually aimed at pursuing the employer's interest to prevent so-called "differentiated competition" by a former employee whose position enables him or her, upon leaving the business, to divert clientele and/ or to

disclose confidential information. However, the Court added, the law protects the employee whose freedom of work such clauses restrain, by making their validity dependent on compliance with strict conditions. One of those conditions is that the employee is entitled to adequate compensation.

Moving forward with its analysis, the Court of Appeal of Lisbon noted that for as long as an employment contract continues in existence, Portuguese Labour Law does not grant the employer a prerogative to cancel a non-compete clause contained in it, nor does it allow the parties to agree such a prerogative. In the Court's words, the reason for this is as follows: "the possibility of unilateral cancellation of such clause by the employer goes against *bona fides*, as it enables the employer to recall the non-competition covenant at a moment when the employee is already enduring a limitation on her or his freedom of work". As the Court remarked, from the moment it has been agreed, a non-compete clause prevents an employee from looking for another job or accepting job proposals.

In view of all this, the Court of Appeal of Lisbon considered that the answer to the question at stake lay in the *pacta sunt servanda* principle: contractual clauses resulting from the parties' agreement can only be modified or cancelled by mutual agreement. Accordingly, the court held the employer's 'waiver' of the non-competition clause to be void, and thus ineffective. It ordered the employer to pay the employee the compensation agreed in the non-compete clause, with interest.

The decision was confirmed by the Supreme Court of Justice. In doing so, it deepened its doctrine regarding the impact of non-compete clauses on an employee's position before the employment contract ends. This is a topic that is usually disregarded by those who accept the employer's right to unilaterally waive a non-compete clause, as they tend to focus on the post-contract termination period. The Supreme Court of Justice, in contrast, emphasized the non-compete clause's effect on the employee's situation immediately following its entering into effect and up to termination - a period during which the clause is not yet operational, even though it already has effect. In the Court's words, non-compete clauses: "also limit the employee's full participation in the labour market long before the inactivity period, as they condition her or his possibility and interest in searching or considering other professional options, hence of optimizing his or her career management" - a reality that quite often results in loss of opportunities.

Consequently, while the employment contract is in force, a noncompete clause has the same effect as a 'permanence clause'. A permanence clause is a clause in an employment contract under which the employee, in consideration of the employer incurring significant expenses on his training, agrees not to resign for a certain period, with a statutory maximum of three years,

and agrees to refund the training expenses in the event he resigns before the permanence period has expired. A permanence clause binds the employee to the employer by making leaving disadvantageous, thus discouraging it. By analogy, to entitle the employer to unilaterally cancel a non-compete obligation on the grounds that it has not yet become operational, disregarding the limitations the employee is subject to by its mere inclusion in the contract, would be similar to allowing the employer to attain the same result as a permanence clause without offering anything in return. Moreover, allowing unilateral cancellation disregards the noncompete clause's bilateral nature, as it denies that the clause limits the employee's freedom to work whilst the employment contract is still in operation.

The Supreme Court of Justice ruled, in line with the Court of Appeal of Lisbon, that "in the absence of a legal provision to the contrary [...] no other conclusion can be reached than the impossibility for noncompetition clauses to elude the principle that contracts freely entered into must be thoroughly enforced as accorded and can only be modified by agreement".

Commentary

In this case, the Portuguese courts were for the first time asked to determine whether an employer can unilaterally cancel a non-compete clause. This fact alone would justify special attention to both decisions addressed in the present report (Supreme Court and Court of Appeal). There are, however, several other reasons why the decision stands out as remarkable, three of which are discussed below.

First, the fact that although a non-compete clause is aimed at protecting the employer's interests (provided they exist), it also affects the employee and for that reason, does not "belong" to the employer, who cannot unilaterally decide either to maintain or cancel it.

Second, the employee's interests and expectations derive from the fact – so often forgotten – that it has an immediate effect on the employee's position, whether it is agreed at the beginning or during the course of an employment relationship. The effect it has on the employee is different from the effect after termination, yet it is related: the fact that the employee will be prohibited from competing post-termination deters the employee from seeking other jobs, accepting job offers - and ultimately from leaving the employer - thus ensuring the employer remains in the employer's service.

Third, the judgment clarifies that if an employer could cancel a noncompete clause, this would not only go against *bona fides*, by frustrating the employee's legitimate expectations, but would also be a way of circumventing the limitations on permanence clauses. It would make it possible for the employer to bind the employee using a non-compete clause that it could maintain just for as long as the employer thought necessary to prevent the employee from

leaving - and be cancelled as soon as the employer wanted - with no costs or obligations on the employer and no benefit or compensation for the employee.

Comments from other jurisdictions

Austria (Jana Eichmeyer / Anna Spiegl): With regard to noncompetition clauses, Austrian labour law makes a distinction between the prohibition against an employee working for a competitor during the employment contract and a restriction on starting an activity for a competitor after the employment relationship has ended. Whereas the general rule that determines that the employee should not compete during the employment relationship applies automatically, after the employment relationship has ended, a non-compete clause must be agreed upon specifically and needs to respect certain statutory restrictions in order to be effective.

There is no general obligation on the former employer to compensate the former employee for compliance with restrictions on competing during the employment set out in the clause. Therefore, an employer may unilaterally waive a pre-termination non-compete clause – particularly as there is no financial incentive and any such waiver would be in the employee's favour. However, post-contractual non-compete clauses without compensation are only enforceable if the employment relationship is terminated by the employee without good cause or by the employer with good cause. In all other cases, the employer loses the right to enforce the non-compete clause. Based on this rule, the only situation in which the former employer would pay the former employee his last-earned remuneration for the duration of the noncompete clause, is where the employer has terminated the contract (presuming the employer still wants the non-compete clause to remain in force).

However, the parties can agree, either in the employment contract or at any time during the employment contract or in the termination agreement, that the employer will pay compensation during the restriction period.

If the employer decides to uphold the clause and in doing so binds itself to compensate the former employee, the Austrian Supreme Court has ruled in a judgment of 1982 that it is not possible for the former employer to stop the payments by simply stating that the non-compete clause is cancelled. Hence, a unilateral cancellation of the noncompete clause by the employer without any reason, such as breach of the clause by the employee, is not valid under Austrian labour law. This would also apply if an agreement for compensation has been made for termination of the contract - such an agreement would exceed the statutory requirements but would be valid and enforceable.

Belgium (Eveline Ankaert): In accordance with the Belgian Employment Contracts Act, an

employee must refrain from engaging in unfair competition or assisting in the commission of these both during and after termination of the employment contract. Hence, an employee is allowed to engage in fair competition with his former employer, unless a valid non-compete clause is signed before or during employment. In order to be valid and enforceable the non-compete clause must meet very strict conditions, for example:

The non-compete clause can only prohibit the employee from engaging in similar activities by a competitor during a certain period of time after termination of the employment contract. Such a prohibition may not last longer than 12 months. Hence, the noncompete clause can only affect the post-contract termination period.
The non-compete clause must provide for payment by the employer of compensation in one lump sum. The amount of this must be at least 50% of gross salary for the effective period of application of the clause.

As a consequence, Belgian case law accepts that the employer can decide to unilaterally waive the application of a non-compete clause during employment or within a maximum of 15 days following termination of the employment contract. If the employer fails to waive a non-compete clause in time, it will be liable to pay the lump sum compensation.

Croatia (Dina Vlahov Buhin): Under Croatian law the employer may waive a contractual non-compete obligation provided it has informed the employee about this in writing. In such a case, the employer is not obliged to pay the agreed compensation to the employee after the expiry of a three month period from the date of delivery of the written notice to the employee. Although not expressly stated in law, this provision relates to the post-employment period, meaning that cancellation can only be effected after the employment relationship has ended. On the other hand, during the employment relationship it should not be possible to "waive" either a contractual non-compete obligation or any other provision mutually agreed between the parties. Although this is not expressly prohibited by law, it is clear that the parties to the employment relationship agree mutually on their rights and obligations (within the limits prescribed by the Croatian Labour Act) and thus none of the provisions of the employment contract, including the non-compete obligation, can be waived unilaterally.

We are therefore of the view that the Croatian courts would have come to the same conclusion as the Court of Appeal of Lisbon and the Supreme Court of Justice in Portugal.

Germany (Dagmar Hellenkemper): Germany has statutory provisions in the Commercial Code that deal with bans on competition and unilateral waivers. First of all, employers are legally obliged to compensate non-competition periods with at least 50% of the former salary. Often,

contractual provisions augment this to 75 or 100% of the former salary. The employer may unilateraly cancel the non-compete clause but is only released from its obligation to pay the compensation one year after declaration the cancellation. If the employee stays in the employment relationship for a year after the declaration of cancellation, the employer will not have to pay any compensation. However, if the employment relationship ends, for example, four month after the declaration, the employer will have to compensate the employee for the remaining eight months (if the agreed non-competition period does not end sooner). Usually, part of the compensation period is covered by an existing employment contract that prevents the employee from any competing activity. While the employer is only released from its obligation to pay the compensation one year after the cancellation, the employee is free from his obligation to refrain from competing the minute his employment ends (sometimes at the same time as the cancellation).

Lithuania (Inga Klimasauskiené): Lithuanian case law considers that non-compete agreements are civil transactions even though they are made between the parties to an employment contract. Therefore, an issue such as this would be subject to the Civil Code, as opposed to the Labour Code.

The Civil Code of Lithuania does not specify the content of a non-compete agreement. The general principles, as with all civil transactions, are therefore applied. The parties are free to determine their mutual rights and duties at their own discretion, including agreeing on compensation for non-competition. If the parties agree on compensation for a certain period of time, the parties are bound to comply with the agreement. This corresponds with the position of the Portuguese Courts in the case discussed above, in which they have applied the principle of the pacta sunt servanda. With regard to the unilateral withdrawal of a noncompete clause by the employer, such as the one in the present case, it is very likely that the Lithuanian courts would recognize this action as void too, because under the Civil Code of Lithuania, amendments and supplements to a contract must be made in the form in which the contract was formulated. This means that both parties must mutually agree to cancel the clause. There are some exceptions under Lithuanian law that allow for unilateral changes to a contract, but in this case, these are unlikely to apply.

It should be pointed out, however, that a new draft of the Labour Code is currently being debated in Lithuania and non-compete agreements are affected. The draft law says that the parties to an agreement can agree to a non-compete clause up to a specified time limit after the termination of an employment contract, but the time limit should not be longer than two years. As to compensation, the draft establishes that the burden is on the employer to pay the (former) employee compensation amounting to not less than 40% of the salary of the employee was receiving by the day of termination of the employment contract. Unfortunately,

however, the draft is silent on the possibility of unilateral waiver of the obligation to pay compensation. This leads to the conclusion that where this is concerned, general civil law principles will continue to apply.

The Netherlands (Peter Vas Nunes):Under Dutch law there is no requirement to pay a former employee any compensation for being bound by a restrictive covenant such as a non-compete undertaking. Such an undertaking benefits only the (former) employer; there is no advantage for the (former) employee. As a consequence, an employer may unilaterally waive its rights under a non-compete clause, either as a gesture of good will or as part of a severance package (the employee perhaps getting lower severance pay than he would otherwise). In 2001, the government introduced a Bill of Parliament that would have changed the system. The plan was to require employers to compensate (former) employees for being bound to a non-compete agreement. The Bill was voted down. Had it passed, a non-compete clause would have changed from something that is favourable for employers to something that in many cases would actually have been attractive for the employee.

In the parliamentary debate, there was discussion about whether the employer should have the right to cancel the agreement, thereby robbing the (former) employee of his entitlement to the compensation. The general opinion was that employers could not do this. This Portuguese judgment confirms that opinion.

Romania (Andreea Suciu, Andreea Tortov): Just like the Portuguese legislation, the Romanian Labour Code expressly regulates noncompetition clauses. Such a clause should consist in an obligation by the employee not to carry out a competing activity for a maximum of two years following termination of employment, in exchange for compensation by the employer, payable on a monthly basis. In order to be effective, a non-competition clause must include certain provisions (e.g. activities prohibited to the employee; third parties for whom providing the activity is prohibited; the duration of the noncompete obligation; the geographical area where the employee may be restricted from competing; and the amount of compensation). The purpose of such strict regulations is to avoid a general comprehensive ban on the exercise of a person's trade or profession. Further, a noncompete clause must be agreed and included in the employment agreement either during the employment or when it ends.

Just as in Portugal, in Romania the opinions expressed in professional literature are divided, some authors considering that the employer may unilaterally terminate a non-compete clause, since it only works in its favour. Others consider that the employer cannot waive a non-compete clause because of its consensual character. However, Romanian Courts support the opinion that the employer cannot unilaterally terminate a non-compete clause.

The Constitutional Court of Romania considers that, in theory, such a clause favours the employer and so it should be able to choose to cancel it. However, in the absence of a legal provision to the contrary, the Court stated in Decision no. 1277/2010 that a non-compete clause could not be unilaterally terminated by either of the parties, as it was of a consensual character - thus implying the parties' agreement both when it was made and, more importantly, when it is terminated. Even so, the Court suggests employers should include in the wording of the agreement a right for the employer to decide whether to apply the non-competition clause or not. Otherwise, the non-competition clause would automatically activate and only terminate at the end of its term or if the parties mutually agree to cancel it.

Subject: Miscellaneous, non-competition clause

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