EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

SUMMARY

2015/20 Non-compete obligations do not cross to transferee in transfers of undertakings (PL)

<p>The Polish Supreme Court has recently narrowed the scope of rights and obligations transferred to a transferee in case of transfer of an undertaking</p>

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Facts

On 1 April 2000, the plaintiff, Ms U.K., concluded a contract of employment for an indefinite duration with Company A under which she was employed as an executive assistant on a full-time basis. Clause 5 of the contract included a non-compete obligation according to which the plaintiff was required not to engage in competitive activity within one year following termination of the employment relationship. In consideration of this obligation, she was to receive a compensation amounting to PLN 11,474.52[1].The non-compete clause was to enter into force following termination by the parties of the employment relationship.

On 2 January 2008 Company A was acquired by Company B.

On 29 February 2012, the plaintiff and Company B concluded an agreement under which they terminated the contract of employment. They did not invalidate the non-compete clause.

On 28 May 2013 Company B, the defendant in this case, gave notice of cancellation of the non-compete clause[2]. The plaintiff did not accept the cancellation and filed a petition to order the

defendant to pay her the contractual compensation of PLN 11,474.52 plus statutory interest for refraining from competitive activity.

The courts of the first and the second instance ruled in favour of the plaintiff and awarded her the entire amount of the requested compensation. They reasoned that although the plaintiff had concluded the non-compete agreement with Company A, as a result of the transfer of the undertaking to Company B, the latter became a party to the non-compete agreement. The courts also held that cancellation by Company B of the non-compete clause had no legal grounds and thus was ineffective.

The defendant filed a 'cassation' appeal with the Supreme Court.

Judgment

The Supreme Court, in its assessment of the effectiveness of the noncompete clause following the transfer of an undertaking to another employer, pointed out that the Labour Code provides that in the case of transfer of an undertaking or a part of an undertaking to another employer, the latter shall by law become a party to the existing employment relationships. It noted that, in accordance with the system provided by Article 3 of Council Directive 2001/23/EC, the Polish Labour Code introduced the principle of automatic assumption by the new entity of the rights and obligations of the previous employer. The employer acquiring the undertaking or part of it becomes a party to the existing employment relationships. This becomes effective upon acquisition of the undertaking by operation of law, with no need for any additional action by the parties, in particular, with no need for termination of the existing and conclusion of new employment contracts.

However, in terms of the non-compete clause in question, the Supreme Court pointed out that it was an agreement on non-competition after termination of the employment relationship. An essential feature of such agreements is that its term exceeds the period during which parties are bound by the employment relationship. The rights and obligations arising from the agreement are exercised only after termination of employment.

The Supreme Court went on to hold that an obligation not to compete after termination of an employment relationship is not an element of the employment relationship governed by the principle of "automatism", that is to say that all terms of employment existing at the time of the transfer automatically move across to the new employer. Since a noncompete agreement is separate from the contract of employment and

is not subject to its terms and conditions, it does not fall within the employment relationship with the new employer under the Labour Code following the transfer.

The outcome of the case, therefore, was that Company B cannot hold the plaintiff to her non-compete obligation. The plaintiff's claim for payment of compensation under the contract was denied.

Commentary

First, it should be noted that the Supreme Court's judgment constitutes a change to the Court's previous standpoint. Until recently, the Supreme Court's usual approach was as expressed in its judgment of 11 January 2005, I PK 96/04, according to which "in the case of transfer of an undertaking or part of an undertaking to another employer, the latter shall by law become party to the existing employment relationships. Acquisition of the original employer of the plaintiffs by the defendantconstituted the transfer of an undertaking (...) including also the rights and obligations under a non-compete agreement".

The Supreme Court's approach, as expressed in the current case, strikes me as incorrect. Article 3 of Council Directive 2001/23/EC provides that the transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer shall, by reason of such transfer, be transferred to the transferee. The expression "rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer" should be broadly interpreted. It covers not only matters arising directly from the contract of employment but also

other rights and obligations, which, although not provided by such contract, are closely connected to the employment relationship and thus arise from it.

An agreement on non-competition after termination of employment is not simply a civil contract but a mixed agreement (even though it enters into force after employment has ended). The agreement is based on the Labour Code and can only be concluded when the employment is still continuing. Because of the nature and purpose of the agreement, it cannot, in my view, be completely separated from the employment relationship. Therefore, in the case of a transfer of an undertaking to another employer, the rights and obligations arising from the noncompete agreement should also transfer.

This interpretation is supported also by the need to protect employees. If an employee enters into a non-compete agreement and refrains from competitive activity following termination of the employment, the employer should reasonably be expected to have to compensate the employee for this. An employee should not be deprived of the right to compensation as a result of the acquisition of the business by another entity.

If the Supreme Court's position is accepted, this could also be open to abuse by employers,

who might deliberately sell off parts of their businesses to subsidiaries so as to avoid non-compete obligations.

Comments from other jurisdictions

Belgium (Isabel Plets): The decision of the Polish Supreme Court appears to me to be incorrect and it would certainly be different if a Belgian court had ruled on it. Directive 2001/23/EC was transposed in Belgium through Collective Bargaining Agreement n° 32bis (CBA 32bis), concluded in the National Labour Council on 7 June 1985. This was adjusted by CBA 32*quinquies* of 13 March 2002.

All rights and duties arising from employment contracts existing on the date of transfer automatically transfer from the transferor to the transferee (Article 7 CBA 32*bis*). There is no doubt that a non-compete agreement included in an employment contract would transfer to the transferee. In Belgium, a non-compete agreement can be concluded during the employment relationship, but also after termination of the employment relationship. The first type is governed by the specific and strict rules laid down in the Act on employment contracts. The second type is governed exclusively by civil law, not by labour law.

Denmark (Mariann Norrbom): Contrary to the ruling of the Polish Supreme Court, in Denmark a non-compete clause would be considered as arising from the employment relationship. Thus, it would be considered to be part of the "rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer", as provided under Article 3 of Directive 2001/23/EC. Consequently, a non-compete restriction will automatically transfer as part of the employment relationship, allowing the new employer to maintain the restriction vis-à-vis the employee. It seems that Danish law is more in line with the views of the author of this case report than with Polish law as such.

In my opinion, it would be inconvenient if a non-compete restriction did not automatically transfer with the employment relationship in the case of a transfer of the undertaking. Sometimes, the knowledge and expertise of key employees is the main reason why the new employer wants to take on the transferring business. If those employees are not automatically bound by their existing non-compete clause, there is a risk that the new employer will be taking on a business that is far less valuable than expected, as all key employees would be free to leave and take up employment with competitors.

Further, it is interesting to see that Polish law does not allow an employer to terminate a non-compete restriction, irrespective of whether a transfer has taken place. Under Danish law, employers can terminate a non-compete clause both during the employment and after termination. If the employer has not terminated the non-compete restriction prior to

termination of the employment, the employee is entitled to compensation for the first three months in the form of a lump sum payment. After that, the employer can terminate the noncompetition restriction at any time with one month's notice, to expire at the end of a month. However, if the restriction is terminated within the last six months of the employment, the employee will still be entitled to the lump sum payment for the first three months of the restricted period.

Germany (Dagmar Hellenkemper): German legal literature agrees with the Polish commentary above, that the transferor's rights and obligations arising from a contract of employment or from an employment relationship existing on the date of a transfer should, by reason of such transfer, be transferred to the transferee and that this would include any individuals' rights relating to the employment relationship with the transferor. Commentators point out that the scope of the non-compete obligation may be affected.

As noted in relation with the Portuguese decision on the waiver of a non-competition clause (see below: EELC 2015/29), an employer in Germany may unilaterally waive a non-compete clause but is only released from its obligation to pay the compensation one year after declaration of the waiver. If the transferee does not want to be bound by a non-compete clause it is free to issue a waiver to all employees transferring to the company. It would still be obliged to pay (part of) the compensation if an employee leaves within a year of the waiver, the amount depending on the time of termination.

United Kingdom (Bethan Carney): post-termination non-compete provisions in the contract of employment are deemed by UK courts to continue post-transfer as if made between the individual and the transferee as a result of the Transfer of Undertakings (Protection of Employment) Regulations 2006 ('TUPE'). This is due to the operation of regulation 4 ("a relevant transfer shall not operate so as to terminate the contract of employment of any person employed by the transferor and assigned to the organised grouping of resources or employees that is subject to the relevant transfer, which would otherwise be terminated by the transfer, but any such contract shall have effect after the transfer as if originally made between the person so employed and the transferee"). Even though the relevant restrictions do not take effect until after the termination of employment they are still deemed to be terms of the contract and can transfer.

Although it is well-established by the courts that restrictive covenants are part of the terms and conditions of employment that do transfer as a result of TUPE, there are other issues which have been found to impact upon the effectiveness of such clauses post-transfer. In the case of *Morris Angel and Son Ltd - v - Hollande and anor 1993 ICR 71* the Court of Appeal found that restrictive covenants entered into pretransfer did transfer to the benefit of the

transferee who could enforce the covenant to restrain the employee from dealing with former clients of the transferred undertaking. However, the clause could not be read so as to prevent the individual from dealing with clients who had been customers of the transferee before the transfer – as this had not been contemplated by either party when the contract was agreed. It is not clear whether this decision will operate so as to effectively 'freeze' the scope of restrictive covenants so that they only catch the customers with whom the individual was dealing in the period immediately before the transfer and do not cover customers of the transferee with whom the individual might deal post-transfer. In practice, employers usually try to deal with this by asking key employees to enter into new restrictive covenants after a transfer. This is in itself problematic because changes to employment contracts are void if the reason for the change is a TUPE transfer. In order to effect changes in these circumstances employers have to terminate employment and offer re-employment on the new terms – which is obviously a delicate and risky process.

Footnotes

1 Under Polish law, a requirement to pay the (former) employee compensation is mandatory.

2 Polish law provides that unilateral cancellation of a non-compete clause by the employer is invalid unless expressly agreed otherwise, which was not the case here. This aspect of the case is not crucial, the main issue being whether the non-compete clause retained its validity following the transfer of undertaking.

Subjects: transfer of an undertaking

Parties: U.K. – v – A

Court: Sąd Najwyższy (Supreme Court)

Date: 11 February 2015

Case Number: I PK 123/15

Creator: Sąd Najwyższy (Supreme Court)
Verdict at: 2015-02-11
Case number: I PK 123/15