

# NON-COMPETITION AGREEMENTS

Lexia Growth Academy

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Legal Excellence



# AGENDA

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- Non-competition agreements and present condition
- Background and objectives of the non-competition reform
- Planned changes in legislation
- Impact of the reform and practicalities

**NON-COMPETITION  
AGREEMENTS AND PRESENT  
CONDITION**

# AGREEING ON NON-COMPETITION

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- The practice of a competing trade, profession or other activities to one's own or another's account may be limited.
- At the start of employment or during the period of employment.
- Particularly weighty reason.
  - Nature of the employer's activities and need for protection (construction vs. technology companies).
  - Business and trade secrets (significant information from the customer and contract database).
  - Special training (costs, improved professional skills).
  - Status and duties of the employee (key personnel vs. employee level).
- The Supreme Court's judgement (KKO 2014:50): There was no particularly weighty reason for the non-compete obligation in the employment contract of an engineer employed by a company supplying robot-based automation systems.

# AGREEING ON NON-COMPETITION

- Non-competition restrictions for a maximum of 6 months without compensation.
- Validity assessed only afterwards.
- Obligation to provide reasonable compensation only if the restriction period exceeds 6 months.
- Maximum 12 months.
  - Does not apply to those in managerial positions.
- Contractual penalty or damages.
  - Contractual penalty equivalent up to 6 months' salary (does not apply to those in managerial positions).
- Not binding if the employment relationship is terminated for a reason deriving from the employer.

# AGREEING ON NON-COMPETITION (SHAREHOLDERS' AGREEMENT)

- No provision in the Limited Liability Companies Act.
- Primarily a matter of agreement.
- Does the shareholders' agreement / employment meet the characteristics of an employment relationship.
- When a shareholder has a normal employment relationship with the company and a non-compete obligation concerning him/her has been agreed in the shareholders' agreement, problems of interpretation arise as to whether the non-compete obligation is valid.
- The Employment Contracts Act is either applicable or not.
- The provisions of the Employment Contracts Act cannot be disregarded if the characteristics of the employment relationship are met.
- If a shareholder owns a majority of the company, it is not likely to be an employment relationship.
- The Supreme Court's judgement (KKO 1991: 60) shows that a person's shareholding, board membership or the fact that the person is a founding shareholder of the company does not indicate that he has not performed work under contract on behalf of the company, under the management and supervision of the company and thus as an employee in an employment relationship with the company.

# **BACKGROUND AND OBJECTIVES OF THE NON- COMPETITION REFORM**

# OBJECTIVES OF THE REFORM

- According to the proposal given by the Government on 12.11.2020, the reform is intended to enter into force on 1.1.2022.
- Note that this is only a government *proposal*.
- The objective of the reform is
  - To prevent non-competition agreements that do not comply with the conditions laid down.



# **PLANNED CHANGES IN LEGISLATION**

# EMPLOYER OBLIGED TO PAY COMPENSATION TO THE EMPLOYEE

- The employer would be obliged to compensate the employee for the restriction period agreed in the non-competition agreement.
  - Restriction period means the period during which the non-compete obligation is in force after the termination of the employment relationship.
- As under current legislation, a restriction period for a maximum of 12 months may be agreed upon in a non-competition agreement.
  - Restriction period may be longer for those in managerial positions.

# STATUTORY AMOUNT OF COMPENSATION

- The amount of compensation would depend on the employee's salary and the length of the restriction period agreed in the non-competition agreement.
  - Maximum of 6 months' restriction period -> 40 % of the employee's salary
  - Over 6 months' restriction period -> 60 % of the employee's salary for the entire restriction period
- The compensation would be based on the employee's normal salary which would be paid if the employment relationship continued.

# COMPENSATION PAYMENT DATE

- Within the restriction period, the compensation should be paid according to the pay periods followed during the employment relationship, unless otherwise agreed after the termination of the employment contract.
- In respect of the payment date, the parties may not agree otherwise in the non-compete agreement in advance.

# EMPLOYER'S RIGHT TO TERMINATE THE NON-COMPETITION AGREEMENT

- Government proposal: for situations where the circumstances and the need for a non-competition agreement change during the employment relationship, the employer would have the right to terminate the non-compete agreement.
- Note that the provision itself does not require the existence of certain circumstances in order for the employer to have the right to terminate.
- The notice period is at least 2 months or 1/3 of the competition restriction period, whichever is longer.
- However, the non-competition agreement could no longer be terminated after the employee has terminated the employment contract.
- After the notice period has ended, the employer could not demand compliance with the non-compete obligation nor the employee claim compensation.

# TRANSITION PERIOD

- After a transition period, the new provisions would also apply to non-competition agreements concluded before the reform entered into force.
- One year transition period.
  - Non-competition agreements concluded during 2022 before the reform enters into force may be terminated without notice.
  - Non-competition agreements concluded before the reform enters into force will be subject to the current regulation during the year 2022.
  - Compensation payment started before the reform enters into force is also continued after the transitional period of one year (unusual).

# **IMPACT OF THE REFORM AND PRACTICALITIES**

# REVIEWING EXISTING NON-COMPETITION AGREEMENTS

- It is important for the employer to review existing non-competition agreements in terms of their basis, duration and sanctions.
- Does it make sense economically to pay compensation for a valid/invalid non-compete obligation of an individual employee?
  - It is therefore good to consider the economic significance of existing non-competition agreements after the reform enters into force.
- Please note the transition period.
  - For non-competition agreements concluded before 2022, the terms of those agreements will be complied with in full until 31.12.2022.



# WHAT SHOULD BE CONSIDERED REGARDING EMPLOYMENT CONTRACTS IN THE FUTURE

- In the future, it would be important for the employer to assess in which roles non-competition agreements have been or should be concluded in order to secure the employer's operations.
- The recruitment process should be changed so that the basis and necessity of each non-competition agreement are carefully assessed when concluding employment contracts.
- Securing operations under other terms of the employment contract.
  - Confidentiality obligations
  - Non-solicitation and recruitment obligation.

# TO DO

- Reviewing existing non-competition agreements.
- Termination of unnecessary non-competition agreements.
  - Note that the reform enters into force on 1.1.2022. Prior to this, termination of the agreements has not been made possible.
- Negotiating new employment contracts.
  - Non-competition agreement
  - Confidentiality obligations
  - Non-solicitation and recruitment obligation.
- Reviewing employment contract templates.
  - Non-competition agreement
  - Confidentiality obligations
  - Non-solicitation and recruitment obligation



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