Protecting your business - confidentiality clauses, restrictive covenants & more

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Agenda

- Introduction
- Statutory Protection
- Restrictive Covenants
- Team Moves
- Technical/practical protection
Introduction: Interests to protect

- Confidential information, business and trade secrets (during and after employment)
- (Also Intellectual Property – not covered here)
- Guarding against unfair competition
- Workforce stability
- Clients
- Suppliers
Statutory Protection
Statutory Protection I

- Fiduciary duty during employment: Confidentiality obligation
  - Restricted to trade and business secrets
  - Trade secrets relate to commercial affairs of the company, eg customer lists, sales planning, calculations, strategic plans
  - Business secrets relate to technical affairs eg regarding production processes or service delivery
  - Secret
    - Not obvious
    - Known to a small circle of people
    - Plausible commercial interest of employer in keeping information secret
Statutory Protection II

- **Contractual non-compete**
  - Covers competition **during** employment relationship
  - Not covered: Preparation of future competitive activities
    - Registration of a company by employee
    - Conclusion of employment contract with competitor which comes into effect upon termination of the current employment contract

- **Contractual non-solicit regarding employees**
  - Restriction to entice away employees
  - No protection against mentioning new employment opportunities
  - **Ends on termination date**
Statutory Protection III – criminal offences (17 UWG)

- Disclosure of legitimately obtained trade or business secrets – only during employment relationship
  - Can be criminal offence if for competition purposes, own or third party’s gain or with the intention to inflict damage on company → fine or up to three years imprisonment

- Industrial espionage by employees or third parties
  - *Unauthorised* procuration of trade or business secrets for competition purposes, own or third party’s gain or with the intention to inflict damage on company by use of technical equipment, removal of relevant objects etc
  - Also if legitimately obtained but not returned after termination, eg customer lists
  - Not applicable where employee simply remembers information
  - Possible criminal liability of new employer if intentionally makes use of such information

→ Criminal complaint needs to be lodged

- Claim for damages → (P) Damage amount
- Injunction
Restrictive Covenants
Confidentiality

- Post-contractual confidentiality obligation after termination – needs to be agreed
  - Identify confidential information carefully
  - Instruction to keep information confidential in writing
  - “Catch-all” provision is not valid
  - Balancing between employee’s and employer’s interests
  - Combination with contractual penalty possible

Possible wording of contractual confidentiality clause:

The Employee undertakes to keep confidential all the Company’s company and business secrets. The duty of confidentiality also extends to matters of other firms with whom the Company is commercially or organisationally connected. The duty of confidentiality applies also to confidential information of the Company’s clients. The Employee is also obliged to keep confidential such information, which is explicitly disclosed to him by the management as being confidential or if the need to keep them confidential is otherwise evident for him.

A breach of the duty of confidentiality agreed here can justify termination and lead to a liability to pay damages. In addition, it is pointed out to the Employee that betrayal of secrets is also punishable under the Unfair Competition Act (Gesetz über den unlauteren Wettbewerb - UWG) (Section 17 UWG).

This obligation to keep confidential also continues after the employment relationship has terminated.
Post-contractual non-solicit

- Post-contractual non-solicit regarding employees – needs to be agreed
  - Not effective if ex-employee sets up own business
  - Compensation not required
  - Maximum period of two years
  - Combination with contractual penalty possible

- Possible wording of contractual clause:

  In case of the termination of the employment relationship, the Employee warrants not to entice away or solicit employees of the Company and/or associated companies of the Company for a duration of two years. The foregoing clause only applies to the extent permissible pursuant to Section 75 f of the German Commercial Code (Handelsgesetzbuch - HGB).

- Post-contractual non-solicit regarding customers/suppliers
  - Legal rules on post-contractual non-compete apply!
Post-contractual non-compete I – general principles

- Post-contractual non-compete should be included in the employment agreement
  - Contractual obligation to sign post contractual non-compete upon request of employer is difficult to enforce (controversial)
    - Can be enforceable if details already stipulated and employer may no longer exercise option after notice given/termination agreement signed
  - Non-compete can be agreed at any time, but it is not recommendable to rely on this option
    → Alternative: Make promotion contingent upon signing a non-compete

- Material conditions
  - Maximum period of 2 years
  - In writing
  - Compensation
  - Legitimate interest of employer
  - Handover signed document to employee!
Post-contractual non-compete II – cost

What does it cost?

- Compensation required amounting to a minimum of 50 percent of the last remuneration ("all-in")
- A lower compensation results in an unbinding non-compete – precise wording of clause!!!
- Remuneration by another employer is credited up to
  - 110 percent or
  - 125 percent (if employee was forced to relocate) of last salary

Example:

Previous monthly total comp: 10,000
Normal non-compete compensation: 5,000
New remuneration: 8,000
Actual non-compete compensation: 10,000 + 1,000 – 8,000 = 3,000
Post-contractual non-compete III – scope and validity

- **Commencement/end**
  - Only after expiry of probationary period?
  - Expiry if employee retires?

- **A legitimate business interest is required in relation to**
  - the scope of the restrained competitive activity (industry/business area)
  - the scope of protected clients, customers, suppliers and employees
  - geographical scope

- **Partially non-binding non-compete**
  - If the scope of the non-compete is beyond the legitimate interest of the employer, the non-compete is reduced to the legitimate part
    - Blue pencil test
  - Employee has to comply to the extent non-compete is legitimate
Post-contractual non-compete IV – validity

- Void non-compete
  A void non-compete is not effective. Neither party can derive any rights from it
  - Verbal non-compete
  - No compensation at all

- Worst case scenario: Unbinding non-compete
  - Cannot be unilaterally enforced by employer
  - Employees can opt to comply with non-compete against promised compensation or can opt to compete
    - Non-compete beyond 2 years
    - Conditional non-compete (e.g. upon request of employer)
  - No legitimate interest of employer at all
  - Insufficient non-compete compensation
  - Employee has to make decision upon termination
Post-contractual non-compete V – cancellation

- Amicable cancellation at any time
  - Often in compromise agreement; recommended to stipulate explicitly

- “Ordinary” unilateral cancellation by employer
  - Only before termination, e.g. in notice letter
  - Comes into effect after 1 year
  - Employee is immediately free to compete with employer
  - Employer has to pay the compensation during the one year period if employee leaves
    → Constantly review whether non-compete is indeed necessary!

- “Extraordinary” unilateral cancellation by employer
  - Dismissal without notice: within one month in writing

- Unilateral cancellation by employee: within one month in writing or whole duration
  - Resignation without notice by employee
  - In case of dismissal for operational reasons (rare in practice!) → employer can only prevent by offering non-compete compensation of 100% at time of dismissal
Post-contractual non-compete VI – drafting

- Flexible wording required to cover future developments
  - Non-compete probably in force during the complete employment
  - No automatic adjustment of non-compete if employee is promoted, transferred to another role/region, etc
  - Relevant laws/case law might change
  - Technical progress, change of business model etc

- (P) German rules on General Terms and Conditions
  - Provisions have to be clear and precise
  - If wording could be interpreted in a way which does not comply with law, the non-compete might be invalid
  - “For and in consideration of the compensation to be paid”

→ A non-compete agreement should be tailored to the individual circumstances, do not use UK/US style agreements!
Drafting non-competes – general principles

- Limit to industry / business area / region in which the person was engaged during the last two years
- Maximum period of two years
- No legitimate interest to include all competitors of employer if employer is engaged in various areas
- Worldwide scope usually not valid
- Not unusual to list (inclusively) competitors to which covenant applies and have ability to update the list
- Stick to the wording of the law to the extent possible
Management of post-contractual non-compete agreements

■ Before commencement date: Non-compete yes or no?

■ During employment: Review!!!
  – Notification of waiver if not required anymore
  – Make promotion/transfer conditional upon signing a non-compete if desired

■ At the end of employment
  – Notification of waiver at the beginning of separation considerations or
  – Send Reminder to employee and
  – Agree scope of non-compete with individual (if possible)

■ Post-termination period
  – Require employees to inform you about new jobs and salary to credit salary against the due compensation
  – Enforcement of non-compete agreements
    – Injunction!
    – (P): Evidence
    – Easier: valid contractual penalties!
Team Moves
Team moves I

- Team moves
  - Jump to the market effect
  - No training period
  - Transfer of know-how

- Principle: Solicitation of complete teams permitted

- Reservation: Intention to cause harm to competitor not permitted
  - Solicitation of employees/teams which are not required for the business
  - Use of unfair methods, eg defamation of old employer
  - Enticement to breach of contract, eg agreeing to cover contractual penalty of employee

- Solicitation during working time
  - Headhunters may approach an employee by phone **once** during their working time
Team moves II – How to protect your personnel

- Work environment
  - Adequate salary
  - Good working atmosphere
  - Strong employer branding/identification

- Notice periods

- Contractual obstacles
  - Post-contractual non compete
  - Non-Solicitation
  - Deferred compensation/retention bonuses
    - New case law: Retention bonuses must not be performance-based
Technical/practical protection
Technical/practical protection

- Ensure access to employees’ e-mail accounts: prohibit private use!
  - Investigation of data theft
  - Access to e-mails of clients when employee has left, is sick, on holiday whatsoever

- General IT security concept, eg
  - USB sticks
  - BYOD
  - Need to know data access

- Raise awareness, eg on
  - Phone conversations in public
  - Confidential work on train/planes
  - No confidential documents outside the office
  - Clean desk policy
Any Questions?
Hot topics in international employment law

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- consistent in level of detail and terminology

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