EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

SUMMARY

2018/46 Limits to a contractual penalty for non-compliance with a non-compete clause (CZ)

The Czech Supreme Court has ruled that the concept of good moral conduct must be taken into account when assessing whether an employee has breached his or her non-compete obligation and thus whether it is fair to demand that the employee pay a contractual penalty for the breach. The Court annulled the penalty.

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Facts

The employer, acting as plaintiff in the case at hand, and the employee, terminated their relationship by mutual agreement, having agreed, during the course of her employment, a 12-month non-compete clause.

The employee breached her non-compete obligation just two weeks after termination when she entered into employment with her former employer's competitor. That employment lasted only a few days and was terminated by the employee herself, for unknown reasons.

With no regard to the duration of the new employment, the employer asked the employee to pay the agreed contractual penalty of one year's salary for breaching the non-compete clause.

The employee refused to do so and the employer brought a claim against her. During the course of several years of legal proceedings, the courts of first and second instance, and finally the Czech Supreme Court, dealt with the following questions, among others:

whether the employee could obtain information that might damage the employer's business (as required under Czech labour law);
how to determine whether the amount of the contractual penalty was proportionate.

Judgment

First, as a matter of Czech law, a post-termination non-compete clause may be agreed only if:

it can be fairly requested of the employee, having regard to the nature of the information, findings and knowledge of working and technological procedures that the employee has obtained during his or her employment (collectively the 'Knowledge'); and
if use of the Knowledge in a competing activity could substantially harm the employer's activity.

The courts confirmed that since the employee worked as a Commercial Manager and thus had knowledge of the employer's current and potential client base, pricing list and product portfolio, she had an unfair advantage and was potentially able to cause damage to her employer if she engaged in a competing activity. As a result, agreeing on a non-compete clause with such an employee took account of the employer's interest in preventing the misuse of acquired know-how, whilst not harming her constitutional right to choose her occupation freely.

Second, Czech law provides that, in order to safeguard the employer's interests and to avert any potential damage caused by non-compliance with a non-compete obligation, the parties may agree on a contractual penalty, to be paid if the non-compete obligation is breached.

The contractual penalty must be proportionate to:

the Knowledge; and
the potential damage that could be caused by use of the Knowledge at a competitor of the employer; and
the monetary compensation paid to the employee for compliance with the non-compete obligation.

the Appeal Court ruled that the contractual penalty agreed in the case at hand was appropriate, taking account of the above, as the amount was equal to the compensation the employee would have received if she complied with the non-compete obligation, i.e. her annual salary.

The Czech Supreme Court firstly upheld the arguments applied in the previous decisions and confirmed that the non-compete obligation had been breached. It also stated that the question of whether the employee had used or had the opportunity to use the Knowledge during her new employment (and thus breach the non-compete clause) was irrelevant.

However, the Supreme Court also stated that despite this, the employee had breached only breached her non-compete obligation in a minor way, as her new employment had lasted for a mere three days. As a result, the employer's request that the employee pay any of the contractual penalty was unconscionable and against the general moral principles inherent in a democratic society.

Commentary

This decision is somewhat surprising, since the Czech Supreme Court states that the adequacy of a contractual penalty should not be assessed based on actual damage, but at the same time considers the length of the breach and its materiality to be relevant. It also raises additional questions (without offering any answers), namely what period would not be considered 'negligible': would one week or one month be enough?

In any case, it seems clear that the Czech Supreme Court is continuing its relatively employee-friendly approach when, instead of either upholding the parties' agreement or decreasing the amount of the penalty, it dismisses it as a whole.

Unfortunately, this is not something that could be avoided by better drafting of a non-compete obligation. The Czech Supreme Court has reminded us once again of the far-reaching 'good moral conduct' concept which has to be taken into account with respect to any decision made in relation to an employee or other weaker party.

The Supreme Court also stated that if the employer was concerned about potential information leaks, it should have used other means of protection, such as legal action against breach of trade secrets and unfair competition or the relevant criminal charges.

Although Directive (EU) 2016/943 of of 8 June 2016 on the protection of undisclosed know-how and business information has not yet been fully implemented into Czech law, the Czech

Civil Code already contains a similar definition of trade secrets to the one envisaged in the Directive. Nonetheless, the Directive should simplify the process of recovering damages for breaches of trade secrets and could therefore help employers fight any such breaches perpetrated by their ex-employees via this route.

Comments from other jurisdictions

Germany (Ines Gutt, Luther Rechtsanwaltsgesellschaft mbH): In German law, the function of the contractual penalty is, on the one hand, to provide a general compensation for damages and, on the other hand, to ensure compliance. The contractual penalty is often the employer's only leverage.

In general, the relevant time of assessment as to whether a contractual penalty is effective is the time of conclusion of the contract. A disproportionately high contractual penalty is ineffective according to Sec. 307 (1) German Civil Code ('BGB'). As a rule, the upper limit is a gross monthly salary, but this is not a rigid limit.

However, a subsequent reduction of the contractual penalty also comes into consideration in accordance with Sec. 343 BGB. As a first step, it is necessary that the contractual penalty is effective according to Sec. 307 (1) BGB. Even if a contractual penalty is in general appropriate in the meaning of Sec. 307 (1) BGB, it can still be disproportionate in the meaning of Sec. 343 BGB in the individual case. In this respect, the decisive difference is the assessment time and the assessment standard. This is on the one hand the time of conclusion of the contract (Sec. 307 BGB) and on the other hand the time of assertion of the claim (Sec. 343 BGB). Secondly, a reduction can then be made according to the individual circumstances of each case. The German Federal Labour Court ('BAG') considered it appropriate to impose a high penalty for a brief infringement if the employer is threatened with serious harm as a result of the disclosure of trade secrets.

Moreover, it should be noted that the court reduces the penalty according to Sec. 343 BGB only at the employee's request. However, any suggestion by the employee that he wants to get away from the contractual penalty because he considers it to be unreasonably high is sufficient for this purpose.

In summary, for the present case this means that the German BAG would probably have decided in the same way as the Czech Supreme Court. This is because the parties agreed a contractual penalty of one year's salary. This agreement significantly exceeds the "normal" upper limit. Therefore, the contractual penalty is ineffective after Sec. 307 (1) BGB. A

reduction according to Sec. 343 BGB cannot be made.

Either in German law the Directive (EU) 2016/943 of 8 June 2016 on the protection of undisclosed know-how and business information has not yet been fully implemented. However, there is already a government draft regarding a new statute (Trade Secrets Protection Act – 'GeschGehG') to implement the directive. The new statute is intended to provide a coherent protection against unlawful acquisition, unlawful use and unlawful disclosure of trade secrets. In the future, this statute will probably make it easier for the employer to take action against his former employee in the event of non-compliance with a non-compete obligation. In this respect Sec. 6, 10 GeschGehG will be the legal basis. Moreover, there is also a penal provision: Sec. 23 GeschGehG.

Belgium (Peter Pecinovsky, Van Olmen & Wynant): The Belgian Act on Employment Contracts restricts the use of post-contractual non-compete clauses. These are only allowed for higher paid employees (min. annual salary of 68.361 euro in 2018), the duration is limited to one year. Their application is limited to the Belgian territory (except for positions with an international dimension) and the clause must provide a compensation for the employee of at least half of the wage during the duration of the clause (so min. 6 months wage if the clause has a duration of 12 months). If the employee breaches the clause, he will have to not only repay this compensation, but also pay damages equal to the amount of the compensation. However, the labour court can reduce the amount of the compensation to be paid by the employee, if the court deems this amount too high. This might be the case if the breach of the non-compete clause is very substantial like in the Czech example.

Finland (Janne Nurminen, Roschier, Attorneys Ltd.): The Finnish Employment Contracts Act (55/2001, as amended) provides that a non-compete agreement may be concluded if there are significant reasons for it. The agreement may provide penalties for breach. Whether a breach has occurred does not depend on loss or threat of loss to the employer. As such, if faced with a similar situation, a Finnish court would probably also have found that the non-compete agreement had been breached.

However, the Contracts Act (228/1929, as amended) provides that if a contract term is unreasonable or its application would lead to an unreasonable outcome, the term may be adjusted or set aside. A Finnish court would probably have applied this provision in a similar situation. As such, the judgment would probably be similar to the one made by the Czech Supreme Court.

Subject: miscellaneous

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