

# Comparison of post-employment restraints in South Africa, England and Germany

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**DECLARATION:**

I, the undersigned, hereby declare that the work contained in this study project is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Date: 28.10.2003

For Rainer and Ulrike,  
with love and gratitude

**ABSTRACT:**

This dissertation deals with restraints in post-employment cases in England, South Africa and Germany. The attempt was made to compare the restraint of trade doctrine that was developed in England and is still used in the common law countries, on one the hand, and the German restraint of trade rules on the other.

Therefore the development of the restraint of trade doctrine in England is described, as well as the modifications of the restraint of trade doctrine in South Africa. Also it is given an overview of the German restraint of trade rules.

As far as the English and South African law is concerned, the historical developments and applicable principles of the restraint of trade doctrine are emphasised, whereas the main aim in the German part is to give an overview about the codified restraint of trade rules.

While comparing the common law doctrine and the German restraint of trade law it is emphasised that in the common law countries the reasonableness and public interest plays an important role, whereas in German restraint of trade law, on the other hand, the payment of compensation is an important matter.

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## COMPARISON OF POST-EMPLOYMENT RESTRAINTS IN SOUTH AFRICA, ENGLAND AND GERMANY:

### PREFACE

Throughout the world one finds restraints of trade. In some countries a codified body of law regulates different restraints, in others ancient principles and judgements achieve this.

In the common law system you have to deal with the “restraint of trade doctrine” that has been developed over the past few centuries.

Due to this doctrine contracts concerning labour law can be subject to these restraint rules. In particular restraints during an employment, after an employment and in anti-poaching cases have to comply with this doctrine. The doctrine applies also to restraints of trade where land is leased out or in cases of sale of business. In cases like the *George Michel case*<sup>1</sup> the doctrine is also applicable, where an artist is restrained.

Whereas Germany is a country where the law basically is codified, and therefore the restraint of trades rules are laid down in different acts. A general rule covering the whole range of topics, like the restraint of trade doctrine does, has never existed in Germany. Rather the principle of restraint of trade law appears in many different statutes.

For instance the law of restraints during employment is laid down as a basic rule in the Civil Code. The law of post-employment restraints for commercial agents and commercial employees is laid down in the Commercial Code. To solus agreements sec. 242 Civil Code is applicable. Anti poaching contracts are void due to sec. 611, 138, 242 Civil Code.

The scope of this dissertation is to present on the one hand an overview of the English and South African restraint of trade doctrine as examples of common law jurisdictions, and on the other hand an overview of the German restraint of trade rules.

Furthermore the focus of this dissertation is on the post-employment restraints in these three countries. The main aim is to describe the fundamental and structural similarities and differences of the three legal systems.

Unfortunately many interesting topics have to be left out, like anti-poaching contracts, as well as remedies in all three legal systems or the restraint of trade law of commercial agents in the German system.

Despite this limitation, an attempt has been made to compare most of the different aspects of restraint of trade occurring in the context of employment in the different countries.

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<sup>1</sup> *Panayiotou v Sony Music Entertainment Ltd* [1994] EMLR 229.

## **PART I: THE DEVELOPMENT OF THE RESTRAINT OF TRADE DOCTRINE IN THE COMMON LAW SYSTEM**

The modern Restraint of Trade Doctrine was mainly developed, and the main principles settled in a number of major cases at the end of the 19<sup>th</sup> and the beginning of the 20<sup>th</sup> centuries.<sup>2</sup> However, the roots of the doctrine went much deeper.<sup>3</sup>

### **1. DEVELOPMENT DURING MEDIEVAL TIMES:**

Though the modern doctrine operates mainly in the area of negotiated contracts, it was formed partly as a result of the law's response to three other problems during medieval times. They were firstly, the attempts of private individuals to make a profit by interfering with food supplies, secondly, the attempt of guilds to regulate the economic affairs of their members and thirdly, grants of monopolies by the Crown. These problems raise different issues; and public opinion has not been unchanging with regard to them. However, until the late sixteenth century the common law was not much concerned with those issues.<sup>4</sup>

#### **1.1. INTERFERENCE WITH FOOD SUPPLIES**

During medieval times salesmen tried to dominate parts of the "food markets". As a result many medieval statutes were enacted to prevent private individuals having exclusive control over the price of goods, particularly food.<sup>5</sup> In 1552 the most elaborate of these statutes defined the criminal offences of forestalling, regrating and engrossing in detail. These offences all have in common that the goods were purchased by middlemen before they reached the retail markets so that the retail price was artificially increased. In the late eighteenth century the Act was repealed. Nevertheless some of the underlying general policies are the same and they made little particular contribution to the development of the modern restraint of trade doctrine.<sup>6</sup>

#### **1.2. POWER OF THE GUILDS**

More important was the activity of the guilds in those times. During medieval times two principal kinds of guilds existed. Firstly, freemen formed associations in towns with exclusive rights of trading within them. The second was an association of persons exercising the same trade. Both kinds of guilds have in common that they existed to protect their members' interests. They developed statutes to regulate their markets. In the main, that led to a reduction of competition of members with one another and, by repressing competition from "outside-traders", with people who did not belong to that

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<sup>2</sup> Nordenfeldt v Maxim Nordenfeldt Guns and Ammunition Co, [1894] AC 535; Mason v Provident Clothing and Supply Co, [1913] AC 724; Herbert Morris Ltd v Saxelby, [1916] 1 AC 688.

<sup>3</sup> The history is discussed in: JD Heydon, "The Restraint of Trade Doctrine" (1999) 1 – 27, Anon., "Of Contracts Operating in Restraint of Trade" (1837), 21 Law Magazine 306; JM Kerr, "Contracts in Restraint of Trade" (1888), 22 Am. L.R. 873; Sanderson, Restraint of Trade in English Law (1926) 7 – 47, 94 – 9.

<sup>4</sup> JD Heydon, op cit p 2.

<sup>5</sup> Cf. RO Wilberforce, A Campbell and N Elles, "The Law of Restrictive Trade Practices and Monopolies" (1966) paras. 115-24.

particular town or guild. The great power of guilds stemmed from their right to demand that only guildmen could trade, and from the fact that the entry to the guilds was regulated by the guilds themselves.<sup>7</sup> The first important restrictions of the power of the guilds came at the end of the sixteenth century.

For instance in *Davenant v. Hurdis (The Merchant Tailor's Case)*<sup>8</sup> the King's Bench had to consider the validity of a by-law made by the Merchant Tailors' guild in an attempt to strengthen its position against the Clothworkers' Guild, requiring members who put out cloth to be finished by outside labour to have an equal amount finished by other members. The by-law was held void as tending a monopoly: "a rule of such nature as to bring all trade or traffic into the hands of one company, or one person, and to exclude all others, is illegal".<sup>9</sup> Within the following years some other cases had to be judged, like the *Gowby v. Knight*<sup>10</sup> or *Ipswich Tailors' Case*,<sup>11</sup> where similar rules were declared void and brought all sorts of repressive restrictions and manorial customs to an end. The law of guilds then stood like this until the law of restraint of trade was reviewed in the early eighteenth century in the important case of *Mitchel v. Reynolds*.<sup>12</sup>

### 1.3. ROYAL GRANTS OF MONOPOLIES

Medieval kings commonly made grants of monopolies for particular purposes; indeed in the sixteenth century the technical meaning of monopoly was generally limited to royal grants. One type of royal monopoly grant was to guilds, which made by-laws in restraint of trade by royal authority. Another type of monopoly grant purported to protect inventors of new manufacturing processes in the same way as the modern patent. These were introduced into England from Italy in the later seventeenth century, and were used by the Crown to raise revenue without Parliamentary sanction and without regard as to whether a genuine invention had in fact been made.<sup>13</sup> Later these grants were rejected and in *Darcy v. Allen*<sup>14</sup> the grant was held void as against various statutes, but more importantly, as contrary to common law.

## 2. CONTRACTUAL RESTRAINTS BEFORE MITCHEL V. REYNOLDS

The earliest reported case concerning a contractual restraint of trade is the *Dyer's Case*.<sup>15</sup> The defendant entered a bond not to practice the trade of dyer in a certain town for half a year. He pleaded no breach, and won on this point. But HULL J, also said that he could have demurred

<sup>6</sup> JD Heydon, op cit p 3.

<sup>7</sup> Ibid.

<sup>8</sup> (1598) Moore, KB 576.

<sup>9</sup> Ibid, p 591.

<sup>10</sup> (1601), Noy 183.

<sup>11</sup> (1614), 11 Co Rep 53.

<sup>12</sup> (1711), 1 P Wms 181.

<sup>13</sup> JD Heydon, op cit pp 5-6.

<sup>14</sup> (1602) 11 Co Rep 84.

<sup>15</sup> 2 Hen 5, f 5, pl 26 (1414).



as the bond was illegal; “By God, if the plaintiff were here he should go to prison until he paid a fine to the King.” It is still unclear what made HULL J make this severe statement. It is suggested that restraints in bonds were intrinsically more oppressive than in other contracts and were more likely to be struck down. Another suggestion is that *Dyer’s Case* does not depend on “any special vice in the bond [but reflects a general] medieval view [...] that any restraint upon the freedom of a man to carry on his trade or profession was completely void.”<sup>16</sup> The key to this case seems to lie in the great hardship involved,<sup>17</sup> but on the other hand side restraints were also held valid, e.g. in *Rogers v. Perrey*,<sup>18</sup> where the defendant promised the plaintiff, his landlord, that he would not practice his trade of joiner in a shop leased to him for twenty-one years.

### 3. MITCHEL V. REYNOLDS

As mentioned above, cases before *Mitchel v. Reynolds* were dominated by political upheaval and personal hardship. Compared with this, *Mitchel v. Reynolds* made matters clearer. The defendant had assigned the lease of a bakehouse to the plaintiff for five years, and gave a bond undertaking to pay a penalty if he worked as a baker during that term. The court found for the plaintiff because there was “a special consideration [...] set forth in the condition, which shows it was reasonable for the parties to enter into it”;<sup>19</sup> but the actual decision is less important than PARKER CJ’s masterly review<sup>20</sup> of trade restraints, whether imposed by contract, royal charter, custom, or by-law, in his attempt to “reconcile the jarring opinions”.<sup>21</sup> PARKER CJ dogmatically pointed out the existence of two kinds of restraints; firstly involuntary and secondly voluntary restraints.

#### 3.1. INVOLUNTARY RESTRAINTS

The involuntary restraint can be split up into three further categories. The first comprised those depending on grants or charters from the Crown. These were generally void,<sup>22</sup> except grants to a guild of exclusive rights of admission to a trade,<sup>23</sup> and some others.<sup>24</sup> The second category depended on customs: “All customs that restrain liberty of trade, must be clear and plain, and not doubtful”.<sup>25</sup> Lastly, the third class of involuntary restraints comprised those stemming from a by-law. These were valid if supported by a reasonable custom to the same effect, or if made to restrain trade, in order to the better government and regulation of it.<sup>26</sup>

<sup>16</sup> JD Heydon, *op cit* p 7.

<sup>17</sup> as PARKER CJ stated in *Mitchel v. Reynolds*.

<sup>18</sup> (1614), 2 Bulst 136.

<sup>19</sup> (1711), 1 P Wms 182.

<sup>20</sup> JD Heydon, *op cit* p 9.

<sup>21</sup> *Ibid.*

<sup>22</sup> *Darcy v Allen* (1602), 11 Co Rep 84b.

<sup>23</sup> *Norris v Staps* (1616), Hob 210.

<sup>24</sup> Cf. JD Heydon, *op cit* p 9.

<sup>25</sup> *Colchester Corporation v Goodwin* (1667), Carter 68, 114.

<sup>26</sup> (1711), 1 P Wms 181, 184.

In summary PARKER CJ laid down a simple rule: “General restraints are all void, whether by bond, covenant or promise, ..., with or without consideration, and whether it be of the party’s own trade, or not ... Particular restraints ... without consideration ... are void by what sort of restraint soever created ... Where a contract for restraint of trade appears to be made upon a good and adequate consideration, so as to make it a proper and useful contract, it is good”.<sup>27</sup>

### 3.2. VOLUNTARY RESTRAINTS

According to PARKER CJ voluntary restraints must have a different basis from involuntary restraints. Therefore he stated that the true reasons why the law frowned on voluntary restraints were as follows: First, a contract of restraint of trade causes the covenantee to lose his livelihood and brings suffering to his family. Secondly, it deprives the public of a useful worker. Thirdly, such contracts can be abused to give covenantees unfair advantages like masters trying to protect themselves from future competition from their apprentices.

On the other hand, the law frequently upholds restraints which are “useful and beneficial, as to prevent a town from being overstocked with any particular trade”.<sup>28</sup>

Lastly, PARKER CJ pointed out that the public interest was not affected in *Mitchel v. Reynolds*. The only issue was whether the plaintiff or the defendant should be the local baker; in any event there would be a baker. Furthermore the contract was reasonable particularly because the restraint was “exactly proportioned to the consideration, *viz.* the term of five years”.<sup>29</sup>

## 4. THE LATER DEVELOPMENT OF THE DOCTRINE

“There is very little in the modern approach to the problem for which a basis cannot be found” in PARKER CJ’s opinion.<sup>30</sup> But some points of principle were left obscure by him,<sup>31</sup> and some more detailed principles have been developed, mainly during the early nineteenth century, when a flood of litigation had to be judged.

### 4.1. REASONABLENESS

The restraint of trade doctrine arose for consideration mainly in connexion with three kinds of contracts. Restraints were reasonable if they protected the goodwill of a business after its sale. Such a restraint was validated in *Mitchel v. Reynolds*,<sup>32</sup> though problems arose in courts of equity.<sup>33</sup> Secondly, contracts were reasonable if they did no more than

<sup>27</sup> (1711), 1 P Wms 181, 185-6.

<sup>28</sup> 1 P Wms 181, 191.

<sup>29</sup> *Ibid.*, p 197.

<sup>30</sup> Blake, “Employee Agreements not to Compete” (1960), 73 Harv LR 625, 630-1.

<sup>31</sup> JD Heydon, *op cit* p 13.

<sup>32</sup> (1711), 1 P Wms 181.

<sup>33</sup> Cf. JD Heydon, *op cit* p 15.

prevent an employee from competing against his employer during or after the employment.<sup>34</sup> Thirdly, contracts were reasonable if they prevented a partner from competing against the partnership during or after it.<sup>35</sup>

But also another issue that was settled during the nineteenth century was that the courts would not investigate the adequacy of the consideration provided for a restraint, as they had had to do before. Some courts began to question the restraints utility because of the difficulty of determining adequacy<sup>36</sup> and in *Hitchcock v. Coker*<sup>37</sup> a new approach was adopted by TINDAL CJ, in the court of Exchequer Chamber, revising the Court of King's Bench. The question is not "whether the consideration is equal in value to that which the party gives up or loses by the restraint under which he has placed himself...".<sup>38</sup> The true test is whether "the restraint of a party from carrying on a trade is larger and wider than the protection which the party with whom the contract is made, can possibly require."<sup>39</sup>

Furthermore, during the nineteenth century the distinction between "general" restraints (over the whole kingdom) and "partial" restraints (over a narrower place) was discussed. It was argued that general restraints should not be held bad per se, but only if unreasonable. This culminated in the famous *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co., Ltd* Case,<sup>40</sup> where the defendant sold his world-wide armaments business and agreed not to compete anywhere in the world for twenty-five years, and it was held reasonable by the Court of Appeal. This new approach was supported and later adopted by the House of Lords,<sup>41</sup> and quickly became widely accepted: a contract in restraint of trade was reasonable if it did no more than protect the interests of the covenantee. The earlier test that had considered the adequacy of the compensation was thereafter no longer applicable and the test was now firmly one of reasonableness.<sup>42</sup>

#### 4.2. THE PUBLIC INTEREST

Though PARKER CJ, in *Mitchel v. Reynolds* stressed that the vice of unreasonable restraints lay substantially in the damage they inflicted on the public interest; but this was little considered by the later courts until the mid-nineteenth century.<sup>43</sup> The public interest was, for instance, considered in a case about an agreement by two coachowners to fix prices and not to compete,<sup>44</sup> or a market-sharing agreement between box makers.<sup>45</sup> But, generally the public policy issues were judged restrictively and the contracts were upheld.

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<sup>34</sup> *Chesman v. Nainby* (1727), 2 Str 739.

<sup>35</sup> *Bryson v. Whitehead* (1822), 1 Sim & St 74.

<sup>36</sup> *Keppell v. Bailey* (1834), 2 My & K 517.

<sup>37</sup> (1837), 6 Ad & E 438.

<sup>38</sup> *Ibid.*, 457.

<sup>39</sup> *Ibid.*, 454.

<sup>40</sup> [1893] 1 Ch. 630; on appeal, [1894] AC 535.

<sup>41</sup> *Mason v. Provident Clothing and Supply Co., Ltd.*; [1913] AC 724; *Herbert Morris, Ltd v Saxelby*, [1916] 1 AC 688.

<sup>42</sup> Cf. JD Heydon, *op cit* p 18.

<sup>43</sup> Cf. *ibid.*, p 19.

<sup>44</sup> *Hearn v. Griffin* (1815), 2 Chit 407.

<sup>45</sup> *Wickens v. Evans* (1829), 2 Y & J 318.

The main reasons for those judgements was the political attitude that the state should interfere as little as possible in the workings of the economy or, in other words, the principle of freedom of trade was intensely uphold.

## **PART II: THE RESTRAINT OF TRADE DOCTRINE IN ENGLAND**

In the *Nordenfelt Case*,<sup>46</sup> the restraint of trade doctrine was developed to a stage, where it became the basis for the “modern restraint of trade doctrine”.

### **1. WHAT IS A RESTRAINT OF TRADE?**

As mentioned in Part I, the restraint of trade doctrine was used in medieval times in a wide range of topics; from anti-trust problems to general public policy issues. To examine and compare the restraint of trade doctrine with other law systems, you have firstly to define the scope of the modern doctrine. Normally you have to deal with three problems. First, is there a restraint? Secondly, is it a restraint of *trade*? Thirdly, is it one of those restraints to which the restraint of trade doctrine applies?<sup>47</sup> Only if all these answers are affirmatively answered, can the reasonableness of the restraint be examined.

#### **1.1. IS THERE A RESTRAINT?**

To answer this first question several propositions were made. LORD DENNING MR, said in *Petrofina Ltd. v. Martin*,<sup>48</sup> “Every member of the community is entitled to carry on any trade or business he chooses and in such a manner as he deems most desirable in his own interests, so long as he does nothing unlawful: with the consequence that any contract which interferes with the free exercise of his trade or business, by restricting him in the work he may do for others, or the arrangements which he may make with others, is a contract in restraint of trade.” A more formal definition was used by DIPLOCK LJ<sup>49</sup> in the same case, which was approved by LORD HODSON in *Esso Petroleum Co. Ltd. v. Harper's Garage Ltd.*<sup>50</sup>: “A contract in restraint of trade is one in which a party (the covenantor) agrees with any other party (the covenantee) to restrict his liberty in the future to carry on trade with other persons not parties to the contract in such manner as he chooses.”

The tests have three particular elements in common: First, a restrained person must be bound by the future, and with respect of third parties. Secondly, ordinary contracts of sale are excluded, and thirdly, agreements to serve the covenantee exclusively for a future period fall within these definitions.<sup>51</sup>

#### **1.2. WHAT IS A RESTRAINT OF *TRADE*?**

Over time the courts developed some classical types of restraints, as in post-employment cases, post-partnership cases, anti-poaching contracts, etc. but in some cases the question arises, if as to whether the restraint is one that restrains someone from trading with something, and therefore the restraint of *trade* doctrine can be applied. Courts have not

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<sup>46</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 535.

<sup>47</sup> [D Heydon, op cit p 42.

<sup>48</sup> [1966] Ch 146, 169.

<sup>49</sup> [1966] Ch 146, 180.

<sup>50</sup> [1968] AC 269, 317.

often dealt with this topics, but in one case<sup>52</sup> the validity of an agreement between the seller and the first-hand buyer of a car not to resell it within a certain time was considered. Lords Russel and Keith considered that the agreement restrained the trade of a second hand car dealer, so that the doctrine applied even though they were not parties to the contract.

### 1.3. IS THE RESTRAINT OF TRADE DOCTRINE APPLICABLE?

Before investigating the reasonableness of the restraint one has to decide whether the restraint is of the kind to which the restraint of trade doctrine applies. If not, the contract is enforceable and the reasonableness of the restraint has not to be considered.

Therefore, Sutherland PJ<sup>53</sup> proposes, the courts should ask whether there is a clause that can be said to interfere with the principles underlying the doctrine, and they should thereafter determine whether the doctrine should apply to such a contract in the light of the particular contractual relationship of which it forms a part.

#### 1.3.1. PROTECTED PRINCIPLES

In General, it can be stated that the aim of the doctrine is to protect the ability to work, as an important public policy value, against infringement in cases where it doesn't constitute a benefit to the community. Benefit, in this case, means that it is economically necessary that certain interests are protected. In detail:

##### 1.3.1.1. FREEDOM OF WORK

Freedom of work underlies the doctrine.<sup>54</sup> Courts have often mentioned that the interest to be protected is the right or ability to earn a livelihood through acquired skills.<sup>55</sup> In addition the right to acquire further skills belongs as well to the core of the freedom of work principle. The courts have emphasised society's entitlement to the fruits of the work of persons who have the necessary skills.<sup>56</sup> As well, freedom to choose work is part of the freedom of work principle.<sup>57</sup> Courts should not only focus on direct negative contractual obligations that restrict a person from working in certain areas; they should also consider the wider freedom of work issues like contracts that tie the accrual of certain advantages, like the payment of a pension or other privilege, to a condition or obligation prohibiting a person from doing certain work, if the practical effect is also specific interference with the freedom of work.<sup>58</sup> Also a Scheme according to which the covenantor

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<sup>51</sup> Cf. JG Collinge, "The Modern Doctrine of Restraint of Trade" (1968), 41 A.L.J 414.

<sup>52</sup> See the American Restatement, Contracts para. 513 and comment.

<sup>53</sup> PJ Sutherland, "The restraint of trade doctrine in England, Scotland and South Africa" (1997) 52.

<sup>54</sup> *Ibid*, pp 31-2.

<sup>55</sup> *Dyer's Case* (1414) YB 2 Hen 5 fo 5; cf PJ Sutherland op cit 35.

<sup>56</sup> *Ipswich Tailors Case*, 11 Co Rep 53.

<sup>57</sup> Cf. PJ Sutherland op cit 38-9.

<sup>58</sup> *Ibid*, p 53.

would be forced to restrict his freedom of work, or pay certain penalties<sup>59</sup> as well as positive obligations, if they cause the exclusion of other possibilities<sup>60</sup> have to be judged as an encroachment of the freedom of work principle.

Furthermore, third party agreements can fall under the freedom of work principle, as in the *Kores Case*<sup>61</sup>, where two companies agreed that they would not employ each other's employees or in the *Eastham Case*<sup>62</sup>, where a footballer was directly bound by contract to a club and agreed to obey certain restrictive rules when leaving the club for another.

#### 1.3.1.2. FREEDOM OF TRADE

Besides the freedom of work principle "freedom of trade" is often mentioned as the basis of the restraint of trade doctrine and this is certainly acceptable.<sup>63</sup>

Nevertheless it is necessary to distinguish what is covered by the freedom of trade, and what is not. There is no *numerus clausus* of particular transactions that are protected by the doctrine, while others are not.

Courts, for instance, had to judge several cases concerning solus agreements in the petrol industry. Garage owners commonly agree to take all their supplies from one petrol company, to operate the garage at certain times, and by the "continuity covenant", to procure a similar agreement from assignees. In *Petrofina Ltd v. Martin BUCKLEY J*, held such an agreement to be an (unreasonable) restraint of trade. By contrast, in *Esso Petroleum Co Ltd v. Harper's Garage Ltd*<sup>64</sup> MOCATTA J, held that restraint of trade doctrine did not apply to solus agreements relating to a particular piece of land, but only to restraints on persons. But the Court of Appeal rejected this view.

## 2. SUBSTANTIVE QUESTION

The second step, after deciding if a certain contract falls within the restraint of trade doctrine, is to determine whether the contract should be condemned for being in restraint of trade. Different methodologies are currently being used for determining the effectiveness of the classic restraints, i.e. post-employment, sale of goodwill, and post-partnership restraints on the one hand, and all the other types of restraints on the other.<sup>65</sup> When determining the reasonableness in classic restraints, one will see that there is a structured and more layered reasonable test.<sup>66</sup>

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<sup>59</sup> Ibid.

<sup>60</sup> Ibid, p 54.

<sup>61</sup> *Kores Manufacturing Co Ltd v. Kolok Manufacturing Co Ltd* [1959] 1 Ch 108.

<sup>62</sup> *Eastham v Newcastle United Football Club Ltd* [1964] 1 Ch 413.

<sup>63</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 566, 567-8.

<sup>64</sup> [1968] AC 269.

<sup>65</sup> Cf. P] Sutherland op cit p 60.

<sup>66</sup> Ibid.

In this dissertation the attention is tuned mainly on the structure of the substantive question, as well as on the classic post-employment restraint.

## 2.1. NORDENFELT TEST

The current substantive test in England for determining the reasonableness of a restraint is still the Nordenfelt test. The key statement was made by LORD MACNAGHTEN in *Nordenfelt*.<sup>67</sup> “It is a sufficient justification and indeed it is the only justification if the restriction is reasonable – reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public”. In essence the restraint must be reasonable *inter partes* and reasonable in the interest of the public.

Nevertheless, it might be suggested that LORD PEARCE in *Esso* attempted to compress the doctrine into one broader public interest test. He stated: “There is not, as some cases seem to suggest, a separation between what is reasonable on the grounds of public policy and what is reasonable as between the parties. There is one broad question: is it in the interest of the community that this restraint should, as it is between the parties, be held to be reasonable and enforceable?”

As Sutherland stated, the judge merely attempted to stress that the public policy underlies both requirements. He did not attempt to fuse them into one test.<sup>68</sup> Heydon suggested, furthermore, that the reasonableness and public policy interest elements would still have to distinguished because the onus would be different with regard to the two elements.<sup>69</sup> Because of all these arguments the reasonableness of the restraint has firstly to be judged by the interest of the parties and secondly by the public interests.

## 3. POST-EMPLOYMENT COVENANTS

As described above, the interests have to be reasonable *inter partes*. The covenantee must do no more than protect his interests with the restraint. Or more precisely: “The covenantee may not in the widest sense, restrict someone where such a restriction exceeds any interest of his.”<sup>70</sup> But courts have also accepted that not all interests of the covenantee are protectable. Only legitimate interests can be subject to an effective restraint of trade.

### 3.1. LEGITIMATE INTERESTS IN POST-EMPLOYMENT RESTRAINTS

In England courts have accepted that trade connections and trade secrets may be protected, as legitimate interests in post-employment restraints.<sup>71</sup>

<sup>67</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 565.

<sup>68</sup> PJ Sutherland op cit p 61.

<sup>69</sup> JD Heydon, “Recent Developments in Restraint of Trade” (1975) 21 McGill LJ 325,343.

<sup>70</sup> *SV Nevanas & Co v Walker and Foreman* [1914] 1 Ch 413.

<sup>71</sup> Cf. PJ Sutherland op cit p 77.



### 3.1.1. TRADE CONNECTIONS

“Trade connections” is an extensive term for different kinds of economic relations. Customer connections belong to the core of trade connections as well as wider trade connections.<sup>72</sup>

#### 3.1.1.1. CUSTOMER CONNECTIONS

Customer connections are connections between a customer and a particular covenantee. Therefore every customer connection has a covenantee-related element, because only a particular connection between a customer and an employer’s business can be protected. Such connections will only be protectable if customers belong to the covenantee, with some exclusivity and continuity in the relationship. Secondly, every customer connection has as well a covenantor-related element. Customer connections will only exist relative to a particular employee.

Covenantee-related requirements must, in particular, not be applied too strictly. Employers need the protection of fragile customers. It was for instance stated<sup>73</sup> “When an employee has access to the customers of a business and is in a position to build up a particular relationship with the result that when he leaves his employer’s service he could easily influence customers to follow him and trade with him at the expense of his employer, there is no reason why, in principle, a restraint should not be enforced to protect the employer’s trade connections. The onus being on the employee to prove the unreasonableness of the restraint, it is for him to show that he never acquired any significant personal knowledge of or influence over a person he dealt with”. In other words courts will only refuse to protect customer connections that were created and maintained by the aptitude and skill of the employee alone.<sup>74</sup> They are only protectable if the customers belong to the employer. The covenantee can protect customer connections even if the covenantor has contributed substantially towards their establishment.<sup>75</sup>

The second covenantee-related requirement is, that a certain exclusivity and recurrence of the relationship has to exist.<sup>76</sup> It is controversial if a customer connection is established only after the conclusion of recurring transactions with the covenantee, or already after the first one. However, recurrence cannot be an absolute requirement. A customer connection will also be established where only

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<sup>72</sup> PJ Sutherland op cit p 78.

<sup>73</sup> Branco and Another T/A Mr Cool v. Gale (1996) 1 SA 163, 164.

<sup>74</sup> Bowler v Lovegrove [1921] 1 Ch 642, 652-3.

<sup>75</sup> The reasons are given in *Eastes v. Russ*, [1914] 1 Ch 468, 487, where an employee has been paid to assist in building up the connection.

<sup>76</sup> Douglas Llambias Associates Ltd v Napier 1990 GWD 39-2243.

a singular transaction forms the basis of the relationship, if the single transaction is fundamentally important and valuable over a period of time.

Furthermore, a customer connection is not protectable forever. A customer connection can only be protected during a particular period if the customer would have remained with the employer during the period of restraint but for the fact that the employee had left the service of the covenantee.<sup>77</sup>

As mentioned above, every customer connection has a covenantor-related element as well. Firstly, the customer connection has to exist to a particular employee, so not every customer of the employer is protectable against every single employee. Mere knowledge that the covenantor is an employee of a business of which a particular person is a customer will not suffice. In other words a protectable customer connection only exists, if the particular employee has contact with the customers or influence over them because of the employment which makes it possible to plunder them from his employer.<sup>78</sup>

Further, there is no doubt, that also the employee's knowledge of customer's personal affairs or requirements is protectable. It is only disputed if it is also possible to protect it as a customer connection or only as trade secrets. Sutherland PJ<sup>79</sup> stated "knowledge probably cannot be protected under this rubric if no relationship has been created. This knowledge [over customers] can help to show that a protectable relationship or influence has developed between customer and employee. It might show that influence over a customer has been gained, and the customer might follow the employee when he leaves the employment of the covenantee."

#### 3.1.1.2. OTHER TRADE CONNECTIONS

Other trade connections besides the customer connections are connections that a business has with organisations that allow it to have a competitive edge, and which are important assets to the business, for instance a particular connection to a supplier who grants exclusive privileges.

#### 3.1.2. TRADE SECRETS

The knowledge of trade secrets and know-how can also justify a restraint of trade.<sup>80</sup> A consistent distinction between trade secrets and know-how was not developed. Rather you can say, "trade secrets" include "know-how".

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<sup>77</sup> John Michael Design plc v Cook [1987] 2 All ER 332, 334-5.

<sup>78</sup> Ropeways Ltd v Hoyle (1919) 120 LT 538, 543.

<sup>79</sup> PJ Sutherland op cit p 87.

<sup>80</sup> The principle was established in Herbert Morris Ltd v Saxelby, [1916] 1 AC 711-12.

It is generally accepted that trade secrets can justify a post-employment restraint. But the protection of trade secrets depends on two criteria. First, a trade secret must exist and secondly, the covenantor must be able to undermine the trade secret as a result of the knowledge<sup>81</sup> of it.

But not all business-related knowledge is a trade secret. The basic criteria are: Firstly, the information must not be publicly known, secondly, the information must belong to the employer and thirdly, the information must have an economic value for the employer.

Of course it is complicated to determine if particular information is not accessible or publicly known. At least there is no doubt that the test depends only on objective facts. It is not in the hands of the parties to make information a trade secret merely by “declaring” particular information confidential.<sup>82</sup>

Another very important distinction that has to be made is between confidential information and mere personal skill and knowledge, because the latter are not protectable. Information that has been acquired during employment but which constitutes general skill and knowledge cannot be protectable information. In addition, it is not possible to protect information that is of general applicability in an industry.<sup>83</sup> But one has to keep in mind that this definition of trade secrets is only valid for *post*-employment restraints. During employment the employee has a much wider obligation to act with fidelity and good faith,<sup>84</sup> therefore the employee will be prohibited from disclosing a broader range of information.

Lastly, trade secrets can only be protected as long as they are secrets, meaning as long as they are not publicly known. If a trade secret becomes publicly known it cannot be protected any more, because otherwise it would lead to discrimination against the covenantor.

### 3.1.3. OTHER INTERESTS

Basically every restraint has to be reasonable to be an effective restraint. Therefore most possible cases will fit in one of the categories described above. Hence, a restraint against mere competition, which ex-employees might generate, cannot be justified by the restraint of trade doctrine.<sup>85</sup> Freedom from possible future competition has not been regarded as a proprietary interest.<sup>86</sup> The possibility that the servant may be a competitor in the future is not a danger

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<sup>81</sup> The covenantor may only be restricted from utilizing the trade secret in so far as it is directly or indirectly derived from the employer.

<sup>82</sup> *Faccenda Chicken Ltd v Fowler* [1987] Ch 117, 13.

<sup>83</sup> *Herbert Morris Ltd v Saxelby*, [1916] 1 AC 711.

<sup>84</sup> *Faccenda Chicken Ltd v Fowler* [1987] Ch 117, 137.

<sup>85</sup> *Vincent v Reading v Fogden* (1932) 48 TLR 613, 614.

<sup>86</sup> *PJ Sutherland op cit* p 132.

against which the master is entitled to safeguard himself.<sup>87</sup> Freedom from competition cannot be said to be an asset that belongs to the covenantee in a free market society.

Restraints against the use of personal skill, knowledge and other personal attributes are also not protectable. The courts have steadfastly refused to accept the effectiveness of restrictions that inhibit employees in the use of their personal skill, knowledge and other personal attributes. Personal skill is unprotectable even if it has been acquired in the service of the employer or as a consequence of training of the covenantor.<sup>88</sup>

#### 4. ONUS OF PROOF

This question usually arises in connexion with reasonableness. Ever since *Mason v Provident Clothing and Supply Co Ltd* and *Herbert Morris Ltd v Saxelby* it has been standard doctrine that the onus of proving circumstances enabling the court to conclude that a contract in restraint of trade is reasonable in the interest of the covenantee is on the party seeking to enforce the contract, while the onus of proving circumstances enabling the court to conclude that it is against the public interest is on the party resisting enforcement.<sup>89</sup>

#### 5. ATTITUDES OF THE COURT / WIDER REASONABLENESS ISSUES

Reasonableness factors beyond the interests of the covenantee will also have an influence on the reasonableness question. But these factors are not simply weighed against the interests of the covenantee.<sup>90</sup> These further factors affect are more or less the “attitude” of the courts towards interests.

Therefore the courts “developed” attitudes with regard to post-employment restraints as well as to sale of business restrictions. Hence, different interests are protectable in those cases.

Furthermore, acknowledgement clauses have to be inspected under the rubric of wider reasonable issues. Basically the acceptance of reasonableness by a clause in the contract (Acknowledgement clause) is ineffective, because such a clause constitutes an attempt to oust the jurisdiction of the courts.<sup>91</sup>

Another topic that has to be discussed under the wider reasonable issues is the payment of a consideration, and the two questions that arise in this context. Firstly, is it obligatory to pay a consideration? And secondly, can a unreasonable restraint become a reasonable one, if the consideration is high enough?

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<sup>87</sup> MP Furmston *Cheshire, Fifoot and Furmston's law of Contract* (1991).

<sup>88</sup> PJ Sutherland *op cit* p 133.

<sup>89</sup> JD Heydon *op cit* p 28.

<sup>90</sup> PJ Sutherland *op cit* p 193.

<sup>91</sup> *Hinton & Higgs (UK) Ltd v Murphy* 1989 SLT 450.

The latter question is easily answered. An invalid restraint can never become a reasonable one, merely because a consideration is paid.

But that does not mean automatically, that it is superfluous to pay a consideration at all. Adequate consideration will still have a considerable role to play in the determination of reasonableness.<sup>92</sup> Where there is adequate consideration, the courts will be more benevolent towards protecting the covenantee. However, where adequate consideration is lacking the courts will meticulously ensure that only clear legitimate interests are protected.<sup>93</sup> Consideration in this case means not only effective payments to the covenantor but also other means of consideration, such as the duration of an employment contract as consideration for a restraint.<sup>94</sup>

## 6. WHEN MUST REASONABLENESS BE DETERMINED

The question whether a contract is acceptable or ineffective may differ depending on the time at which such reasonableness is determined.<sup>95</sup> Facts may intercede between the making of the contract and the coming to the court of the restraint, and these may influence the effectiveness of the contract. Nevertheless, it is common opinion that questions of ineffectiveness have to be determined at the moment when the restraint is concluded. Both reasonableness *inter partes* and reasonableness in the public interest will be so determined. But the reasonableness should be determined by looking at what was likely from this point.

## 7. SCOPE OF PROTECTABLE INTERESTS

The restraint cannot go further than is adequate for the protection of the covenantee's legitimate proprietary interest.

### 7.1. VAGUENESS OF RESTRAINT

Restrictions can be limited as to time, space and activity. The techniques will have to be used in a manner which does not make the restraint void for vagueness.<sup>96</sup> General vagueness principles will apply here.

### 7.2. AREA RESTRAINT

Basically, a restraint must be limited to the area where it is necessary for the protection of the legitimate interests of the covenantee. Spatial restraints have at least to be limited to the sphere of activity and interest of the covenantee. Furthermore they have to be restricted to the legitimate interests of the covenantee, which will necessarily mean that restraints will sometimes have to be narrower than the sphere of business of the

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<sup>92</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 565.

<sup>93</sup> *Attwood v Lamont* [1920] 3 KB 571, 589.

<sup>94</sup> *JD Heydon op cit* p 135.

<sup>95</sup> *JD Heydon op cit* p 133.

<sup>96</sup> *Marshall's Ltd v Leek* (1900) 17 TLR 26.

covenantee. Spatial reasonableness will depend on the facts of a particular case. If there is, for instance, a clause that denies setting up a business from a particular base within a certain area (brass plate covenant), you will have to consider whether the restricted activities from the prohibited place for setting up a business will interfere with the legitimate interest. If there is, for instance, a clause that denies certain business activities in the restricted area, you will have to determine whether the restricted activity will interfere with legitimate interest of the covenantee if carried on within the restricted area.

#### 7.2.1. POST-EMPLOYMENT CASES

Area restraints concerning customer connections especially in post-employment cases have to be covered by legitimate interests as mentioned above. But it is not necessary to show that the trade has been practised in all parts of the restricted area. It is sufficient if a certain density is reached.

Another question arises, if an employer has particular customers and he intends to restrict an employee from competing with these customers, meaning that the employee can work in the area as long as he does not deal with these customers. Such a restraint is possible but not very useful because it is difficult to enforce.

In cases of trade secrets spatial restraints are less important, because trade secrets are not bound to a specific area.

### 7.3. TEMPORAL DIMENSION

The duration while the employee is under restraint must be reasonable as well and therefore the restraint must not exceed legitimate interests. Or as BLAKE stated: A restraint may only endure for as long as it will take for the “risk of injury to be reasonably moderated”<sup>97</sup>.

#### 7.3.1. TRADE CONNECTIONS

In early decisions it was held that the restraint might not be longer than the foreseeable duration of customer relationships with the employer<sup>98</sup>. Yet this is not sufficient. The courts should consider how long it will take for the covenantor to lose the hold gained over customers because of his employment.<sup>99</sup>

#### 7.3.2. TRADE SECRETS

Trade secrets do not justify keeping a man out of his trade indefinitely<sup>100</sup>.

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<sup>97</sup> Blake op cit p 677.

<sup>98</sup> M & S Drapers v Reynolds [1956] 3 All ER 814, 819-20.

<sup>99</sup> Eastes v Russ [1914] 1 Ch 468, 490.

<sup>100</sup> JD Heydon op cit 133.

Where trade secrets are protected the restraint may endure for as long as such information constitutes a trade secret in the hands of the covenantee; this will be for as long as the knowledge remains secret, reasonably up to date and valuable.

The trade secrets may only be protected while it constitutes a useful trade secret in the covenantor's hands<sup>101</sup>.

### 7.3.3. POST-EMPLOYMENT

It is theoretically and practically likely that a restraint in an employment case may be invalid for the sole reason that it is too long in duration<sup>102</sup>. The protectable interest must exist for the whole period of the restraint.

## 7.4. RESTRICTION ON THE ACTIVITIES

The activities of the covenantor may be not further restricted than is necessary for the reasonable protection of the legitimate interest of the covenantee. Further, the restrictions must also be not too vague. For instance a restraint "not to compete or interfere with the business of the covenantee" would be invalid, because it is too difficult for the covenantor to determine what he is obliged not to do.

Problems arise also concerning activity restrictions based on certain or all of the activities of the business for which the employee worked, or certain or all of the activities of the business sold. A restraint will often be ineffective for being wider than the protection of any interest of the covenantee if it restricts wider activities than those exercised by the business of the employer, in post-employment cases, or the business sold, in sale of business restraints.<sup>103</sup>

A more interesting topic concerning possible activities is the distinction between non-dealing and non-solicitation restraints.

Basically only those customers with whom the covenantor has formed connections are protectable. But there are two possibilities in restraining the covenantor, firstly, by a non-dealing restraint and secondly, by a non-solicitation restraint.

### 7.4.1. NON-DEALING

In non-dealing cases the covenantor is under no circumstances allowed to do business with the customers of the covenantee. He is restrained from dealing with particular customers, even if the customers come to the covenantor. Such a restraint will be allowed in sale of goodwill cases, because in these cases a wider protection will be allowed.<sup>104</sup> In cases of confidential information a wider

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<sup>101</sup> *Davies v Davies* (1887) 36 ChD 359, 366-7.

<sup>102</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 666.

<sup>103</sup> *Avery v Langford* (1854) 1 Kay 663, 665.

<sup>104</sup> *JD Heydon op cit* 163.

protection will normally also be justifiable. In cases where trade secrets are concerned it depends on the information.

#### 7.4.2. NON-SOLICITATION

In non-solicitation cases the covenantor may still do business with the customers of the covenantee in the field in which he was employed by the covenantor, but he may only deal with customers who come to him of their own accord; he may not attempt to convince them to change allegiance. A non-solicitation restraint is possible in cases of sale of goodwill, in cases where confidential information is protected and also where trade secrets are concerned. A non-solicitation restraint stipulates a narrower protection as a non-dealing restraint. Therefore, at least it is possible in all cases where a non-dealing restraint is possible to also use a non-solicitation restraint.

#### 7.4.3. NON-DISCLOSURE AND NON-USE OF TRADE SECRETS

It is also possible to restrain somebody by a non-disclosure or non-use of trade secrets restraint. However, it is not a good way to protect trade secrets, and it is therefore not very much liked by the courts. One of the reasons is, that such restraints cannot be policed very effectively.

### 8. THE PUBLIC INTEREST REQUIREMENT

According to the *Nordenfelt* test a restraint of trade must not only be reasonable in the interest of the parties, but must also not be against the public interest. While the “first leg” of the *Nordenfelt* test asks if the restraint is reasonable *inter partes*, the “second leg” of the *Nordenfelt* test is a check-and-catch-all test. It allows for the consideration of relevant public policy elements that have not been discounted by reasonableness *inter partes*.<sup>105</sup> Therefore it is important to ask what public policy factors should be dealt with in terms of the public interest leg. The public policy factors are:

#### 8.1. ECONOMIC ARGUMENTS

It has been suggested that economic arguments may be considered by the court.<sup>106</sup> However in *Texaco*<sup>107</sup> it was stated that the doctrine is not aimed at producing the “utmost economic advantage”. The restraint of trade doctrine is not a doctrine of economics but rather a doctrine of the common law. Therefore the House of Lords in *The Pharmaceutical Society of Great Britain v Dickson*<sup>108</sup> followed a careful and sophisticated approach. The case concerned limitations by the Pharmaceutical Society on the type of products that could be

<sup>105</sup> *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co, Ltd* [1894] AC 566.

<sup>106</sup> JD Heydon op cit pp 214ff.

<sup>107</sup> *Texaco Ltd v Mulberry Filling Station Ltd* [1972] 1 WLR 814, 827.

<sup>108</sup> [1968] 2 All ER 686, 695ff.



sold by pharmacies. As a result small pharmacies in small villages decreased and the competition between pharmacies was diminished. In this case, LORD MORRIS for instance argued that restraints of this nature also have to be in the public interest, but he only looked at this when he discussed the wider interests that can be protected.

## 8.2. FREEDOM OF WORK-RELATED PUBLIC INTEREST

The most important public interest argument for the contract denier will concern freedom of work issues. And within this category probably the most important issue is the hardship to third parties, through interference with the right to work.<sup>109</sup> In cases of anti-poaching contracts, where the “other” employer is not part of the particular contractual relationship, the interests of employees who are the object of the anti-poaching contract will have to be protected by utilising the public policy interest requirement.<sup>110</sup> A restraint may be contrary to public interest if it merely interferes with the interests of a particular outside group even if the restraint is not contrary to the interests of society as a whole.<sup>111</sup> But, on the other side, it has been accepted that a medical man may be restricted even though the public will be deprived of his service<sup>112</sup>

## 9. SEVERABILITY OR PARTIAL ENFORCEMENT

Basically the ineffectiveness of the stipulated contractual restraint will never affect the underlying contract.

But the question is what happens to the restraint clause or clauses if it or they are ineffective. Naturally there is no problem, if all clauses are enforceable or all of them are ineffective. The question of partial enforcement arises only if there are both void and enforceable parts.

In this regard English courts follow a very technical approach (blue pencil test). Basically it is trite that only parts that are too wide will be deleted; words, or the word order of a restraint clause, will not be altered.<sup>113</sup> Secondly, courts will only allow severance by deleting if it does not change the meaning of what remains, and the effective part must be independent. Lastly, only clauses that the parties regarded as independent may be severed.

Parties sometimes add a term to a restraint in which they acknowledge that some parts of the restraint agreement are intended to be severable from other parts. The status of these clauses is very problematic. The acknowledgement clause will sometimes merely restate the accepted principles of severability. In such a case the clause will be of no real value. An acknowledgement clause only has real value if the intention of the parties and the manner they express will impact on the extent to which the court will be prepared to sever clauses. In other

<sup>109</sup> GH Treitel “The Law of Contract” (1999) 413-4.

<sup>110</sup> Kores Manufacturing Co Ltd v Kolok Manufacturing Co Ltd [1959] 1 Ch 108, 120.

<sup>111</sup> *Ibid* p 127.

<sup>112</sup> PJ Sutherland *op cit* p 241.

<sup>113</sup> Baker v Hedgecock (1888) 39 Chd 520.

words, courts will have to look at the acknowledgement clause, and will then have to determine whether it applies in a particular situation, and whether it changes the severability position if it is read with other relevant clauses.

**PART III: THE RESTRAINT OF TRADE DOCTRINE IN SOUTH AFRICA****1. DEVELOPMENT OF THE RESTRAINT OF TRADE DOCTRINE IN SOUTH AFRICA****1.1. LEGAL SYSTEM IN SOUTH AFRICA**

It is outside the scope of this dissertation to explain the roots of South African law and legislation. But in a nutshell South African law was influenced over a long period of time by the colonial powers. In the 16<sup>th</sup> century it was influenced by the Dutch colonial rule that brought the Roman-Dutch law with them. Later South Africa as a colony of the Crown was subjected to the English legal system.

After England gained power over South Africa, in some cases where a restraint of trade was involved, courts contended that English law applied in this area.<sup>114</sup> But this is not the view generally taken. Rather the question is whether South African courts are free to modify the English law doctrine in South Africa.<sup>115</sup> Indeed, a restraint of trade rule or principle cannot be applicable in South Africa simply because it applies in English law.<sup>116</sup>

As Sutherland PJ stated, the doctrine is most accurately anchored in South Africa via the Roman-Dutch *principle* that contracts which are contrary to public policy are illegal.<sup>117</sup>

Whether the doctrine that is used nowadays is the adopted English doctrine or a very similar one reproduced on Roman-Dutch principles, does not have to be decided in this dissertation.<sup>118</sup>

Anyway, the English doctrine was used in South Africa; during the earlier days more strictly and later in a laxer way. In 1984 the renunciation of the English law culminated in the *Magna Alloys*<sup>119</sup> judgement.

**1.2. MAGNA ALLOYS CASE**

One of the important matters in the *Magna Alloys* Case is that it was accepted that some restraints were still illegal due to different public policy values in South Africa.<sup>120</sup> It was stated that restraint of trade problems had to be dealt with in terms of South African principles of public policy.<sup>121</sup> However, the court did not really discuss the principles that made South African law different from English law, and the case is opaque<sup>122</sup> in laying down more specific rules. The consequence of the *Magna Alloys* case will probably be that some change of emphasis concerning public interest will take place, and that the

<sup>114</sup> Durban Rickshas Ltd v Ball 1933 NP 479, 489.

<sup>115</sup> Katz v Eftimiou 1948 (4) SA 603 (O) 610.

<sup>116</sup> Federal Insurance Corp of SA Ltd v Van Almelo (1908) 25 SC 940, 943.

<sup>117</sup> PJ Sutherland op cit p 13.

<sup>118</sup> Cf ibid p 12-3.

<sup>119</sup> Magna Alloys and Research (SA) (Pty) Ltd v Ellis 1984 (4) SA 874 (A).

<sup>120</sup> Ibid p 891.

<sup>121</sup> Ibid pp 892 ff.

<sup>122</sup> JT Schoombee "Agreements in Restraint of Trade: The Appellate Division Confirms New Principles" (1985) 48 THRHR 139.

importance of traditional public interest factors will be slightly enhanced, but this constitutes no real departure from the English position.

The following paragraphs will point out some important differences between the English and South African systems.

## 2. TIME OF DETERMINATION OF REASONABLENESS

One of the main differences between the English and the South African systems of determining if a restraint is void or enforceable is the fact, that the time of determination is different. This fact has various influences on other aspects of the restraint of trade doctrine, and therefore it has to be dealt with first.

The question as to whether a contract is void or enforceable depends very often on the time at which such reasonableness is determined. For instance, facts may intercede between the time when the contract was concluded and brought to court, and public policy values tend to change over the years.

As mentioned above, it is trite in England that questions of ineffectiveness have to be determined *at* the moment when the restraint is concluded. Both, reasonableness *inter partes* and reasonableness in the public interest will be so determined.

Yet, the South African approach is quite different. Over time the courts steadily developed the view that the reasonableness of the restraint has to be determined at the moment when the court is asked to enforce it. Since RABIE CJ accepted that in the in the Appeal Court decision in *Magna Alloys*<sup>123</sup> there is no influential opinion left. This does not mean that you only have to examine the time of enforcement of the restraint. You also have to examine the reasonable foreseeability from the moment when the courts are asked to enforce restraints, as well as reasonableness during the entire duration of the restraint.

Due to this different approach, some linked topics have to be dealt with in a modified way.

## 3. ONUS OF PROOF

In both the English and South African legal systems, the onus to determine whether a restraint falls within the restraint of trade doctrine will probably be on the party who wants to rely on the doctrine.<sup>124</sup> But when it comes to the onus within the restraint of trade doctrine South African courts follow a different approach to those in England. In early cases, the onus of proof was handled as in England. They accepted that restraints were *prima facie* ineffective. The onus for proving reasonableness was on the enforcer.<sup>125</sup> The onus to show that the contract is against public interest was on the denier once reasonableness was proved. Careful

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<sup>123</sup> *Magna Alloys and Research (SA) (Pty) Ltd v Ellis* 1984 (4) SA 894, 895-8.

<sup>124</sup> Cf PJ Sutherland *op cit* p 250.

developments away from the English approach took place in the late 60s and culminated as well in the *Magna Alloys*<sup>126</sup> case. RABIE CJ decided that the onus of proving all aspects of illegality will be on the person who relies on it. However the onus of proof is on the denier in cases where it has to be shown that the restraint is unreasonable or against public interest for other reasons. The reasonableness and public interest onus will no longer be distinguished in South Africa.<sup>127</sup> The onus will simply remain on the denier once reasonableness is proved.

#### 4. SECOND LEG OF NORDENFELDT TEST

As described above the substantive question as to whether a restraint is enforceable or not, is examined firstly *inter partes* and secondly by examining if the restraint clause is against public interest (second leg of Nordenfeldt test).

In South Africa the role of public interest was enhanced by the judgment of *Magna Alloys*. The Appeal Court in this decision stressed the importance of public interest. However, a greater consideration of public interest issues has not materialized.<sup>128</sup> One will have to see, how South African courts will use their gained flexibility.

#### 5. PARTIAL ENFORCEMENT

Before *Magna Alloys* courts in South Africa followed principles that are very similar to those that apply in England. It was regarded as the minimum requirement that the court would not change or add words to a contract. Yet, the courts follow a different approach. They have accepted that the question in a restraint of trade clause is one that pertains to enforceability at the time when the restraint is brought before the court. Hence, they have stressed that the problem is one of “partial enforcement” rather than “severability”. This partial enforcement principle was supported in an *obiter dictum* by Judge RABIE CJ in *Magna Alloys*.<sup>129</sup>

However, the basic principles that now should apply were laid down in *National Chemsearch*.<sup>130</sup> Therefore, the court should deal with this topic in the light of public policy. The courts should be prepared to restrict a clause whether by adding, deleting or changing words contained in the clause, although partial enforcement will only take place within narrow parameters.<sup>131</sup> Judge Botha J stipulated in *National Chemsearch* that restraints will only be partially enforced if certain requirements are met.<sup>132</sup> Firstly, the party who is seeking partial enforcement must raise the issue and lay a basis for it. A court will not partially enforce a restraint if alternatives are not proposed by the enforcer. Secondly, the reformulation of the particular clause must not be dramatic and the clause must not require “major plastic surgery”. Thirdly, only

<sup>125</sup> KVV van ZA Bpk v Botha 1923 CPD 429, 437-8.

<sup>126</sup> *Magna Alloys and Research (SA) (Pty) Ltd v Ellis* 1984 (4) SA 893, 897.

<sup>127</sup> Schalk Van der Merve, LF Van Huyssteen, MFB Reinecke, GF Lubbe, JG Lotz “Contract General Principles”(1959) 157.

<sup>128</sup> PJ Sutherland op cit p 235.

<sup>129</sup> *Magna Alloys and Research (SA) (Pty) Ltd v Ellis* 1984 (4) SA 896.

<sup>130</sup> *National Chemsearch (SA) (Pty) Ltd v Borrowman* 1979 (3) SA 1092 (T) 1112ff.

<sup>131</sup> PJ Sutherland op cit p 300.

<sup>132</sup> *National Chemsearch (SA) (Pty) Ltd v Borrowman* 1979 (3) SA 1092 (T) 1116ff.

restraints should be saved, that are clumsily – not deliberately – drawn too wide. Lastly, the party to be restrained must not be unfairly or harshly affected by the restraint.

#### **6. ACKNOWLEDGEMENT CLAUSE**

As mentioned above, courts decided in England that clauses wherein parties acknowledge that a certain restraint in a contract is reasonable, are invalid, because such clauses are an attempt to oust the jurisdiction of the courts.

In South Africa, a different view was taken: the courts distinguished contracts where the parties were in an unequal bargaining position and where parties were in a relatively equal bargaining position. In the latter situation, the acknowledgement clauses should at least have an attitudinal impact.<sup>133</sup>

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<sup>133</sup> Roffey v Catterall Edwards and Goudre 1977 (4) SA 494 (N) 499.

## **PART IV: THE DEVELOPMENT OF THE RESTRAINT OF TRADE RULES IN GERMANY**

### **1. DEVELOPMENT OF FIRST RESTRAINT OF TRADE RULES**

In contrast to the English developments, German restraint of trade rules developed some centuries later. The German legislation was characterised by the doctrine of “freedom of trade”. Therefore neither in the very early General German Commercial Code<sup>134</sup> from 1861 nor in the Industrial Code<sup>135</sup> from 1889 could one find any regulations concerning restraint of trade. They simply applied the doctrine of “freedom of trade”. However the Supreme Court of the German Reich<sup>136</sup> decided in 1893 that a restraint of trade clause is invalid if the covenantor’s ability to work is restricted too much in general or within a particular branch. It decided that “every employee has a non-seizeable right to decide about the kind and branch of his job” and therefore “he must not be permanently or at all restricted from any business enterprise”.<sup>137</sup>

The first legal regulations were developed at the turn of the century. Sec. 74 and sec. 75 Commercial Code<sup>138</sup>, governing regulations concerning commercial employees<sup>139</sup>, came into force on 01.01.1900. In those times, no regulations forced the covenantee to pay a consideration, although only those restraints were enforceable that did not exceed a time span of 3 years and did not unfairly impede the development of the covenantor. In 1900 also a regulation (sec. 133f Industrial Code) came into force, that stipulated the same rules for technical employees<sup>140</sup>.

### **2. 1914 REVISION OF THE COMMERCIAL CODE**

In 1914 the Commercial Code was revised and the protection of the commercial employees was considerably improved. Since then, by virtue of sec. 74 (2) Commercial Code all restraints were void that exceeded the duration of two years. Also very important was the introduction of the obligation to pay a compulsory compensation of at least 50% of the last salary.<sup>141</sup> However, the latter regulation only applied to restraints of commercial employees and not to technical employees.

### **3. CHANGES BY LEGISLATION**

Since 1914 sec. 74 ff has remained almost unchanged. But since then courts and commentators have been discussing the inequality of commercial employees and technical employees. Courts were divided on whether to abolish the inequality or not. In the beginning the Federal Labour Court<sup>142</sup> introduced an obligatory compensation also for technical employees, by utilizing sec.

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<sup>134</sup> In German: „Allgemeines Deutsches Handelsgesetzbuch (ADHGB)“.

<sup>135</sup> In German: „Gewerbeordnung (GewO)“.

<sup>136</sup> In German: „Reichsgericht (RG)“.

<sup>137</sup> RGZ 31, 97, 100.

<sup>138</sup> In German: „Handelsgesetzbuch (HGB)“.

<sup>139</sup> In German: „kaufmännische Angestellte“.

<sup>140</sup> In German: „technische Angestellte“.

<sup>141</sup> Sec. 74 (2) Commercial Code.

<sup>142</sup> In German: „Bundesarbeitsgericht (BAG)“.

138 Civil Code.<sup>143</sup> Later, in 1966, the Federal Labour Court also applied sec. 74 ff *contra legem* to restraints on technical employees<sup>144</sup> – like e.g. engineers. In the same way the Federal Labour Court applied sec. 74 ff also to restraints on workers.

In its decision from 13.09.1969 the Federal Labour Court turned away from its previously followed view and decided that sec. 74 ff would have to be applied to all kinds of employees but analogically not directly.<sup>145</sup> This last decision was more a kind of cosmetic decision, and had no real impact on the legal status of restraint of trade clauses.

During the following years the Federal Labour Court “revised” the restraint of trade rules, by holding that particular regulations<sup>146</sup> were unconstitutional, because they violated the German Constitution<sup>147</sup> because they violated the right to equality and freedom to choose an occupation. In the following years those unconstitutional provisions, as well as sec. 133f Industrial Code was repealed.<sup>148</sup>

#### **4. 2002 REVISION OF LAW OF OBLIGATIONS**

In 2002 the legislator completely revised the whole law of obligations. It was the biggest revision of the Civil Code since 1900. In this process the legislator decided among other major changes to apply the law of general terms and conditions also to restraint of trade clauses. The influences of this change in legislation will be discussed later.

#### **5. FACTS ABOUT RESTRAINT CLAUSES IN GERMANY**

Different surveys were made in Germany to examine how important restraint clauses in employment contracts are. In 1990 HANAU/PREIS<sup>149</sup> found out, that 2.2% of employees who were paid by a tariff, 5.0% of employees that were paid above tariff and 10.5% of executive employees were restrained by a clause in their employment contract, and 16% of salesmen concluded a restraint clause. The duration of the restraint was two years in 73% of all cases. The stipulated compensation in 55% of all cases was based on the legal minimum requirements. In 12% of the cases the full remuneration was in fact paid as a compensation. Managing directors were even restrained by 35% and got a compensation of between 50% and 100% (on average 64%).<sup>150</sup>

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<sup>143</sup> In German: „Bürgerliches Gesetzbuch (BGB)“.

<sup>144</sup> BAG 2.12.1966 and 18.12.1967 AP 18, 19 zu § 133f GewO.

<sup>145</sup> Obviously sec. 74 ff have to be applied directly to commercial employees.

<sup>146</sup> Sec. 75 (3), Sec. 74a(2) sentence 1, Sec. 75b sentence 2, Sec. 75b sentence 1, Sec. 75e.

<sup>147</sup> In German: „Grundgesetz (GG)“.

<sup>148</sup> (as a matter of form).

<sup>149</sup> P Hanau/U Preis “Der Arbeitsvertrag” (Loseleaf) B.I. pp 46 ff.

<sup>150</sup> Kienbaum Vergütungsreport 1995, 76.



## **PART V: THE SYSTEM OF RESTRAINT OF TRADE IN GERMANY**

### **1. INTRODUCTION**

#### **1.1. GENERAL RESTRAINT OF TRADE RULES**

In German law there are no statutory prohibitions of competition, neither for particular groups of employees nor for any employees. The only provisions that exist are restraint of trade rules regulating the competition during the employment. Such rules are, for instance, sec. 60 Commercial Code, restricting commercial employees during the employment, sec. 112, 113 Commercial Code and sec. 88 Company Law<sup>151</sup>, restricting partners of general partnership or executive board members during the employment.

#### **1.2. PROHIBITION OF COMPETITION DURING THE EMPLOYMENT**

Basically the employee is prohibited from working for a competitor while he is employed. This rule is laid down in sec. 60 and 61 Commercial code, and has to be applied to all employees.<sup>152</sup> It was stated that if the employee earns his living from a certain employer he is prohibited from competing in that way, as the employer is endangered in his business activities.<sup>153</sup>

#### **1.3. POST-EMPLOYMENT CASES**

After leaving the employer's business, the employer has basically no right to restrict the employee from using his legally gathered skills and experiences and from competing with his former employer. Such a restraint is only possible, valid and enforceable, if the parties concluded an agreement that is not against the regulations of sec. 74 ff Commercial Code. These restraint of trade rules acknowledge an interest of the employer to protect himself from competition of the former employee, but also guarantees the employee an opportunity to decide about his career independently and to choose a vacancy freely.<sup>154</sup>

#### **1.4. CONFIDENTIAL DATA AND TRADE SECRETS**

By virtue of sec. 17(1) Unfair Competition Act<sup>155</sup> it is made a punishable offence, to use or divulge trade secrets during the employment period. But by virtue of sec. 17(2) Unfair Competition Act the use of trade secrets that were gathered unauthorised is also prohibited. Unauthorised in that context means if, for instance, the employee copies or remembers certain information in a specific way.<sup>156</sup> Or as stated in the Federal Supreme

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<sup>151</sup> In German: „Aktiengesetz (AktG)“.

<sup>152</sup> BAG, EzA § 4 KSchG Nr. 38.

<sup>153</sup> T Müller “Vertragliches Wettbewerbsverbot” (2000), FA 2000, 152.

<sup>154</sup> Decision of the Federal Supreme Court, in German: „Bundesgerichtshof (BGH)“ in BGH, AP 2 zu § 75f HGB.

<sup>155</sup> In German: „Gesetz gegen den unlauteren Wettbewerb (UWG)“.

<sup>156</sup> Cf. J Kunz “Betriebs- und Geschäftsgeheimnisse und Wettbewerbsverbot während der Dauer und nach Beendigung des Anstellungsverhältnisses” (1993), DB 1993, 2482.

Court<sup>157</sup>, all information that is taken out of the employer's business "by all methods exceeding the normal remembrance" is gathered unauthorised.

Of course there are also more specific regulations like sec. 18 Unfair Competition Act that stipulates certain obligations to return written documents and punishes industrial espionage.

### **1.5. BLANKET CLAUSES: SEC 241(2), 242 CIVIL CODE**

As mentioned above, there are no statutory prohibitions of competition in German law. However, that does not mean that there are no restrictions for a former employee to compete with his former employer.

Due to sec. 241(2) Civil Code the employee has not only during but also after his employment certain collateral duties. A very disputed topic is, to what extent a former employee can attract customers of the former employer. On that topic, the Federal Labour Court decided, that an employee is not restricted in attracting customers of his former employer and is also allowed to use technical knowledge or experiences, if they concluded no restraint of trade agreement. It further stated, however, that in cases where the employer prepares a contract with a customer to that extent that the conclusion of the contract is just a mere formality, the former employee breaches his duties, if he then attracts the customer to his business.

## **2. SCOPE OF THE POST-EMPLOYMENT REGULATIONS**

### **2.1. SUBJECTS OF THE RULES**

As mentioned above, the law of restraint of trade is divided into different areas and therefore regulated in different statutes. This dissertation deals mainly with the restraint of trade rules concerning post-employment restraints. In German law the rules of post-employment restraints are laid down in sec. 74 ff Commercial Code and Sec. 138, 241, 242 Civil Code. In the following paragraphs the restraint of trade law will be examined with reference to this focus.

As we have seen subjects of the restraint of trade rules can only be the employers and employees. As mentioned above, the sec. 74 ff Commercial Code nowadays will be applied not only to commercial employees, but also to all other kinds of employees analogously. In fact there is no factual difference. The courts apply the rules to all kinds of employees.<sup>158</sup>

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<sup>157</sup> BGHZ 38, 391.

<sup>158</sup> All formerly stipulated exceptions were repealed.

## 2.2. TIME OF CONCLUSION OF RESTRAINT OF TRADE AGREEMENT

As mentioned above, there is only a minimum protection against post-employment competition, if the parties did not conclude a restraint of trade agreement.

If the parties – usually the employer – want to conclude a restraint of trade clause with the employee, normally such a restraint of trade agreement is part of the employment contract in the form of a restraint of trade clause. It is also, however, possible to conclude such an agreement later; but the agreement has to be concluded during an employment relationship. It can be concluded, therefore, even after giving notice of terminating the employment contract, but before termination of the employment relationship – within the termination period.

If the restraint of trade agreement is concluded after termination of the employment relationship, the sec. 74 ff Commercial Code are no longer applicable, the relevant regulations are rather sec. 138, 242 Civil Code. The consequences are basically the same as restraints of executive officers of company boards.<sup>159</sup>

## 3. DEFECT OF TITLE AND CONSEQUENCES

If one of the parties violates regulations that are laid down in sec. 74ff Commercial Code, different consequences will be triggered off. The basic consequence is laid down in sec. 75d sentence 1 Commercial Code. By virtue of this rule, the principal cannot assert rights that disadvantage an employee more than stipulated in sec. 74 ff Commercial Code. This also applies to agreements intended, by means of set-off or other methods, to circumvent legal provisions concerning the minimum compensation. In other sections, some further consequences are stipulated. For instance in sec. 74(2) Commercial Code the expression “is only binding” is used, and in sec. 74a(1) Commercial Code the words “is non-binding insofar” are used. Therefore, repeatedly discussions started how to interpret those different words and concepts.<sup>160</sup> Over time a system developed that now deals with three fundamentally different sanctions. Firstly, agreements can be void, or secondly, can be *non-binding* and thirdly, can be *partly non-binding*.

### 3.1. VOID AGREEMENTS

As mentioned above, some of the violations lead directly to the nullity of restraint clause. Nullity in this context means that none of the contracting parties can derive any right from the restraint of trade clause. Judges and commentators expressly stated that in the following cases the restraint of trade agreement will be void.

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<sup>159</sup> See V 13. *infra*.

<sup>160</sup> Cf. D Löffel, “Die Behandlung unzulässiger Wettbewerbsverbote”, 1968.

- By virtue of sec. 74(1) Commercial Code the restraint agreement must be in writing, and a copy of the document must be signed by the principal. Furthermore, the agreement has to contain the agreed conditions and has to be provided to the employee. If this formality is not followed, the agreement is void.<sup>161</sup>
- By virtue of sec. 74(2) Commercial Code the employer has to pay compensation to the employee. If the agreement does not stipulate any compensation, the agreement is void.<sup>162</sup>
- By virtue of sec. 74a(2) sentence 1 Commercial Code the restraint agreement is void, if the clerical employee is a minor at the time the contract was concluded.
- By virtue of sec. 5(1) sentence 1 Vocational Training Law<sup>163</sup> a restraint agreement with a trainee is basically void.<sup>164</sup>
- By virtue of sec. 74a(2) sentence 1 Commercial Code the restraint agreement is void, if the principal causes the clerical employee to give his word of honor or a similar assurance.
- By virtue of sec. 74a(ii) sentence 2 Commercial Code the agreement by which a third party, in lieu of the clerical employee, assumes the obligation to ensure that the clerical employee will restrict his professional activity following the end of the employment relationship, is void.
- Except these rules, stipulated in the Commercial Code, there are also some other regulations applicable, like sec. 9 no. 5 Law on Temporary Employment.<sup>165</sup> And obviously the general rules about nullity of agreements like sec. 143, 119, 123, 138 and 104 ff Civil Code will apply.

As consequence of the nullity of an agreement, none of the contracting parties can derive any right from the restraint of trade clause. The employer cannot prohibit the employee from taking up some work, and nor can the employee claim compensation from the employer. Both parties can plead anytime that the agreement is void. Even if the employee consciously takes up some work and the employer pays compensation, both parties can untie themselves from the agreement. If a restraint clause is carried out in ignorance of the nullity of the agreement, the clause is void and therefore the parties have a right to be refunded in accordance with the rules of unjustified enrichment.

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<sup>161</sup> See V 4. *infra*.

<sup>162</sup> See V 8. *infra*.

<sup>163</sup> In German: „Berufsbildungsgesetz (BBiG)“.

<sup>164</sup> Except if the restraint is concluded within the last 6 month of the trainee period, and the trainee is employed afterwards.

<sup>165</sup> In German: „Arbeitnehmerüberlassungsgesetz (AÜG)“.

### 3.2. NON-BINDING AGREEMENTS

In some cases the sec 74 ff Commercial Code stipulates that a clause is non-binding (*unverbindlich*). The legal concept behind this expression is, that such a clause is basically valid and enforceable. Nevertheless, the employee has the option to decide whether to enforce the clause or not. The employer does not have such a right; he is bound by the decision made by the employee. Judiciary and commentators commented that in the following cases the restraint of trade agreement will be non-binding.

- By virtue of sec. 74(2) Commercial Code the restraint clause is only binding where the principal is obligated, for the term of the prohibition, to pay annual compensation equal to at least one-half of the most recent contractual remuneration received by the clerical employee. In other words, the agreement is non-binding, if the employer promised a compensation, but the compensation is too low.<sup>166</sup>
- By virtue of sec. 74a(1) sentence 1 Commercial Code the restraint clause is non-binding insofar as it does not serve to protect a legitimate business interest of the principal. This would be the case for instance, if the employer only wanted to protect himself against mere competition of the employee.<sup>167</sup>
- By virtue of sec. 74a(1) sentence 2 Commercial Code the restraint clause is non-binding insofar as, with respect to the compensation allowed, the place, time or subject matter, it constitutes an unreasonable interference with the clerical employee's career. This would be for instance the case, if the restraint clause would totally sterilize an employee from working in his profession.<sup>168</sup>

For quite a while it was unclear, which consequences would apply if a clause or agreement is non-binding. In some early decisions, the Federal Labour Court<sup>169</sup> judged that the employee simply does not need to comply with the agreement whereas the employer has no rights against the employee. However, these judgments only helped those employees that wanted to escape from the agreements.<sup>170</sup> In a slightly later decision the Federal Labour Court<sup>171</sup> also decided, that the employee had to decide whether he wanted to be bound by the agreement or not.<sup>172</sup> According to a new decision of the Federal Labour Court<sup>173</sup> the employee now has basically a duty to give notice to the employer, whether he wants to enforce the restraint clause or not. It simply depends on the behaviour of the employee after termination of the employment-relationship. However, the employee is bound by his decision, once he gives notice to the employer to enforce the clause or not.

<sup>166</sup> See V 8. *infra*.

<sup>167</sup> See V 5. and V 7. *infra*.

<sup>168</sup> See V 7. *infra*.

<sup>169</sup> BAG, AP 1 zu § 75 a HGB und 21, 26, 27, 29, 32, 33 zu § 74 HGB.

<sup>170</sup> W Grunsky, "Festschrift 25 Jahre BAG", 155.

<sup>171</sup> BAG, AP 36, 37, 53 zu § 74 HGB.

<sup>172</sup> Some exceptions applied, for instance if the status of a termination notice was not yet decided by the court.

If he gives notice, to the effect that he wants to enforce the clause dogmatically the clause gets unrestricted valid. On the other hand, if he gives notice, to the effect that he does not want to enforce the clause, dogmatically the notice becomes a waiver for the purpose of sec. 397 Civil Code.

Lastly, the employer has a right to request the employee to make a decision, whether he wants to enforce the agreement or not. If the employee does not answer within a reasonable time, the right to enforce the agreement or not devolves upon the employer.<sup>174</sup>

### 3.3. PARTLY NON-BINDING AGREEMENTS

In some cases the sec. 74 ff Commercial Code stipulates that a clause is partly non-binding (“teilweise unverbindlich”). Sometimes a restraint clause is not void or non-binding in total. It is possible, that a clause can be only partly non-binding, because only in one respect the prescribed limits were exceeded. Judiciary and commentators stated that only in the following cases the restraint of trade agreement can also be partly void or partly non-binding:

- By virtue of sec. 74a(i) sentence 1 Commercial Code the restraint clause is non-binding insofar as it does not serve to protect a legitimate business interest of the principal. Mostly cases fall under this provision, where employees were restrained in areas or branches, where they could not be “dangerous” for the employer. If there are no business interests of the employer at all, then the clause will be completely non-binding. The same applies to the provision of sec. 74a(i) sentence 2 Commercial Code, where the restraint clause is non-binding insofar as, with respect to the compensation allowed, the place, time or subject matter, it constitutes an unreasonable interference with the clerical employee's career.
- By virtue of sec. 74a(i) sentence 3 Commercial Code the restraint clause cannot extend beyond a period of two years following the end of the employment relationship. Therefore the restraint is also non-binding insofar it is longer than two years.

## 4. FORM OF THE AGREEMENT

By virtue of sec. 74(i) Commercial Code the restraint agreement must be in writing, and a copy of the document signed by the principal and containing the agreed conditions must be provided to the clerical employee.

The reason for the provision that the agreement must be in writing is unclear. BUCHNER<sup>175</sup> stated that the main aim of the provision is to *warn*<sup>176</sup> the employee, concluding such an

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<sup>173</sup> BAG, AP 60 zu § 74 HGB.

<sup>174</sup> Ibid.

agreement. HEYMANN/HENSSLER<sup>177</sup> mention also the protection against someone's unawareness<sup>178</sup>. However, the most important function is obviously the function of *documentation*<sup>179</sup>.

The provision that a copy of the document signed by the principal and containing the agreed conditions must be provided to the clerical employee, sound very easy and unspectacular. However, this provision is responsible for a vast number of void restraint of trade clauses.

In practice, many employers let the employee sign the deed and hand out only a photocopy of it. In this case, the restraint clause is (correctly) in writing, but the employee did not receive a signed copy of the document, he only received a copy of the signed deed.<sup>180</sup>

## 5. PROTECTABLE ISSUES IN RESTRAINT OF TRADE CLAUSES

### 5.1. DEFINITION OF BUSINESS ACTIVITY

Sec. 74(1) Commercial Code defines a restraint clause as an "agreement ... which limits the clerical employee in his business activity". Therefore it is necessary to determine what a business activity is. The covenantor is basically restrained in working for a competitor. However, he is not restrained from concluding legal contracts with competitors, as long as he is not working for them. For instance, he can lease a property to a competitor or sell them a patent.<sup>181</sup> The employee can also apply for a job, or he can even conclude an employment contract, concerning the time after the restraint period.

### 5.2. RESTRAINTS ON FUNCTIONS AND RESTRAINTS OVER A WHOLE BRANCH

The Federal Labour Court<sup>182</sup> often distinguishes between restraints on functions in a company and restraints over a whole branch or enumerated business.<sup>183</sup> An example of the latter one is, where the employee is restricted from working for any insurance company or e.g. Sanlam Ltd. An example of a restraint narrowed down by stipulating a certain function is if the employee is restricted in working as an accountant. Both kinds of restraints are basically possible, but the restraint over a whole branch is much more effective, because it is easy to police it, whereas a restraint where the employee is restricted in working as an accountant, can easily be ineffective if he is for instance employed as a controller.<sup>184</sup>

<sup>175</sup> H Buchner „Wettbewerbsverbote während und nach Beendigung des Arbeitsverhältnisses“ (1995), C160.

<sup>176</sup> In German: „Warnfunktion“.

<sup>177</sup> E Heymann/M Henssler „Handelsgesetzbuch“ (1995), §74 Rn. 18.

<sup>178</sup> In German: „Übereilungsschutz“.

<sup>179</sup> In German: „Dokumentationsfunktion“.

<sup>180</sup> H Buchner op cit C 146.

<sup>181</sup> K Bartenbach/FE Volz „Gesetz über Arbeitnehmererfindungen“ (1997), § 8 Rn 54.

<sup>182</sup> BAG, AP 24 zu § 133f GewO.

<sup>183</sup> In German: „Tätigkeits- und unternehmensbezogenen Wettbewerbsbeschränkungen“.

<sup>184</sup> Cf. BAG, AP 24 zu § 133f GewO.

### 5.3. EMPLOYEES AND SELF-EMPLOYED PERSONS

The Federal Labour Court<sup>185</sup> also distinguishes between restraints on starting as a freelancer or a self-employed person on the one hand, and restraints on taking up an employment on the other. Restraint clauses, can include all elements or be narrowed down to one of those elements.<sup>186</sup> The Higher Regional Court Frankfurt<sup>187</sup> decided, that a clause that stipulates only that a person is restrained from taking up an employment with a competitor, will not restrain him from becoming a self-employed person.

### 5.4. DEFINITION OF A COMPETING COMPANY

Numerous restraint clauses prohibit employees from working for “a competing company”<sup>188</sup>. Although the provisions do not define what a competing company is.<sup>189</sup> As the Higher Labour Court Köln<sup>190</sup> decided, there must be more evidence, than just having the same branch specification in the company name, or in the commercial register. MARTENS<sup>191</sup> proposes to define “a competing company” by using a spatial and product orientated<sup>192</sup> view. Due to his opinion, a competing company will be one that is participating on the same market, where the same people satisfy their demand for goods and services. If you would follow this approach an employee could change from a retailer to a wholesaler. Rather the term of “a competing company” has to be defined more generously.<sup>193</sup> The Higher Labour Court Frankfurt<sup>194</sup> even decided that also the production and sale of technically different products can cause a competitive relationship. This is for instance the case if the products can be substituted for each other, like wooden windows and plastic windows. Furthermore it is not obligatory that the whole range of products is the same. The Federal Labour Court<sup>195</sup> decided that is enough if 10% of the products are overlapping.

Lastly, a non-competing company becomes “a competing company” if it starts to compete with the covenantee after the particular employee started working there. It does not matter if it is because the employee started working there, or not. In such a case the employee has to leave the business immediately. However, the company does not become only a competitor if it starts producing or selling certain goods, it already becomes a competitor if it develops certain goods or prepares the product placement.

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<sup>185</sup> BAG, AP 24 zu § 133f GewO.

<sup>186</sup> BAG, AP 5 zu § 611 BGB.

<sup>187</sup> OLG Frankfurt, DB 1973, 139.

<sup>188</sup> In German: „Konkurrenzunternehmen“.

<sup>189</sup> Cf. E Dorndorf, „Freie Arbeitsplatzwahl und Recht am Arbeitsergebnis“ (1979), 227ff.

<sup>190</sup> LAG Köln, NZA 1995, 994.

<sup>191</sup> KP Martens “Das Arbeitsrecht der leitenden Angestellten” (1982), 184.

<sup>192</sup> In German: „Räumlich und gegenständlich“.

<sup>193</sup> E Dorndorf op cit pp 228 f.

<sup>194</sup> LAG Frankfurt, LAGE 1 zu § 74a HGB

<sup>195</sup> BAG, AP 21 zu § 133f GewO.



### 5.5. EMPLOYMENT BY A SERVICE PROVIDER, TAKER OR SUPPLIER

Another range of problems is worth discussing. Sec. 74 ff Commercial Code stipulates that an employee can be restrained from being employed by a competitor, but what happens if the employee is being employed by a service provider, a supplier or even a customer. All those are normally not competitors to the covenantee. Therefore a restraint clause, that only restrains a covenantor from being employed by a competitor, does not restrain him from being employed by a service provider, supplier or customer. The Federal Labour Court<sup>196</sup> simply stated that it is the matter of the covenantee, to draw a proper clause, if he wants it to be protected.

### 5.6. NON-DEALING AND NON-SOLICITATION WITH FORMER CUSTOMERS

A possibility to narrow down restraints, is to restrain a covenantor from dealing with the customers of the covenantee. As previously mentioned in the part, on the English restraint of trade doctrine,<sup>197</sup> it is possible to conclude non-solicitation or even non-dealing covenant. Both kinds are also known in Germany, and the same principles apply as in common law. But German commentators emphasised, that it is a dangerous way to narrow down a restraint, because the clause can easily become too vague. The Higher Regional Court Düsseldorf<sup>198</sup> stated that an agreement that merely stipulates that the customers or clients of the covenantee are protected is ineffective. The covenantee has rather to designate which customers or clients are protected and for how long.<sup>199</sup> The parties should also stipulate if they only intend to conclude a non-solicitation restraint or a general non-dealing restraint.

### 5.7. DUTIES AND LIABILITIES OF THIRD PARTIES

Due to sec. 74a(2) sentence 2 Commercial Code an agreement by which a third party, in lieu of the clerical employee, assumes the obligation to ensure that the clerical employee will restrict his professional activity following the end of the employment relationship, is void. In the past, this provision caused no problems. Judgments concerning this provision are not known. An example for such a void agreement is, if a father, a brother or a wife would assume the obligation to ensure that the son, the brother or husband will not work for a competitor. Hence, this provision only applies to agreements between a third-party and the covenantee.

More problematic are cases, where the covenantee concludes an agreement with a third-party that restrains itself from competing with the covenantee. Such agreements are sometimes concluded, if the employer fears that the employee will start a business after

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<sup>196</sup> BAG, AP 44 zu § 611 BGB.

<sup>197</sup> Sec II 11.4. *supra*.

<sup>198</sup> BAG, BB 1994, 1958.

his employment relationship for instance under the name of his wife as a dummy. Such agreements are always concluded as apart agreements with the actual covenantor (employee). The agreement with the third-party is therefore only a supplement or confirmation.<sup>200</sup> Hence, this agreement is valid even if no *further* compensation is paid.

## 6. AREA OF RESTRAINT

Normally a restraint clause stipulates the area where the covenantor is restrained. However, in practice sometimes problems arise because vague expressions are used. Basically a restraint can be limited to a city, a county, a federal state or be stretched over the whole Federal Republic of Germany. A restraint stretching over the territory of the European Union was held to be dynamic, so that a competition would become illegal in a country that later joined the European Union. Sometimes the area of a restraint is determined by using a clause like: “the employee is restrained ... in all countries, where he worked during the last 2 years before leaving the company” or “where the company maintains subsidiaries when the employee leaves the company”. Such agreements are basically valid, but the employer has the duty after termination of the employment relationship to inform the employee about the extent of his restraint.

If the restraint clause does not stipulate a certain area, basically a worldwide restraint is agreed. Such worldwide agreements are not *per se* invalid; they even might be reasonable. However, mostly the “legitimate business interest” of the employer will be missing. However, a too wide area of the restraint is not too dangerous for the employer, because by virtue of sec. 74a(1) Commercial Code the restraint is non-binding in the exceeding part – where the employer has no legitimate business interest. In all other respects, the restraint stays valid.

Another kind of drawing spatial restrictions is to use a company-related formulation, like (1) “An employee is restrained from working for a company, that produces and sells pharmaceuticals in Germany.”, or (2) “An employee is restrained from working for a company, that produces and sells pharmaceuticals. The prohibition applies in Germany.” As one can see, drafting in these cases is very difficult. In Example (1) for instance, an employee is restrained in building up the sales structures in South Africa for a German pharmaceutical company. Instead, he can be employed by a South African company, that does not produce or sell medicine in Germany. In Example (2) on the other hand, it does not depend on the company’s activity but rather on the employee’s activity. Therefore, he could change to a South African company in South Africa that is active in Germany, but he would be restricted in working within Germany for a foreign company, that does not produce or sell in Germany at all.

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<sup>199</sup> Cf. M Thamm “Die rechtliche Bedeutung des Begriffs ‘Kundenschutz’” (1995) BB 1995, 790.

## 7. BORDERS OF RESTRAINTS

A restraint is only valid, if the employer has “a legitimate business interest”. However, just this term causes a lot of uncertainty. Every particular restraint clause can be proved by the courts, if it matches the requirement of “a legitimate business interest”. Therefore, numerous decisions exist. The courts decided that every restraint clause has to match the legitimate business interest in a substantial, special and temporal dimension. But if there is a legitimate business interest, it needs not to be the only interest that was followed, it is only important that there is at least one legitimate business interest.

### 7.1. SUBSTANTIAL BORDERS

Obviously, the employer must have a business interest, and not a private interest to restrain the employee. However, not all business interests are protectable. The courts argued that there must be a final connection between the former employment and the prohibited activity.<sup>201</sup> Therefore trade secrets are particularly protectable. But a limitation on bearers of official secrets was explicitly denied by the Federal Labour Court.<sup>202</sup> Rather, an employer has a legitimate interest, if he wants to protect himself from being deprived of his customers, because the employee gained knowledge about them, when he worked for the employer.<sup>203</sup> No legitimate interest, on the other side, is the employer’s desire to protect him from mere competition by the covenantor. The question if the covenantee has a legitimate interest cannot be abstractly determined. The employer’s interest has to be determined in every single case.

#### 7.1.1. FREELANCERS

The civil courts decided in an unbroken line of cases that in cases of freelancers a complete prohibition of competition cannot be covered by a legitimate business interest, and therefore the restraint is void. In such cases, the company can protect itself by concluding a clause that prohibits dealing with former clients of the covenantee. It was stated, that such a clause is only used to edge competitors out of the market. Furthermore, only customers can be protected, with whose was dealt within the last two or three years.<sup>204</sup>

#### 7.1.2. SALESMEN

If salesmen change their jobs, the most serious problem is, that they are likely try to tie their old customers to the new company. In such cases, the company can protect itself by concluding a clause that prohibits dealing with former clients of

<sup>200</sup> MünchKommHGB/G v Hoyningen-Huene § 74a Rn. 31.

<sup>201</sup> BAG, AP 15 zu § 133f GewO.

<sup>202</sup> BAG, AP 2 zu § 74a HGB.

<sup>203</sup> G Schaub „Arbeitsrechtliches Handbuch“ (2000), § 58 III 9, p. 415.

<sup>204</sup> G v Hoyningen-Huene op cit § 74 Rn 12; BGH, NJW 1997,3089.

the covenantee. Mostly, there is no further protectable interest for the covenantee; and particularly no legitimate business interest to restrain him from working for a competitor at all.<sup>205</sup>

#### 7.1.3. WORKERS

Very problematic are restraint clauses with workers that do not have any contact with clients and suppliers. In such cases the intention of the restraint clause is only to keep the qualified worker and withhold him from the competitors.<sup>206</sup> Such an intention is not covered by the restraint rules. Sometimes it is argued that employers often spend a lot of money by training or specializing their workers, and that the employers want to protect these expenses. But such expenses can easily be protected by utilizing obligations of repayment; such expenses cannot justify a restraint.

#### 7.1.4. BRANCHES WITHOUT TRADE SECRETS

The Federal Labour Court<sup>207</sup> had to decide a case where a driving instructor was restrained. In this case the court stipulated, that a restraint cannot be justified, if there are no special trade secrets in a particular branch and no regular customers are involved. In this case the restraint was only used to edge the driving instructor out of the market.<sup>208</sup>

#### 7.1.5. LIMITATION ON PARTICULAR COMPETITORS

Sometimes restraints were placed on covenantors, not to work for a particular competitor, even if there are other equally “dangerous” competitors. Such restraints are indications that the covenantee is primarily not concerned about his own company, but rather intends to weaken a competitor. Such an intention is not covered by sec. 74a(1) sentence 1 Commercial Code. If there are reasonable grounds to distinguish between competitors, a clause might be reasonable.<sup>209</sup>

#### 7.1.6. COMPANY-RELATED RESTRAINTS

As seen above, it is possible to draft clauses by using company-related formulations. By virtue of sec. 74a(1) sentence 1 Commercial Code it has to be distinguished if an employer can restrict an employee from working for a competitor at all, or if he only can restrict him from working in his same profession or position. The Federal Labour Court<sup>210</sup> stated that the employer basically can only have a reasonable interest in restricting an employee from a

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<sup>205</sup> OLG Hamm, GmbHR 1988, 345.

<sup>206</sup> BAG, AP 22 zu § 611 BGB.

<sup>207</sup> BAG, AP 15 zu § 133f GewO.

<sup>208</sup> OLG Köln, OLGZ 1967, 394.

<sup>209</sup> BAG, AP 1 zu § 611 BGB.

particular activity in his job and not at all. The restraint that covers all activities for a competing company can only be reasonable in cases of members of executive bodies or executive personnel alone.<sup>211</sup>

#### 7.1.7. ABSENCE OF COMPETITORS

By virtue of sec. 74a(1) sentence 1 Commercial Code, the restraint clause is non-binding if it does not protect a legitimate business interest of the principal. That requires that the principal *has* a protectable business interest. The latter is lacking if the employer shuts down his business and leaves the market, because he cannot be a subject of competition. In another case the Federal Labour Court<sup>212</sup> decided that an employer has no legitimate business interest if there exist virtually no competitors in the particular market.

#### 7.1.8. EMPLOYEES GAINED NO TRADE SECRETS

In some cases the problem was, that an employee was restrained because the employer thought that the employee could gain some business secrets while working for him. In fact, the employee did not gain any relevant information; e.g. because the employment relationship was terminated after a very short time or because of other factual reasons.<sup>213</sup> In such cases the employer has no legitimate business interest.

#### 7.1.9. INFORMATION GETS PUBLICLY KNOWN

As mentioned above the employer has a reasonable legitimate business interest if he wants to protect business secrets. But if such business secrets become commonly known, or if they are no longer interesting or important for the employer he has no protectable business interest anymore and therefore the restraint clause is no longer enforceable.

### 7.2. SPATIAL BORDERS

Spatial limitations obviously can go only as far as competition or competitors exist. If cases of mass services are concerned, like taxi drivers or insurance agents, a spatial restriction has to be drawn very narrowly. If very sophisticated services are concerned the spatial restriction may be (very) wide. In 1970 the Federal Labour Court<sup>214</sup> considered whether a spatial restriction for a chemical manager of a plant could be extended over the

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<sup>210</sup> BAG, AP 2 zu § 74a HGB.

<sup>211</sup> BAG, AP 21 zu § 133f GewO.

<sup>212</sup> BAG, AP 25 zu § 615 BGB.

<sup>213</sup> D Gaul, "Wechselbeziehungen zwischen betrieblicher Altersversorgung und Wettbewerbsverbot", BB 1980, 59.

<sup>214</sup> BAG, AP 24 zu § 133f GewO

whole European Union,<sup>215</sup> but did not decide the question. Nowadays this question has to be clearly answered in the affirmative.

### 7.3. TEMPORAL BORDERS

Theoretically it has to be considered, how long a restraint is covered by a legitimate business interest. However, sec. 74a(1) sentence 3 Commercial Code stipulates a maximal temporal border of 2 years. Only in isolated cases a shorter temporal border has to be used, to be reasonable.

## 8. COMPENSATION

Due to sec. 74(2) Commercial Code, the restraint clause is only binding if the employer is obligated to pay annual compensation equal to at least one-half of the most recent contractual remuneration received by the employee. Therefore, it is enough if the employer pays 50% of the remuneration. However, consideration should be given to payment of a higher remuneration, if the restraint is wide-ranging.

In the meantime, the principle of “no restraint without compensation” applies completely. Initially the Commercial Code and the Industrial Code contained different regulations, where in some cases restraints were permissible although no compensation was paid. Over time the Federal Labour Court held those provisions as unconstitutional or the legislator repealed them.<sup>216</sup>

In practice, many restraints are invalid, because the clauses were clumsily drafted, and do not match the conditions laid down in sec. 74(2) or 74b Commercial Code. However, in practice the most complicated topic is the specific calculation of the compensation, particularly if the remuneration consists of variable parts.<sup>217</sup>

### 8.1. CALCULATION OF THE COMPENSATION

When the compensation is calculated, only the remuneration of the recent employment relationship has to be considered; no job on the side<sup>218</sup> or former employment relationships have influence on the compensation.

### 8.2. CONTRACTUAL REMUNERATION

The stipulated “contractual remuneration”<sup>219</sup> consists basically of all payments in money and kind that the employee gets from his employer. Therefore a company car or company-owned housing as well as share in profits, bonuses and gratuity have to be

<sup>215</sup> Named in that time: European Community.

<sup>216</sup> See IV 3. *supra*.

<sup>217</sup> The presentation of all this problems would lead out of the scope of this thesis, and are therefore not discussed. Cf. JH Bauer/M Diller „Wettbewerbsverbote“ (2002), pp 139 ff.

<sup>218</sup> See V 12.2. *infra*.

<sup>219</sup> In German: „vertragmäßige Leistungen“.

included. One can say that basically everything falls under this expression that is taxed by the German income tax as benefits in money's worth<sup>220</sup>.

### 8.3. SPECIFIC CALCULATION OF THE COMPENSATION

The calculation of the compensation is extraordinarily complicated. In what follows, only the basic rules are mentioned. If the compensation is calculated, basically it has to be distinguished between steady and variable payments. If steady payments are taken as a basis for calculation, the last month's pay is relevant. If variable elements are concerned, due to sec. 74b(ii) Commercial Code, the period of 36 months before leaving the employment is relevant. Only if the employment relationship was shorter than three years, is this duration applicable.

### 8.4. NAME AND PURPOSE OF COMPENSATION

To comply with sec. 74(2) Commercial Code you have only to pay the necessary compensation. It does not matter if the payment is described as "interim payment"<sup>221</sup> or "retirement payment".<sup>222</sup>

### 8.5. LACK OF STIPULATION OF A SPECIFIC COMPENSATION

In some cases the parties did not stipulate the exact amount that has to be paid as compensation, but they stipulated that the compensation should be paid "as regulated in sec. 74(2) and 74b Commercial Code". The Federal Labour Court<sup>223</sup> decided that such clause would trigger off a compensation of 50%.

## 9. CONDITIONAL RESTRAINTS

In many cases restraint clauses are drafted with the intention to be only effective when a particular condition applies, or if the covenantee chooses to enforce the restraint. Firstly, an attempt was made to draft clauses, where an employer has an option to choose whether he wants to enforce the restraint after termination of the employment, or not. Later they tried to draft the clauses in such a way that the employee has a duty to conclude a restraint agreement with the employer, if the employer wishes to conclude one. Over time many other opalescent clauses came up, all with the intention of enforcing (and paying for) the restraint if it is important to do so, and not enforcing it, if it would become too expensive. However, the Federal Labour Court over and over held those clauses as non-binding.<sup>224</sup>

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<sup>220</sup> In German: „geldwerter Vorteil“.

<sup>221</sup> In German: „Übergangsgeld“.

<sup>222</sup> In German: „Ruhestandsgeld“.

<sup>223</sup> BAG, AP 35 zu § 74 HGB.

<sup>224</sup> Cf. JH Bauer/M Diller „Zulässige und unzulässige Bedingungen in Wettbewerbsverboten“, DB 1997, 94 ff.

## 10. EMPLOYER'S WAIVER DUE TO SEC. 75A COMMERCIAL CODE

Due to sec. 75a Commercial Code the employer can waive his right of restraining the employee. If the employer wants to do so he has to give a written waiver to the employee. Due to this waiver the employee is instantly released from the restraint, but the employer is still obligated to pay compensation for at least one year after transmitting the waiver. This provision should enable the employer to get rid of a costly restraint agreement, that has become no longer interesting for him.<sup>225</sup>

If or how long the employer has to pay compensation depends on the duration of employment after submitting the waiver. If the employee works for the employer for more than a year, after submitting the waiver, the employer has to pay no compensation. If the waiver is submitted right after termination of the labour relationship, the employer has to pay for a full year, though. Once the employer has submitted the waiver, the employee is free to choose a new job, although the employer is obligated to pay compensation for the remaining period.

The Commercial Code concludes no provision that grants such a right to the employee as well, and therefore, the employee has no right to rescue himself from a restraint agreement. However, the parties can conclude an agreement, where they resolve the restraint agreement.<sup>226</sup> For the sake of completeness it has to be mentioned, that in addition such waivers or agreements cannot be conditional.<sup>227</sup>

## 11. INVALIDITY OF THE RESTRAINT CLAUSE DUE TO SEC. 75 COMMERCIAL CODE

Basically restraint clauses become enforceable when the employment relationship ends. The circumstances concerning the kind of the termination basically do not matter. However, sec. 75 Commercial Code stipulates some exceptions from this rule. Due to sec. 75 Commercial Code the party that terminates the employment relationship because of a reasonable extraordinary reason<sup>228</sup> has a right to declare that he does not consider himself bound by the agreement. This is stipulated in sec. 75(1) Commercial Code concerning the employee, and stipulated in sec. 75(3) Commercial Code concerning the employer. These regulations have the intention to sanction the breaching party. It is said that the reason for this regulation is also the fact that there is no more a bond of trust between the parties after one party breaches the contract in such a serious way.

Different legal consequences are stipulated for cases where the employment relationship is terminated because of ordinary reasons<sup>229</sup>. In the case where the employee terminates the contract he has no right to declare that he does not consider himself bound by the agreement,

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<sup>225</sup> W Grunsky op cit pp 106 f.

<sup>226</sup> BAG, BB 1989, 1924.

<sup>227</sup> BGHZ 79, 267.

<sup>228</sup> In German: „Außerordentlicher Kündigungsgrund“.



because that is just a typical case where the restraint shall apply.<sup>230</sup> If the employer terminates the contract one has to distinguish between considerable reasons linked with the person,<sup>231</sup> like illness, bad behaviour or other reasons. In all cases, except those linked with the person, the employee has a right to declare that he does not consider himself bound by the agreement. It is said that the reason for this provision is the protection of the employee if he is fired without giving a reason out of his sphere.<sup>232</sup>

Lastly, it is important to note, that by virtue of sec. 75 Commercial Code, the restraint clause does not become non-binding automatically, rather the party or the parties have only a right to untie themselves from the restraint, if they want to do so. If one of the parties declare that he does not consider himself bound by the agreement the agreement is ineffective instantly and completely. Therefore *ex nunc* the employee is not restrained and the employer goes not have to pay compensation.

## 12. DEDUCTION OF OTHER EARNINGS

Due to sec. 74c Commercial Code the employee must allow all amounts that he earns through employment elsewhere to be deducted from the compensation due. Such regulation does not seem to make sense, because a diligent person would be discriminated against the person, who does not start working within the restraint-period. But due to equitable principles it is fair to reduce the compensation paid by the employer.<sup>233</sup> Such a deduction is stipulated by the law and does not need to be part of the restraint clause.<sup>234</sup> Also, the employer needs not claim it, he has a claim *ipso jure*.

### 12.1. LIMITS OF DEDUCTION

Sec. 74c(1) Commercial Code distinguishes two limits of income. Basically only income that is earned elsewhere will be deducted if it exceeds 110% of the former remuneration. The limit increases to 125% if the employee has to move to another town as result of his new job. This shall compensate the additional expenditures that were caused by the move and shall motivate the employee to find another job and be encouraged not live on the compensation.<sup>235</sup>

### 12.2. KIND OF DEDUCTIBLE INCOME

Due to sec. 74c(1) sentence 1 Commercial Code the employee needs not allow all amounts that he earns to be deducted from the compensation due. Only those amounts are considered that are earned through employment elsewhere, or which he maliciously

<sup>229</sup> In German: „ordentliche Kündigungsgründe“.

<sup>230</sup> H Buchner op cit C 413.

<sup>231</sup> In German: „Erhebliche in der Person liegende Gründe“.

<sup>232</sup> German labour law knows only particular reasons for terminating an employment contract. Therefore it distinguishes between reasons linked with the person, like e.g. illness, or bad behaviour and economical reasons of the employer, like e.g. decrease of orders.

<sup>233</sup> BAG, AP 21 zu § 74 HGB.

<sup>234</sup> BAG, AP 23 zu § 133f GewO.

<sup>235</sup> BAG, AP 14, 17, 20 zu § 74c HGB.

fails to earn. Sec. 74c(1) sentence 1 Commercial Code contains all kinds of income. It includes, for instance, as well payments for being an organ of a company, income by being a self-employed person or a freelancer.<sup>236</sup> Furthermore, the Federal Labour Court created the doctrine of uniformity of calculation and deduction of compensation.<sup>237</sup> Therefore all kinds of income that were considered when calculating the remuneration have also to be considered when calculating the deduction. Insofar as all above-mentioned kinds of income will also apply here.<sup>238</sup>

However, if the employee had a side job during the employment relationship and has the same or a similar side-job during his restraint period, then this income will not be deducted from the compensation. Otherwise a deduction of these earnings would disadvantage him.<sup>239</sup>

### 12.3. MALICIOUSLY FAILS TO EARN

As already mentioned the employee must allow all amounts that he maliciously fails to earn to be deducted from the compensation due. Now it has to be determined what is meant by “maliciously fails to earn”. Obviously the covenantor does not have to accept every job, because he has a constitutional right to choose his job.<sup>240</sup> Only if the employee turns down a job offer without having an objective reason he loses his right of compensation partly or completely. The extent of the deduction depends on the amount he maliciously fails to earn. It was decided for instance that it is not malicious if an employee starts a course at a university<sup>241</sup> or sets up a business.<sup>242</sup> It is also not malicious if an employee terminates an employment relationship that he concluded during the restraint period, because of reasonable grounds.<sup>243</sup>

The onus of proof that the employee maliciously fails to earn money is on the employer. He has the onus to prove that there was a particular job, that the employee could have got, if he had applied for it with reasonable effort.<sup>244</sup>

### 12.4. UNEMPLOYMENT BENEFITS AND OTHER SOCIAL SECURITY CONTRIBUTIONS

Courts always made clear<sup>245</sup> that social security contributions not have to be deducted from the compensation due. Nevertheless serious discussions arose about the deduction of unemployment benefits. Due to the wording of sec. 74c Commercial Code unemployment benefits do not have to be deducted from the compensation due, because they are no earnings resulting from the covenantor’s workforce. Unemployment benefits

<sup>236</sup> BAG, AP 6, 7 zu § 74c HGB.

<sup>237</sup> BAG, AP 34, 59 zu § 74 HGB: “Grundsatz der Gleichheit von Berechnung und Anrechnung”.

<sup>238</sup> See V 8. *supra*.

<sup>239</sup> E Heymann/M Henssler op cit § 74c Rn. 7.

<sup>240</sup> Art. 12(i) Constitution of the Federal Republic of Germany.

<sup>241</sup> BAG, AP 4, 5 zu § 74c HGB.

<sup>242</sup> BAG, AP 4, 13 zu § 74c HGB.

<sup>243</sup> LAG Hamm, 16 Sa 1684/99.

<sup>244</sup> BAG, AP 1 zu § 74c HGB.

usually were paid because the former employee is out of work, and therefore the earning results not from the person's workforce. However, the Federal Labour Court decided<sup>246</sup> that the unemployment benefits have the function to substitute<sup>247</sup> a salary, and therefore have to be included in the system of deductible income. In other words, unemployment benefits are part of "the amount that he earns through employment", and have to be deducted from the compensation due.

### 13. MEMBERS OF EXECUTIVE BODIES

It is very controversial, if the sec. 74 ff Commercial Code also applies to members of executive bodies of companies,<sup>248</sup> like a managing director or a member of a managing board. Due to special regulations like sec. 88, 85 and 404 Company Law, members of executive bodies are restrained from competing with the company during their term of office. After leaving the company they are by virtue of the law restrained from disclosing business secrets. But the restraint does not include a prohibition not to compete with the company after he has left it.<sup>249</sup> Therefore companies can also conclude restraint clauses with their members of executive bodies. In an unbroken line of authorities the Federal Supreme Court<sup>250</sup> held that members of executive bodies are not employees, and therefore sec. 74 ff Commercial Code does not apply to them. The court stated also, that the companies can conclude with those members restraint clauses, being only limited by the rules of sec. 138 Civil Code – contrary to public policy – and Art. 12(1) Constitution of the Federal Republic Germany – right to choose an occupation.<sup>251</sup>

### 14. ONUS OF PROOF

The rules concerning the onus of proof are very simple. The party that wants to enforce the restraint or wants to get the compensation has to prove that the parties concluded a restraint clause. If the employee wants to argue that the restraint is too wide, too vague or void, he has the onus of proof.<sup>252</sup>

### 15. RESTRAINT OF TRADE CLAUSES AFTER THE 2002 REVISION OF LAW OF OBLIGATIONS

In 2002 the legislator completely revised the whole law of obligations. In this process the legislator decided among other major changes to apply the law of general terms and conditions also to "labour law" and therefore also to restraint of trade clauses. In practice this

<sup>245</sup> BAG, AP 46 zu § 74 HGB.

<sup>246</sup> BAG, AP 11 zu § 74c HGB.

<sup>247</sup> In German: "Lohnersatzfunktion".

<sup>248</sup> J Flatten "Nachvertragliche Wettbewerbsverbote aus Unternehmenssicht" (1999), ZIP 1999, 1701, 1705.

<sup>249</sup> BGH, GmbHR 1991, 15.

<sup>250</sup> BGHZ 10, 191; 12, 8; 49, 31.

<sup>251</sup> A different opinion is followed by some commentators: Gravenhorst "Rechtliche Grenzen für die Vereinbarung nachvertraglicher Wettbewerbsverbote mit GmbH-Geschäftsführern" (1999) 62 ff; Staub/W Weber "Handelsgesetzbuch" (1995), vor § 74 Rn. 20ff.

<sup>252</sup> Staub/W Weber op cit § 74a Rn. 3.

revision therefore causes some changes to the law of restraints.<sup>253</sup> But for the purpose of this dissertation only the application of the law of general terms and conditions will be analysed. Most labour contracts that were concluded were bought as forms at stationery or were recurrently printed out by a computer. Therefore in most cases the law of general terms and conditions applies and causes the application of several additional regulations. Due to sec. 305c(2) Civil Code, for instance, all vagueness occurring in the restraint clause will cause the clause to be inoperative. Luckily sec. 74 ff Commercial Code are *lex specialis* to sec. 305 ff Civil Code, with the consequence, that all vagueness problems that are covered by the restraint rules, only cause the clause to be non-binding. But all other cases of vagueness, that are out of the range of sec. 74 ff Commercial Code, will probably<sup>254</sup> cause the clause to be inoperative. Furthermore, until now it was easily possible to include a restraint clause in an employment contract. If, now, the law of general terms and conditions applies, the restraint clause is likely to be a surprising clause, if it is not printed in colour or emphasized in another way.<sup>255</sup> Due to sec. 305c(1) Civil Code such a clause would then probably<sup>256</sup> also be inoperative.

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<sup>253</sup> Very instructive: Bauer/Diller "Nachvertragliche Wettbewerbsverbote: Änderungen durch die Schuldrechtsreform, NJW 2002, 1609 ff.

<sup>254</sup> There are no decisions yet.

<sup>255</sup> In German: „Überraschende Klausel“.

<sup>256</sup> There are no decisions yet.

## **PART V: CONCLUSION**

In part I and II the development of the restraint of trade doctrine in England was described. In part III the modifications of the restraint of trade doctrine in South Africa were shown and part IV gives an overview of the German restraint of trade rules.

As far as the English and South African part is concerned, the historical developments and applicable principles of the restraint of trade doctrine were emphasised, to give an explanation for the restraint of trade law.

By contrast, the main aim in the German part was to give an overview about the codified restraint of trade rules and to discuss how and why they are applicable to which persons and entities.

### **1. SYSTEM OF REASONABLENESS**

While comparing the common law doctrine and the German restraint of trade law one can easily see that two totally different approaches were followed. The common law doctrine is a “system of reasonableness” and the German one is a “system of compensation”.

If you want to restrain somebody in a common law country, you have to ask yourself whether the restraint will be reasonable *inter partes* and will not be against public policy (Nordenfelt test). If this question is answered affirmatively, you will happily be able to restrain somebody “for free”, without being obliged to pay compensation.

Whereas it is much easier in Germany to restrain somebody from working for a competitor, even if the restraint is not fully covered by reasonable grounds. In such a case if you pay the compensation stipulated by the law, you are able to restrain this person effectively.

In my opinion, it is conversely a disadvantage not to be able to restrain somebody in Germany because of a reasonable ground, without paying compensation. It is, for instance, hard to understand why I have to pay compensation to my former marketing manager in a post-employment case, just to prevent him from plundering the clients I gained for my business.

On the other hand, I think it is problematic that I cannot restrain a person in a common law country from competing with me, in a case where the restraint is not against public policy, even if I pay compensation to him. I think this is an intense restriction of the principle of “freedom of trade”.

## **2. TEMPORAL DIMENSION**

When applying the German system, it is hard to understand why I can only restrain a person for two years maximum, if my reasonable ground lasts much longer than these two years. However I will not be able to protect these further interests in this case. In England and South Africa I would be able to restrain somebody as long as it does not exceed the legitimate interests. A trade connection therefore might be protectable as long as the duration of the customer relationship with the employer lasts.

Nevertheless, I think the German system is superior in cases where, for instance, customer connections are involved. Instead of determining how long it will last to tie a customer to a particular business, to determine the reasonable temporal dimension, it is easier to deal with an abstract time span of two years, during which time all customers are protected against competition.

Therefore my sympathy is more on the German side, because German law stipulates clear rules that probably are not fair in all circumstances, but give the parties certainty and security about the underlying rules. Basically the parties have to decide on their own, and in advance, if they have a reasonable ground for a restraint, and how much it is worth to the employer. If they then conclude a restraint clause, the employee has a right to compensation and the employer has a right to enforce the restraint of trade clause. At the time of enforcement of the restraint, there is no space for discussion neither about reasonable and unreasonable restraints, nor about the range or kind of the restraint.

## **3. RESTRICTION OF THE ACTIVITIES**

In the common law system you have to be very careful how you restrain a person. You can restrain a covenantor by using a non-solicitation or a non-dealing restraint, or you can just restrain a person from non-using or non-disclosing trade secrets. If the encroachment is too intensive the restraint will be unreasonable. The German system also distinguishes between different kinds of restraints. You can restrain somebody from working in certain functions, or restrain him from working in a whole branch or for a single competitor. Basically the kind of the restraint plays a role if the restraint clause is valid, void or non-binding, but the standard is not applied as strict as it is in common law countries. The restraint clause will only become non-binding if the restriction is so much too wide, that there is no reasonable ground at all for such an restraint.

#### 4. AREA OF RESTRAINT

Concerning the area of the restraint the German system is more practical as well. In common law countries I have to determine how big the area is, where the sphere of activity and interest of the covenantee is affected, whereas in the German system only the question arises, if the spatial restriction is so much too wide, that there is no reasonable ground at all for such an area restraint.

#### 5. PUBLIC INTEREST

Due to the common law doctrine the restraint must not be against public interest. This was expressly stipulated in the *Nordenfeldt* decision, and is therefore also called second leg of the *nordenfeldt* test. A similar approach is followed in Germany, where the blanket clause sec. 138 Civil Code is applicable, with the outcome, that restraint clauses that are against public policy are void.

#### 6. SUPERIORITY OF ONE SYSTEM

One can see that the two systems have a lot in common, but also differences. Each system is able to solve the upcoming matters and problems. But nevertheless, both systems can improve themselves by learning from each other. In the common law system the compensation should be considered under reasonable aspects, and not only under the topic of wider reasonable issues that cannot justify a restraint.

The German system should be more serious about the general principle stipulated in sec. 241(2) and 242 Civil Code, that a former employee still has after termination of the employment relationship collateral duties, that restrain him from harming his former employer. This principle should be strengthened to prevent competition when reasonable grounds are involved.

**APPENDIX: GERMAN LAW STATUTES:**

**GRUNDGESETZ DER BUNDESREPUBLIK DEUTSCHLAND (GG):**

**Art. 12(1) GG:**

Alle Deutschen haben das Recht, Beruf, Arbeitsplatz und Ausbildungsstätte frei zu wählen. Die Berufsausübung kann durch Gesetz oder auf Grund eines Gesetzes geregelt werden.

**Art. 12(1) GG:**

All Germans have the right to freely choose their occupation, their place of work, and their place of study or training. The practice of an occupation can be regulated by or pursuant to a statute.

**BÜRGERLICHES GESETZBUCH (BGB):**

**§ 138(1) BGB [Gute Sitten]**

(1) Ein Rechtsgeschäft, das gegen die guten Sitten verstößt, ist nichtig.

**Sec. 138(1) BGB Good morals**

(1) A legal transaction which offends good morals is void.

**§ 241 BGB [Pflichten aus dem Schuldverhältnis]**

(1) Kraft des Schuldverhältnisses ist der Gläubiger berechtigt, von dem Schuldner eine Leistung zu fordern. Die Leistung kann auch in einem Unterlassen bestehen.

(2) Das Schuldverhältnis kann nach seinem Inhalt jeden Teil zur Rücksicht auf die Rechte, Rechtsgüter und Interessen des anderen Teils verpflichten.

**Sec. 241 BGB Duties arising out of the obligation**

(1) By virtue of the obligation the obligee is entitled to demand performance from the obligor. Performance may also consist in refraining from doing something.

(2) An obligation may require each party to have regard to the other party's rights, legally protected interests and other interests

**§ 242 BGB [Leistung nach Treu und Glauben]**

Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.

**Sec. 242 BGB Performance according to good faith**

The debtor is bound to effect performance according to the requirements of good faith, giving consideration to common usage.

**HANDELSGESETZBUCH (HGB)<sup>257</sup>:**

**§ 59 HGB [Handlungsgehilfe]**

Wer in einem Handelsgewerbe zur Leistung kaufmännischer Dienste gegen Entgelt angestellt ist (Handlungsgehilfe), hat, soweit nicht besondere Vereinbarungen über die Art und den Umfang seiner Dienstleistungen oder über die ihm zukommende Vergütung getroffen sind, die dem Ortsgebrauch entsprechenden Dienste zu leisten sowie die dem Ortsgebrauch entsprechende Vergütung zu beanspruchen. In Ermangelung eines Ortsgebrauchs gelten die den Umständen nach angemessenen Leistungen als vereinbart.

**Sec. 59 HGB Clerical employees**

One who is employed in a business for the performance of business services in return for compensation (clerical employee) shall, unless special agreements have been made with respect to the type and scope of his duties or the compensation due, perform such services as are in accordance with local custom and have a right to compensation in accordance with local custom. In the absence of local custom, the parties will be deemed to have agreed to services reasonable under the circumstances.

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<sup>257</sup> English translation by: M Pelzer/EA Voigt "German Commercial Code" (2003).



**§ 60 HGB [Gesetzliches Wettbewerbsverbot]**

(1) Der Handlungsgehilfe darf ohne Einwilligung des Prinzipals weder ein Handelsgewerbe betreiben noch in dem Handelszweig des Prinzipals für eigene oder fremde Rechnung Geschäfte machen.

(2) Die Einwilligung zum Betrieb eines Handelsgewerbes gilt als erteilt, wenn dem Prinzipal bei der Anstellung des Gehilfen bekannt ist, daß er das Gewerbe betreibt, und der Prinzipal die Aufgabe des Betriebs nicht ausdrücklich vereinbart.

**§ 61 HGB [Verletzung des Wettbewerbsverbots]**

(1) Verletzt der Handlungsgehilfe die ihm nach § 60 obliegende Verpflichtung, so kann der Prinzipal Schadensersatz fordern; er kann statt dessen verlangen, daß der Handlungsgehilfe die für eigene Rechnung gemachten Geschäfte als für Rechnung des Prinzipals eingegangen gelten lasse und die aus Geschäften für fremde Rechnung bezogene Vergütung herausgebe oder seinen Anspruch auf die Vergütung abtrete.

(2) Die Ansprüche verjähren in drei Monaten von dem Zeitpunkt an, in welchem der Prinzipal Kenntnis von dem Abschluß des Geschäfts erlangt; sie verjähren ohne Rücksicht auf diese Kenntnis in fünf Jahren von dem Abschluß des Geschäfts an.

**§ 74 HGB [Vertragliches Wettbewerbsverbot; bezahlte Karenz]**

(1) Eine Vereinbarung zwischen dem Prinzipal und dem Handlungsgehilfen, die den Gehilfen für die Zeit nach Beendigung des Dienstverhältnisses in seiner gewerblichen Tätigkeit beschränkt (Wettbewerbsverbot), bedarf der Schriftform und der Aushändigung einer vom Prinzipal unterzeichneten, die vereinbarten Bestimmungen enthaltenden Urkunde an den Gehilfen.

(2) Das Wettbewerbsverbot ist nur verbindlich, wenn sich der Prinzipal verpflichtet, für die Dauer des Verbots eine Entschädigung zu zahlen, die für jedes Jahr des Verbots mindestens die Hälfte der von dem Handlungsgehilfen zuletzt bezogenen vertragsmäßigen Leistungen erreicht.

**§ 74a HGB [Unverbindliches oder nichtiges Verbot]**

(1) Das Wettbewerbsverbot ist insoweit unverbindlich, als es nicht zum Schutz eines berechtigten geschäftlichen Interesses des Prinzipals dient. Es ist ferner unverbindlich, soweit es unter Berücksichtigung der gewährten Entschädigung nach Ort, Zeit oder Gegenstand eine unbillige Erschwerung des Fortkommens des Gehilfen enthält. Das Verbot kann nicht auf einen Zeitraum von mehr als zwei Jahren von der Beendigung des Dienstverhältnisses an erstreckt

**Sec. 60 HGB Statutory prohibition of competition**

(1) Without the principal's consent, the clerical employee may neither carry on a business venture on his own nor undertake transactions in the field of the principal's trade, for his own account or that of another person.

(2) The principal shall be deemed to have consented to the operation of the business venture if the principal had knowledge of such business at the time of hiring the clerical employee and did not expressly agree to the cessation thereof.

**Sec. 61 HGB Violation of prohibition of competition**

(1) Where the clerical employee violates his duty pursuant to Sec. 60, the principal may assert a claim for damages; alternatively, he may demand that transactions made for the clerical employee's own account be deemed to be made for the principal's account and that the employee either turn over compensation received from transactions for the account of third parties or assign his rights to such compensation.

(2) The statute of limitation for claims is three months from the time the principal acquires knowledge of the conclusion of the transaction. Regardless of knowledge, the period of limitation is five years from the date of the transaction.

**Sec. 74 HGB Contractual prohibition of competition; paid abstinence period**

(1) An agreement between the principal and the clerical employee which limits the clerical employee in his business activity (prohibition of competition) for the period following termination of the employment relationship must be in writing, and a copy of the document signed by the principal and containing the agreed conditions must be provided to the clerical employee.

(2) The prohibition of competition is only binding where the principal is obligated, for the term of the prohibition, to pay annual compensation equal to at least one-half of the most recent contractual remuneration received by the clerical employee.

**Sec. 74a HGB Non-binding or void prohibition of compensation**

(1) The prohibition of competition is non-binding insofar as it does not serve to protect a legitimate business interest of the principal. Furthermore, it is non-binding insofar as, with respect to the compensation allowed, the place, time or subject matter, it constitutes an unreasonable interference with the clerical employee's career. The prohibition cannot extend beyond a period of two years following the end of the employment relationship.

werden.

(2) Das Verbot ist nichtig, wenn der Gehilfe zur Zeit des Abschlusses minderjährig ist oder wenn sich der Prinzipal die Erfüllung auf Ehrenwort oder unter ähnlichen Versicherungen versprechen läßt. Nichtig ist auch die Vereinbarung, durch die ein Dritter an Stelle des Gehilfen die Verpflichtung übernimmt, daß sich der Gehilfe nach der Beendigung des Dienstverhältnisses in seiner gewerblichen Tätigkeit beschränken werde.

(3) Unberührt bleiben die Vorschriften des § 138 des Bürgerlichen Gesetzbuchs über die Nichtigkeit von Rechtsgeschäften, die gegen die guten Sitten verstoßen.

#### **§ 74 b HGB [Zahlung und Berechnung der Entschädigung]**

(1) Die nach § 74 Abs. 2 dem Handlungsgehilfen zu gewährende Entschädigung ist am Schluß jedes Monats zu zahlen.

(2) Soweit die dem Gehilfen zustehenden vertragsmäßigen Leistungen in einer Provision oder in anderen wechselnden Bezügen bestehen, sind sie bei der Berechnung der Entschädigung nach dem Durchschnitt der letzten drei Jahre in Ansatz zu bringen. Hat die für die Bezüge bei der Beendigung des Dienstverhältnisses maßgebende Vertragsbestimmung noch nicht drei Jahre bestanden, so erfolgt der Ansatz nach dem Durchschnitt des Zeitraums, für den die Bestimmung in Kraft war.

(3) Soweit Bezüge zum Ersatz besonderer Auslagen dienen sollen, die infolge der Dienstleistung entstehen, bleiben sie außer Ansatz.

#### **§ 74c HGB [Anrechnung anderweitigen Erwerbs]**

(1) Der Handlungsgehilfe muß sich auf die fällige Entschädigung anrechnen lassen, was er während des Zeitraums, für den die Entschädigung gezahlt wird, durch anderweite Verwertung seiner Arbeitskraft erwirbt oder zu erwerben böswillig unterläßt, soweit die Entschädigung unter Hinzurechnung dieses Betrags den Betrag der zuletzt von ihm bezogenen vertragsmäßigen Leistungen um mehr als ein Zehntel übersteigen würde. Ist der Gehilfe durch das Wettbewerbsverbot gezwungen worden, seinen Wohnsitz zu verlegen, so tritt an die Stelle des Betrags von einem Zehntel der Betrag von einem Viertel. Für die Dauer der Verbüßung einer Freiheitsstrafe kann der Gehilfe eine Entschädigung nicht verlangen.

(2) Der Gehilfe ist verpflichtet, dem Prinzipal auf Erfordern über die Höhe seines Erwerbs Auskunft zu erteilen.

#### **§ 75 HGB [Unwirksamwerden des Wettbewerbsverbots]**

(1) Löst der Gehilfe das Dienstverhältnis gemäß den

(2) The prohibition is void, if the clerical employee is a minor at the time the contract was concluded or if the principal causes the clerical employee to give his word of honor or a similar assurance. The agreement by which a third party, in lieu of the clerical employee, assumes the obligation to ensure that the clerical employee will restrict his professional activity following the end of the employment relationship, is also void.

(3) The provisions of Sec. 138 of the Civil Code with regard to the nullity of legal acts contrary to public policy remain unaffected.

#### **Sec. 74 b HGB Payment and calculation of compensation**

(1) Compensation guaranteed to the clerical employee pursuant to Sec. 74 Subsection 2 is to be paid at the end of every month.

(2) Insofar as the contractual remuneration due the clerical employee is based upon a commission or other variable payment, the average of such remuneration received over the last three years is to be used to calculate the compensation due the employee. Where the applicable provision of the contract with respect to such amounts has not been in force three years at the end of the employment relationship, the estimate of the compensation amount is to be made by averaging the contractual remuneration paid during the period for which the provision was in force.

(3) Insofar as certain amounts were intended to compensate for specific expenses arising in connection with the employment performance, they are not to be included in the estimate.

#### **Sec. 74c HGB Deduction of other earnings**

(1) The clerical employee must allow all amounts that he earns through employment elsewhere (or maliciously fails to earn) during the period for which compensation is to be paid to be deducted from the compensation due, insofar as the compensation plus this amount would exceed by more than ten percent the contractual remuneration last received by him. Where the clerical employee has been compelled by the prohibition of competition to change his residence, the foregoing amount of ten percent shall be replaced by twenty-five percent. The clerical employee may not claim compensation for any period in which he is imprisoned.

(2) The clerical employee is obligated, on demand, to give information to the principal concerning the amount of his earnings.

#### **Sec. 75 HGB Invalidity of the prohibition of competition**

(1) Where the clerical employee terminates the

Vorschriften der §§ 70 und 71 wegen vertragswidrigen Verhaltens des Prinzipals auf, so wird das Wettbewerbsverbot unwirksam, wenn der Gehilfe vor Ablauf eines Monats nach der Kündigung schriftlich erklärt, daß er sich an die Vereinbarung nicht gebunden erachte.

(2) In gleicher Weise wird das Wettbewerbsverbot unwirksam, wenn der Prinzipal das Dienstverhältnis kündigt, es sei denn, daß für die Kündigung ein erheblicher Anlaß in der Person des Gehilfen vorliegt oder daß sich der Prinzipal bei der Kündigung bereit erklärt, während der Dauer der Beschränkung dem Gehilfen die vollen zuletzt von ihm bezogenen vertragsmäßigen Leistungen zu gewähren. Im letzteren Falle finden die Vorschriften des § 74b entsprechende Anwendung.

(3) Löst der Prinzipal das Dienstverhältnis gemäß den Vorschriften der §§ 70 und 72 wegen vertragswidrigen Verhaltens des Gehilfen auf, so hat der Gehilfe keinen Anspruch auf die Entschädigung.

#### **§ 75a HGB [Verzicht des Prinzipals auf Wettbewerbsverbot]**

Der Prinzipal kann vor der Beendigung des Dienstverhältnisses durch schriftliche Erklärung auf das Wettbewerbsverbot mit der Wirkung verzichten, daß er mit dem Ablauf eines Jahres seit der Erklärung von der Verpflichtung zur Zahlung der Entschädigung frei wird.

#### **§ 75c HGB [Vertragsstrafe]**

(1) Hat der Handlungsgehilfe für den Fall, daß er die in der Vereinbarung übernommene Verpflichtung nicht erfüllt, eine Strafe versprochen, so kann der Prinzipal Ansprüche nur nach Maßgabe der Vorschriften des § 340 des Bürgerlichen Gesetzbuchs geltend machen. Die Vorschriften des Bürgerlichen Gesetzbuchs über die Herabsetzung einer unverhältnismäßig hohen Vertragsstrafe bleiben unberührt.

(2) Ist die Verbindlichkeit der Vereinbarung nicht davon abhängig, daß sich der Prinzipal zur Zahlung einer Entschädigung an den Gehilfen verpflichtet, so kann der Prinzipal, wenn sich der Gehilfe einer Vertragsstrafe der in Absatz 1 bezeichneten Art unterworfen hat, nur die verwirkte Strafe verlangen; der Anspruch auf Erfüllung oder auf Ersatz eines weiteren Schadens ist ausgeschlossen.

#### **§ 75d HGB [Abweichende Vereinbarungen]**

Auf eine Vereinbarung, durch die von den Vorschriften der §§ 74 bis 75c zum Nachteil des Handlungsgehilfen abgewichen wird, kann sich der Prinzipal nicht berufen. Das gilt auch von Vereinbarungen, die bezwecken, die gesetzlichen Vorschriften über das Mindestmaß der Entschädigung durch Verrechnungen oder auf sonstige Weise zu umgehen.

employment relationship pursuant to the provisions of Sec. 70 and 71 because of breach of contract by the principal, the prohibition of competition will be invalid if the employee declares in writing within one month following the termination of employment that he does not consider himself bound by the agreement.

(2) The prohibition of competition will similarly be invalid if the principal terminates the employment relationship, unless a significant cause relating to the person of the clerical employee exists for the termination or the principal declares, upon giving notice, that he will pay to the clerical employee the full contractual remuneration last earned by him for the term of the prohibition of competition. In the latter case the provisions of Sec. 74 b apply analogously.

(3) Where the principal dissolves the employment relationship pursuant to the provisions of Sec. 70 and 72 due to breach of contract by the clerical employee, the clerical employee shall have no right to compensation.

#### **Sec. 75a HGB The principal's waiver of the prohibition of competition**

The principal may effectively waive, by means of a written statement, the prohibition of competition prior to expiration of the employment relationship. In such a case, the principal will, beginning one year after the date of the declaration, be free of the obligation to pay compensation.

#### **Sec. 75c HGB Contract penalty**

(1) Where the clerical employee is subject to a penalty in the event of non-fulfillment of his contractual obligation, the principal can assert claims only pursuant to the provisions of Sec. 340 of the Civil Code. The provisions of the Civil Code with regard to reduction of a disproportionate contractual penalty remain unaffected.

(2) Where the contractual obligation does not depend on the principal's obligation to pay compensation to the clerical employee, the principal can, if the clerical employee is subject to a contractual penalty of the kind outlined in Subsection 1, only assert the penalty forfeited by the employee, the right to specific performance or compensation for additional damages is prohibited.

#### **Sec. 75d HGB Deviating agreements**

The principal cannot, to the prejudice of the clerical employee, assert rights, resulting from an agreement which deviates from the provisions of Sec. 74 through 75c. This also applies to agreements intended, by means of set-off or other methods, to circumvent legal provisions concerning the minimum compensation.

**§ 75f HGB [Sperrabrede unter Arbeitgebern]**

Im Falle einer Vereinbarung, durch die sich ein Prinzipal einem anderen Prinzipal gegenüber verpflichtet, einen Handlungsgehilfen, der bei diesem im Dienst ist oder gewesen ist, nicht oder nur unter bestimmten Voraussetzungen anzustellen, steht beiden Teilen der Rücktritt frei. Aus der Vereinbarung findet weder Klage noch Einrede statt.

**§ 90a HGB [Wettbewerbsabrede]**

(1) Eine Vereinbarung, die den Handelsvertreter nach Beendigung des Vertragsverhältnisses in seiner gewerblichen Tätigkeit beschränkt (Wettbewerbsabrede), bedarf der Schriftform und der Aushändigung einer vom Unternehmer unterzeichneten, die vereinbarten Bestimmungen enthaltenden Urkunde an den Handelsvertreter. Die Abrede kann nur für längstens zwei Jahre von der Beendigung des Vertragsverhältnisses an getroffen werden; sie darf sich nur auf den dem Handelsvertreter zugewiesenen Bezirk oder Kundenkreis und nur auf die Gegenstände erstrecken, hinsichtlich deren sich der Handelsvertreter um die Vermittlung oder den Abschluß von Geschäften für den Unternehmer zu bemühen hat. Der Unternehmer ist verpflichtet, dem Handelsvertreter für die Dauer der Wettbewerbsbeschränkung eine angemessene Entschädigung zu zahlen.

(2) Der Unternehmer kann bis zum Ende des Vertragsverhältnisses schriftlich auf die Wettbewerbsbeschränkung mit der Wirkung verzichten, daß er mit dem Ablauf von sechs Monaten seit der Erklärung von der Verpflichtung zur Zahlung der Entschädigung frei wird.

(3) Kündigt ein Teil das Vertragsverhältnis aus wichtigem Grund wegen schuldhaften Verhaltens des anderen Teils, kann er sich durch schriftliche Erklärung binnen einem Monat nach der Kündigung von der Wettbewerbsabrede lossagen.

(4) Abweichende für den Handelsvertreter nachteilige Vereinbarungen können nicht getroffen werden.

**Sec. 75f HGB Close-out agreements**

In the event of an agreement by which a principal obligates himself to another principal not to employ a clerical employee who has been employed by the latter, or to employ him only under specific conditions, both parties are free to rescind the agreement. Neither a cause of action nor a defense is created by the agreement.

**Sec. 90a HGB Agreement prohibiting competition**

(1) An agreement by which a commercial agent is restricted in his commercial activity following termination of the contractual relationship (agreement prohibiting competition), must be in writing, and the document containing the conditions agreed to must be signed by the principal and delivered to the commercial agent. The agreement may run for no longer than two years following the termination of the contractual relationship. The agreement may cover only the geographical area or group of customers assigned to the commercial agent and may only refer to the type of business in which the commercial agent was responsible for soliciting transactions. The principal is obligated to pay reasonable compensation to the commercial agent for the duration of the prohibition of competition.

(2) The principal may waive the prohibition of competition in writing up to the end of the contractual relationship with the effect that he will be free from the obligation to pay compensation as of the end of six months after the date of such declaration.

(3) Where one party terminates the contractual relationship for an important reason because of culpable conduct of other party, he may, by a declaration in writing made within one month after such termination, declare that he is not bound by the prohibition of competition.

(4) Agreements deviating from these provisions to the disadvantage of the commercial agent cannot be made.