Overview of the non-competition clause in French employment law

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Introduction:

As the UK and the USA governments work to regulate - if not ban - non-competition clauses in their respective labor markets to enable workers to more easily find jobs or create their own businesses, this topic does not attract the headlines in France, where the use of such provisions has long been restricted in the context of employment relationships.

Under French law, while performing the employment contract or the corporate office, the employee or the corporate officer (for better understanding of the legal difference please refer to our previous article available here) is legally bound by an obligation of loyalty prohibiting them, in particular from creating or performing an activity in competition with an activity of the employer. However, immediately upon termination of the employment contract or the corporate office, the employee or corporate officer has complete freedom in terms of who to work for and where to work, including the right to compete with the former employer or company, provided such activity does not constitute an unfair competition which is prohibited by the civil law (e.g. passing off) or result in serious damage to the former employer's business (e.g. when the ex-employee takes other key employees with him or her which impact on the company's ability to continue to operate).

Such competition, even if fair, can be detrimental to the company concerned, particularly when the competitor is a former key employee or corporate officer who had access, during the performance of the employment contract or corporate office, to sensitive or confidential information or who acquired specific know-how.

This is why many businesses want to be able to protect their legitimate, commercial interests with a non-competition clause that applies upon termination of the employment agreement or the corporate office and regulating - if not preventing - competition from the former employee or corporate officer.

In determining the validity of such a restrictive covenant French labor law counsel have to balance the legitimate protection of a business's interests on the one hand and the individual's constitutional right of freedom to work on the other guided by French case law which will validate this kind of restrictive covenant if the court is satisfied that it is justified, proportionate and financially compensated.

This is an important aspect of French legal counsel's role in drafting or advising on non-competition obligations in employment relationships notably in the context of an M&A transaction (our previous article available here). This task is increasingly more difficult as result of the significant changes in the French labour market (such as the home office (*télétravail*) and

Marie-Emilie Rousseau-Brunel | Employment law Partner
Astrid Brébant | Employment law Associate

globalisation) and the fact that the enforceability of the clause will be determined at some future date when the circumstances may have changed.

What are the conditions for a compliant non-competition clause in employment relationships?

The existence of a non-competition clause must be expressly provided for in the employment contract.

As the non-competition clause must not deprive the employee of the possibility to find another job in line with his/her training and professional experience, French case law also requires the following substantive conditions.

First, the non-competition clause must be essential to protect the company's legitimate interests. This requires the employer to prove that because of the role undertaken by the employee (e.g. requiring the employee to have contact with company's clients, access to the company's confidential or sensitive information or specific know-how, etc.) the company would be likely to suffer damages if the employee were to work for, or create, a competing company. Based on this requirement, the French Supreme Court has for example considered that a non-competition clause provided for in the employment contract of an employee performing the duties of a "window cleaner" wasn't essential for the protection of the company's interests.

Second, the non-competition clause needs to be limited in time and space with neither being fixed by regulation or case law although they may be provided for in the applicable collective bargaining agreement. The temporal and geographical scopes must be determined in the employment contract, in a way that does not disproportionately affect the employee's freedom to work. For certain the duration of the clause must be reasonable (and this will rarely be more than 2 years for an employee and 5 years for a corporate officer) and its geographical scope must not be too broad (e.g. the area should be proportionate to the geographic coverage of the company's activities or the geographical areas where the employee's activities are carried out).

Third, since 2002, the non-competition clause must provide for a financial compensation (see below).

Fourth, the non-competition clause has to be sensitive to the particular circumstance of the employee and the job he or she has been performing. If the employee has been solely educated, trained and involved in a specific function, a clause that would operate to prohibit that employee from performing the same function in another company would be tantamount to him or her being unable to work, and so would very likely be void.

These conditions are cumulative.

Do these conditions apply if a non-competition clause applies to someone other than an employee?

Non-competition clauses can also apply to commercial relationships (e.g. service providers, franchisees, etc.) or to a corporate officer or a shareholder.

The conditions that determine the validity of a non-competition clause under French commercial law and French labor law are similar, other than the requirement for financial compensation, which only applies in the case of an employment relationship.

This difference in regime may raise difficulties in the case of a dual status (e.g. an employee who is also a corporate officer or an employee who is also a shareholder) as it may indirectly lead to the imposition on an employee, who has a dual role as shareholder or a corporate officer, of a non-competition obligation under the shareholder agreement or the articles of association of the company, but without financial compensation.

This is why, in a decision of 15 March 2011, the French *Court of Cassation* aligned the conditions of validity of a non-competition clause provided for in a shareholders' agreement or the articles of association with those applicable to a non-competition clause provided in an employment contract, when the shareholder is an employee.

Accordingly, in the case of dual status, the employee status prevails and the non-competition clause must provide for financial compensation even when it's provided for in a shareholder agreement or in the articles of association, otherwise the clause is void. Care needs to be taken when dealing with a non-competition obligation applicable to a shareholder or corporate officer who is also an employee.

How is the financial compensation of the non-competition clause determined?

In principle, the amount of the financial compensation is fixed by agreement between the employer and the employee, subject to (i) the compliance with the provisions of the applicable collective bargaining agreement if they are more favorable to the employee and (ii) the proportionality with the constraints binding on the employee. French case law considers an insignificant financial compensation to be equivalent to an absence of financial compensation.

In practice, the amount of the financial compensation is determined by taking into account the level of the imposed restriction and the related difficulties for the employee who is bound by a non-competition obligation to find a new job. Generally, it usually corresponds to a percentage of the employee's monthly salary and must be paid after the employment contract's termination by a lump sum payment or a monthly payment for the duration of the clause.

In practice, the amount of the financial compensation is generally between 30% and 40% of the employee's monthly salary but may be increased or reduced depending on the scope of the non-competition clause.

Can an employer waive compliance with the non-competition obligation in the employment contract?

When an employee leaves a company, whether the employer can waive the benefit of a non-competition obligation in the employment contract (and in particular to avoid payment of the financial compensation) depends on the terms and conditions of the contract.

It is important to ensure that the non-competition clause provides for the employer's right to waive the non-competition obligation without the prior written consent of the employee.

When a right to waive is provided for in the contract the employer has a "*reasonable*" period within which to inform the employee of the non-application of the restrictive covenant ending on the employee's last day of work which can occur quickly in absence of a notice period. The late exercise by the employer of the waiver is not effective and the employee will be entitled to ask for the application of the non-competition obligation and payment of the financial compensation.

Because of this rule, we usually recommend that our clients waive the non-competition in the termination notification (or during any notice period) or upon receipt of a resignation letter.

What are the consequences of non-compliance with the rules applicable to a non-competition clause in an employment contract?

A non-competition clause which does not meet all the above-mentioned conditions is void, but only the employee is allowed to invoke this nullity.

If the clause is found to be void, the employee is then released from the non-competition obligation.

If the employee has complied with a clause that is later found to be void, he/she is entitled to damages, provided that he/she can prove his or her compliance resulted in a loss.

It is also possible that the clause may be considered as excessive, since a finding that temporal and geographical scopes are too long or too wide, will allow the judge to adapt the clause to restrict its application. However, when the clause doesn't meet the conditions relating to the financial compensation or the protection of the company's legitimate interests the only outcome will be that the clause is void.

What are the consequences for an employee who is in breach of a valid non-competition obligation?

An employee who breaches a valid non-competition clause may be ordered by the judge through urgent proceedings (an injunction) to stop carrying out the competing activity and, if necessary, under penalty.

The employee also loses the right to benefit from the financial compensation and must reimburse the sums paid by the former employer in this respect, except those corresponding to the time during which he/she respected the clause.

The breach of the non-competition clause may also give a right to compensation for the damage suffered by the former employer. On this point, the employment contract should include a provision for liquidated damages, it being specified that the judge can adjust the amount if considered excessive.

Is the new employer at risk of being held to be complicit in the breach by the employee?

If the former employer can prove that the new employer was knowingly involved in the breach of a valid non-compete clause by its new employee, the new employer may be jointly and severally liable with the employee to the former employer for the damages resulting from the breach of the non-competition clause. The existence of this risk should encourage companies to ensure before hiring a new employee that he or she is not bound by a valid non-competition undertaking with their former employer.

In conclusion, whilst a non-competition clause is a tool available to companies in order to protect their interests after key employees' departure, it should be used with caution since its effectiveness is dependent on compliance with certain mandatory conditions and must at the same time respect the fundamental right of employees under French law to be able to work in accordance with their skills.

Since the introduction of the mandatory payment as consideration for the non-competition obligation, we have seen a reduction in the use of non-competition clauses in employment contracts and as explained above, the effects of local and global changes to the labor market suggest that the task of the French labor law counsel in drafting bullet-proof non-compete clauses is likely to become increasingly difficult.

Marie-Emilie Rousseau-Brunel
Employment law Partner
Vivien & Associés, Paris

Astrid Brébant
Employment law Associate
Vivien & Associés, Paris