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International HR Best Practices Tip of the Month

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This Month's Challenge

With a mobile workforce, a multinational employer needs to globalize its non-compete agreements.

Best Practice Tip of the Month

Non-compete Agreements will generally be governed by local law, so a uniform company-wide form probably won't work. Tailor the agreements to the legal requirements where the employees are employed, and check local rulings to see what is considered reasonable in each jurisdiction.

Non-Compete Agreements Need a Local Focus, Even for Global Employers

In the latter part of the eighteenth century, England sought to protect its advantage in textile technology by forbidding the transfer of the plans and drawings of the mill machinery and the emigration of the textile workers. One Samuel Slater, having risen from apprentice to superintendent of one of England's first cotton mills, committed the designs to memory and left for America disguised as a farmer, where he designed and built the first textile mill in America, becoming the father of the American industrial revolution and a very wealthy man.

In the early years of the twenty-first century, the story has changed very little. Employers still seek to ensure that employees do not misappropriate and exploit confidential information for their own benefit, or that of competitors, both during and after the employment relationship. Employers often rely on non-compete agreements to protect their interests and prevent their employees from using valuable confidential information acquired during the course of their employment. Employers struggle to craft these covenants to protect their confidential information while still respecting the conflicting interest of preserving employees' freedom to obtain employment. With an increasingly mobile workforce, there is a strong temptation to rely on a single form of agreement to protect the company, wherever the employees may be found. It is a temptation that should be resisted.

Legal standards governing the enforceability of non-compete agreements differ—often drastically—from one jurisdiction to another. Because the validity of such clauses is governed largely by local laws, multinational corporations cannot rely on a standard, global covenant to be applied to employees no matter where their location. To ensure enforceability, restrictive covenants must be drafted carefully and in compliance with the requirements of the applicable country's laws. While there are several common factors that many countries' courts consider in evaluating the validity of non-compete agreements, the way those factors are analyzed and weighed varies greatly. There is no common denominator that would make one non-compete agreement suitable wherever it might be signed or applied.

Generally speaking, the vast majority of jurisdictions recognize that during the employment relationship employees owe a legally enforceable duty of loyalty to their employers and are not permitted to compete with them during the term of the employment relationship. The major exception to this rule is China. In China, during the employment relationship, employees owe no such duty of loyalty to their employers.

In countries that do recognize the duty of loyalty, the duty typically dissipates upon the conclusion of the employment relationship. To enforce a non-compete obligation upon employees after termination of the employment relationship, therefore, usually requires that a valid non-compete agreement be entered into by the employer and employee. The validity of such agreements depends largely on whether the scope of the activities, time span, and geographical area covered by the provision are reasonable in light of the specific circumstances of the situation. What is deemed reasonable, however, varies depending on the jurisdiction.

In China, the New Labor Contract, which was passed into law in June 2007 and will take effect January 1, 2008, only permits an employer to enforce a non-compete against a former employee for a maximum of two years after the termination of the labor contract. Germany and Spain likewise have a two-year cap on the permissible duration of a non-compete agreement. Italy, on the other hand, has a five-year cap for executive non-compete agreements, and a three-year cap for non-competes enforced against other types of workers.

Additionally, many jurisdictions require monetary consideration for a non-compete agreement to be considered valid. In France, a non-compete agreement must provide for financial compensation to the employee for the loss caused by restrictions on his freedom to work. In Germany, non-compete agreements are binding only if they include a financial component, and in China, the New Labor Contract requires the payment of monthly economic compensation be paid to an employee subject to a non-compete agreement. In the United Kingdom, however, although there is no specific requirement that consideration be provided for a non-compete agreement, the payment of consideration increases the likelihood that the non-compete will be considered reasonable (and enforceable).

Notably, inclusion of a choice of law provision is not a particularly effective means of avoiding the application of local law. Many jurisdictions do not give much weight to choice of law provisions and opt to apply their own law, in the interests of public policy, to the analysis of whether a non-compete is valid. This home-country bias often finds legal support; for example, Article 3.1 of the Rome Convention of June 19, 1980 on the Law Applicable to Contractual Obligations, which is currently in force in the European Union, and which generally allows parties to agree on which law will apply to a contract, specifies that the law chosen cannot deprive an employee who is subject to the agreement of the protection afforded to him by the "mandatory" laws of the host country in which that employee works. Statutory provisions setting forth specific requirements with regard to duration and conditions of validity of non-compete covenants are deemed to fall within the purview of such mandatory rules, which means that employees will typically be subject to the law of the country in which they perform their duties if that law affords a specific protection. As a practical matter, therefore, regardless of the law chosen by the parties, the governing law of the host country where the employee carries out his work is the law that will apply to a non-compete agreement in Europe.

Further, employers should be aware that many jurisdictions will not re-write (or "blue-pencil") overly broad provisions or read into them sufficient restrictions to render them enforceable. In these jurisdictions, if a restriction is too broad, it will simply be void and unenforceable. This is the case in Canada and Hong Kong, for instance. Employers therefore need to take care in crafting these provisions and limiting them to the needs of the specific facts and circumstances of the situation vis-à-vis the employee to whom the restriction will apply.

Employers should also take care, in some jurisdictions, as to how they terminate an employee if they intend to enforce a non-compete restriction against that employee post-termination. In Singapore and Hong Kong, for example, wrongful termination nullifies a non-compete agreement, even if such an agreement is otherwise valid.

Employers would be well advised to exercise caution if implementing global non-competition policies. Both an intimate understanding of local law governing non-compete agreements and a thorough understanding of the business justifications and employment circumstances giving rise to the need for such agreements are required to draft enforceable non-compete covenants. In each jurisdiction, the agreement must be crafted in light of the applicable law and must be tailored to the specific circumstances warranting the non-compete protection.