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THE LEGAL STATUS OF NON- COMPETE AGREEMENTS IN CONTRACT LAW- A COMPARATIVE STUDY

AUTHORED BY - ANSHIKA DHINGRA

Cross-Jurisdictional Analysis: The Legal Landscape of Non-Compete Agreements in Contract Law

ABSTRACT: -

Non-compete agreements have become a common tool for businesses to protect their interests by restricting employees from engaging in competitive activities post-employment. However, the legal landscape surrounding these agreements varies significantly across jurisdictions, leading to complex implications for employers, employees, and the broader economy. This research paper conducts a comprehensive comparative study to analyse the legal status of non-compete agreements in different jurisdictions, focusing on their enforceability, scope, duration, and the balance of interests between employers and employees.

The study utilizes a combination of legal analysis, case studies to examine the origins, evolution, and current trends in non-compete agreement regulations. By comparing and contrasting the legal frameworks in various jurisdictions, including common law and civil law systems, the paper elucidates the divergent approaches taken by different countries and regions. Furthermore, the research investigates the impact of non-compete agreements on innovation, entrepreneurship, labour mobility, and market competition. Through an interdisciplinary approach, incorporating perspectives from law, economics, and sociology, the paper evaluates the effectiveness and efficiency of non-compete agreements in achieving their intended goals while balancing the rights and freedoms of individuals.

Statistics reveal, widespread adoption, with over seventy-eight percent of CEO employment contracts in the United States incorporating a non-compete provision as of 2010. In contemporary business practices, shedding light on their role in protecting proprietary information and fostering competitive advantage. The paper delves into the implications of non-compete agreements for both employers and employees, providing valuable insights into their significance within the broader landscape of employment law and corporate governance.

INTRODUCTION: -

In the Contract Law, there are different facets of legalities and technicalities involved in considering the various parameters of forming a valid contract, employment relationships, indemnity, guarantee, bailment etc.

In the ever- evolving landscape of employment contracts, employers and employees' relations, trade secrets, interpretation of different clauses; the dilemma of deciphering the enforcement of different clauses seems to emerge at every key managerial and personnel level, in almost every contract, impacting all the parties involved. Most prominent of these are Employment Contracts. Employment Contracts provide for terms and conditions of the employment. And in Accordance to that, one of the crucial clauses is: Non-Competition Clause, which has been formulated in the light of concerns related to secrets associated with every organization. **A Non-Competition Clause,** also known as a Non-Compete Clause, is a contractual provision in which an employee agrees not to engage in employment with a competing company or to initiate a similar trade or profession for a designated duration after leaving their current employer. This agreement serves to safeguard sensitive information and trade secrets, preventing former employees from utilizing proprietary knowledge to the detriment of their former employer.[1]

Non-compete agreements trace their origins back to the medieval practice of apprenticeship, wherein an experienced master craftsman would mentor a younger apprentice, providing training and guidance. In certain instances, agreements were made between the master and apprentice, stipulating that the apprentice would refrain from competing with the master upon completion of the apprenticeship. The historical precedent for noncompete agreements dates back to **1414 with Dyer's Case**, where an apprentice named **John Dyer** agreed to abstain from practicing his trade for six months in his training town. The master sought enforcement of this restriction.

However, the modern framework for analysing the enforceability of noncompetition agreements emerged in the landmark case of **Mitchel v. Reynolds**. This case distinguished between contracts "in restraint of trade generally," deemed void, and those limited in time, place, or persons, which were considered valid and enforceable.[2]

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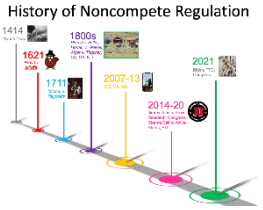
[1] In the **Deshpande v. Arbind Mills Co. case**, a service agreement includes two types of clauses. Firstly, there's a positive covenant, wherein the employee agrees to dedicate their full-time attention to serving the employers. Secondly, there's a negative covenant, which prohibits the employee from engaging in employment elsewhere for the duration of the agreement.
(Oct. 11, 2021), https://faircompetitionlaw.com/2021/10/11/a-brief-history-of-noncompete-regulation/.

Alger v. Thacher, though involving a bakery business sale, further advanced the court's analytical approach established in Mitchel. This approach shaped nineteenth-century courts' treatment of noncompete agreements in employment relationships.



While the legal criteria in various jurisdictions are similar, their application to similar situations can lead to differing outcomes, influenced by the respective public policy considerations.

Section 27 of the Indian Contract Act 1872, reflects the principle that individuals have the right to freely engage in lawful trade or professions, and the law protects against undue interference, even at the expense of contractual freedom.

The Supreme Court of India and various high courts have consistently ruled that negative covenants are only enforceable to the extent that they are reasonable and aim to protect legitimate business interests. These restrictions cannot exceed what is necessary to safeguard those interests[3].

REVIEW OF LITERATURE: -

- **FEDERAL TRADE COMMISSION REPORT (16 CFR Part 910 RIN 3084-AB74 Non-Compete Clause Rule)**

Non-compete agreements have become a contentious issue in employment law, raising concerns about their impact on labour mobility, innovation, and competition. In response to these concerns, federal commission have conducted extensive research and produced reports aiming to understand the implications of non-compete agreements on the workforce and the economy, findings and recommendations from these reports to provide insights into the current state of non-compete agreements.

- **Understanding Non- Competition Agreements: The 2014 Non-Compete Survey Project, (JJ. Prescot, Narman D Bishara and Evan Starr)**

The Non-Compete Survey Project, aimed to comprehensively examine the prevalence and enforcement of non-compete agreements across different sectors and geographical regions. The study surveyed a diverse sample of professionals and businesses to understand the scope and

[3] Regarding employees, Indian courts generally consider restrictions during employment valid and necessary for protecting the employer's business interests. However, controversies arise regarding the enforceability of such restrictions beyond the employment period. Courts have tended to prioritize employees' right to livelihood over employers' interests in such cases. For instance, the Delhi High Court in **Affle Holdings Pte Limited v Saurabh Singh** ruled that a negative covenant preventing an employee from engaging in a competing business after the employment contract's expiration is void and unforceable.

implications of these agreements on employee mobility and market dynamics. The study's findings underscore the need for policymakers to carefully consider the balance between protecting intellectual property rights and fostering competition and innovation. Moreover, it highlights the importance of promoting transparency and fairness in the implementation and enforcement of non-compete agreements to safeguard employee rights and promote economic growth.

- **Employee Non-Competes and Consideration- A proposed Good Faith Standard for Afterthought Agreement (Michael J Garrison)**

The proposed framework mentioned in the article which advocates for a good faith standard for afterthought agreements, seeks to address these inconsistencies by emphasizing the importance of fairness and equitable bargaining in the formation of non-compete agreements. This approach recognizes that employees may agree to non-compete provisions after the commencement of their employment, often in the context of promotions, raises, or other changes in job responsibilities.

RESEARCH PROBLEM AND QUESTION: -

The research problem revolves around examining the significance and validity of non-compete agreements within various contractual frameworks to provide insights for policymakers, businesses, and legal practitioners; analysing and understanding the implementation and validity of these agreements in different types of direct and indirect contracts. To analyse the comprehensive framework of Non-, Compete Agreements and understanding the legal landscape, considering both theoretical perspectives and practical implications.

1. What are the implications of non-compete agreements on competition, innovation, and individual rights?
2. How do variations in the enforceability of non-compete agreements affect the behaviour of employers and employees?
3. What are the potential avenues for reform or harmonization of non-compete laws across jurisdictions?

OBJECTIVES OF RESEARCH: -

1. To analyse the legal framework governing non-compete agreements in different jurisdictions.
2. To evaluate the justifications for enforcing or restricting non-compete agreements, considering competing interests of employers, employees, and the public.
3. To assess the impact of non-, compete agreements on competition, innovation, and individual autonomy.

4. To identify potential reforms or best practices for regulating non-compete agreements in a manner that balances the interests of all stakeholders.
5. To contribute to scholarly understanding and policy debates surrounding non-compete agreements through empirical analysis and comparative research.

DISCUSSION: -

The foundation of modern approaches to restraints in **U.S. employment contracts** stems from the seminal work of Mitchel. Since the early twentieth century, American courts have predominantly applied the "reasonableness" standard to assess the enforceability of non-compete agreements. Notably, California stands out as a prominent exception by outright banning the enforcement of such agreements. In the United States, the enforcement of non-competes is predominantly governed by state law, with states regulating through either statutory provisions or common law principles.

Currently, twenty states have statutes explicitly regulating non-compete agreements, while the remaining thirty regulate them through judicial precedent. The majority of states apply a "rule of reason" to evaluate non-compete agreements, wherein enforceability hinges on the measure of "reasonableness." This standard, as articulated in the Restatement (Second) of Contracts, requires that a non-compete agreement (1) be no more restrictive than necessary to protect the employer's legitimate interests, (2) not unduly burden the employee, and (3) not be injurious to the public.

Central to the enforceability of a non-compete agreement is the concept of a "protectable business interest." U.S. courts typically require employers to demonstrate a legitimate business interest warranting protection through the non-compete agreement. Failure to establish such an interest renders the agreement unenforceable. However, delineating between protectable[4] and unprotectable business interests often poses challenges due to the ambiguity surrounding the distinction. [5]Between 28% and 47% of US private-sector workers are subject to non-compete clauses.

[4] **Protectable interests**: Customer contacts, trade secrets and other confidential information are interests protectable by a covenant not to compete.
[5] Nuna Zekić, *Non-compete clauses and worker mobility in the EU*, Global Workplace Law & Policy (Nov. 30, 2022), https://global-workplace-law-and-policy.kluwerlawonline.com/2022/11/30/non-compete-clauses-and-worker-mobility-in-the-eu/.

In ancient **China,** a proverb stated, "When an apprentice learns the skill, his master will starve," illustrating the competitive dynamic between apprentices and masters prevalent in the pre-reform era. This traditional economic structure began to shift with China's gradual adoption of Reform and Policies.

Article 24 stipulates that non-compete obligations only apply to senior management, senior technicians, and individuals with confidentiality responsibilities. The specifics of these obligations, including scope, geographical limits, and duration, are subject to agreement between the employer and the employee, provided they comply with relevant laws and regulations.

In contrast to the United States, where the Uniform Trade Secrets Act (UTSA) is widely adopted, China lacks a unified trade secret law, relying instead on various scattered regulations. Consequently, there is no consistent legal framework governing trade secrets in China.

Regarding constraints on an employee's occupational freedom, Chinese law, particularly Article 23 of the Labor Contract Law, allows for the inclusion of confidentiality provisions in labour contracts related to intellectual property. While the law permits employers to enter into non-compete agreements with employees, it does not explicitly mention the concept of "protectable business interests."

[6]Across Europe, the requirements for the validity of non-competition agreements between employers and employees vary significantly, with distinct regulations in countries such as Italy, Germany, France, Poland, the Netherlands, and the UK, nuances existing in different jurisdictions.

ITALY: -

- **Form:** Written form is obligatory, typically integrated into the employment contract or as a separate agreement.
- **Restricted Activity:** Specificity in indicating the restricted activity is mandatory, focusing on a particular industry sector.
- **Geographical Limitation:** A specific geographical limitation must be stipulated, avoiding overly broad restrictions.

[6] https://www.nortonrosefulbright.com/en/knowledge/publications/9807eea3/a-comparison-of-laws-in-selected-eu-jurisdictions-relating-to-post-contractual-non-competition-agreements-between-employers-and-employees.

- **Length of the Prohibition:** The maximum duration is capped at 5 years for executive-level employees and 3 years for others.
- **Compensation:** Fair and adequate compensation is mandatory, determined based on scope, duration, and geographical limitation.
- **Right of Withdrawal:** Employers cannot unilaterally withdraw from the non-compete covenant.

GERMANY: -

- **Form:** Written form is obligatory, along with providing the employee with a signed copy of the contract.
- **Restricted Activity:** The covenant must be reasonable and aimed at protecting the company's legitimate interests.
- **Geographical Limitation:** It should be reasonable and typically restricted to the company's local area of operation.
- **Length of the Prohibition:** Limited to a maximum of two years after termination, with compensation required.
- **Compensation:** Compensation must be at least 50% of the employee's most recent contractual remuneration.
- **Right of Withdrawal:** Employers can waive the prohibition before termination by providing a written statement.

FRANCE: -

- **Form:** Written form is mandatory, usually integrated into the employment contract.
- **Restricted Activity:** Limited to protecting the company's legitimate interests and specific activity.
- **Geographical Limitation:** Must be reasonable and not overly broad, considering the company's activity and employee duties.
- **Length of the Prohibition:** Cannot be excessively long, with some sector-wide collective bargaining agreements providing maximum lengths.
- **Compensation:** Specific compensation, not derisory, is obligatory, often calculated as a percentage of the average base salary.
- **Right of Withdrawal:** Employers can withdraw from the non-compete clause under certain conditions.

POLAND: -

- **Form:** Written form is obligatory, either as a separate agreement or part of the employment contract.
- **Restricted Activity:** The scope should relate to the employer's actual or planned activities, without unduly restricting the employee's rights.
- **Geographical Limitation:** Not mandatory but should not exceed the employer's present or planned activities.
- **Length of the Prohibition:** No specific limits, but excessively long periods may be deemed void by courts.
- **Compensation:** Minimum compensation equal to 25% of the employee's salary is mandatory.
- **Right of Withdrawal:** Employers and employees can agree on conditions for terminating the non-compete covenant.

THE NETHERLANDS: -

- **Form:** Written form is mandatory, with certain requirements for fixed-term employment contracts.
- **Restricted Activity:** Should specify prohibited activities, with the court having the power to mitigate the scope.
- **Geographical Limitation:** Not mandatory, but the court can mitigate the geographical scope if necessary.
- **Length of the Prohibition:** No statutory maximum, but one year is generally accepted as reasonable.
- **Compensation:** Not mandatory but may be awarded by the court if opportunities for finding other work are restricted.
- **Right of Withdrawal:** Employers can unilaterally waive the covenant, and the court can annul or mitigate it.

THE UK: -

- **Form:** No mandatory formalities, but the covenant should be expressly contained in the employment contract.
- **Restricted Activity:** Specificity in defining the non-compete restriction increases enforceability.

- **Geographical Limitation:** Not mandatory, but geographic restrictions may enhance enforceability.
- **Length of the Prohibition:** Generally, between six and 12 months, with longer durations unlikely to be enforceable.
- **Compensation:** No specific consideration required, but normal salary/benefits may suffice.
- **Right of Withdrawal:** Employers can waive restrictive covenants, and employees are no longer bound if the employer breaches the contract.

In Canada, non-compete agreements, also known as restrictive covenants, are recognized and enforceable under contract law, but their validity is subject to certain conditions. Non-compete agreements are generally enforceable in Canada if they are reasonable in scope, duration, and geographic extent. Courts will examine the language and intent of the non-compete agreement to determine if it is reasonable and necessary to protect the employer's legitimate business interests. Factors such as the nature of the employer's business, the employee's role, and the geographic area covered by the agreement will be considered.

In the case of Elsley v. J.G. Collins Insurance Agencies Ltd. (1978), the Supreme Court of Canada established the principle that non-compete agreements are enforceable if they are reasonable and necessary to protect the employer's legitimate business interests.

In the case of Lyons v. Multari (1996), the Ontario Court of Appeal emphasized that non-compete agreements must be tailored to the specific circumstances of each case and should not be broader than necessary to protect the employer's legitimate interests. The court held that an overly broad non-compete clause would be unenforceable.

In the case of Payette v. Guay Inc. (2013), the Quebec Court of Appeal held that a non-compete clause that covered an excessively broad geographic area was unenforceable. The court emphasized the importance of limiting the scope of the restriction to areas where the employer actually conducts business.