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# Post contractual non-competition clauses

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# EC DIRECTIVE 653/86 dated 18/12/1986

- ***Article 20***
  - ***Definition of the post-contractual non-competition clause, therein named "restraint of trade clause"***
  - ***Enumeration of requirements/conditions to be met***

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# Definition (art. 20.1)

*"For the purposes of this Directive, an agreement restricting the business activities of a commercial agent following termination of the agency contract is hereinafter referred to as a restraint of trade clause."*

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# Requirements (art. 20.2 and 20.3)

*a) It must be concluded in writing ;*

*b) it must relate to :*

- *the geographical area or the group of customers and the geographical area entrusted to the commercial agent ; AND*
- *to the kind of goods covered by his agency under the contract ;*

*c) It shall be valid for no more than two years after termination of the agency contract.*

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# Autonomy of the Member States in transposing the Directive (art. 20.4)

*National law may freely regulate the post-contractual non-competition clause:*

- *By imposing further restrictions on the validity or enforceability of the clause;*
- *By enabling the courts to reduce the obligations on the parties resulting from such an agreement.*

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# Austria

*Post-contractual non-competition clauses are invalid / not allowed.*

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# Belgium

*Requirements :*

- *Validity period : six months*
- *"Same kind of goods" is replaced by "same kind of activities"*
- *presumptions attached to presence of clause :*
  - *contribution of clients by the commercial agent*
  - *obtainment of substantial gains by the principal*
- *A clause that does not comply : will be declared null and void and the court may not alter it.*
- *The clause has no effect when the principal terminates the contract granting to the agent the period of notice or the agent terminates the contract referring to a substantial breach by the principal or the occurrence of exceptional circumstances.*

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# Special indemnity related to the presence of the clause

| | INDEMNITY |
|---|---|
| *Croatia* | *Provided if the contract is terminated for reasons attributable to the principal* |
| *Germany* | *The court decides what amount is reasonable as compensation case by case* |
| *Italy* | *Provided unless the principal waives his right to request the agent to observe the clause* |
| *Poland* | *Provided if:*<br>• *the parties did not agree otherwise*<br>• *the termination of the contract is not due to the agent* |
| *Portugal* | *Provided* |

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# Member States providing minor deviations from the Directive (some examples)

- *Denmark*

*A non-competition clause may be held invalid if and to the extent the committed party will be unreasonably restricted in the exercise of his profession and/or the restriction goes beyond what is required to protect the beneficiary from compensation.*

- *France*

*The limitation (in time, area, product) must be in connection with the interest of the principal. Excessive restrictive clauses may not be tempered by the court, but will be invalidated.*

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# Member States providing minor deviations from the Directive (some examples)

- *The Netherlands*

- *The court can limit the duration and/or scope of the clause if the commercial agent is deemed to be unreasonably restricted in comparison to the interests of the principal*
- *The principal cannot invoke a non-competition clause if (a) the principal has terminated the agreement irregularly or (b) the agent has terminated the agreement as a result of an urgent valid reason for which the principal is to blame or (c) the agreement is terminated by means of a Court order on the basis of circumstances attributable to the principal.*

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# Member States providing minor deviations from the Directive (some examples)

- *Spain*

*When the contract lasts for less than two years the duration of the clause cannot exceed 1 year (instead of two)*

- *United kingdom*

*Restriction will only be enforceable if it is only so wide as necessary to protect the principal's legitimate business interests. Otherwise it should be declared void.*

*In practice : clause generally does not exceed 1 year (often less). Clauses usually drafted in many different separate categories so that if one clause is void, the rest should remain enforceable.*

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# An interesting case outside the EU: Switzerland

- *Requirements :*
  - *in writing*
  - *agent acquired information about principal's customer list or manufacturing or business secrets*
  - *the use of it could inflict substantial damage*
  - *prohibition limited in terms of place, time and subject*
  - *limited to the principal's field of business and the agent's current sales territory*
  - *may exceed 3 years under special circumstances*
- *Compensation : agent has inalienable right to adequate special compensation upon termination of the contract*

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# Post contractual non-competition clauses under EU competition law

# The issue

- How to deal with the limitations of EU competition law (Art. 101 TFEU) when post-contractual non-competition clauses are involved?
- Is invoking the de minimis rule an appropriate solution?

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# The legal framework: structure of Art. 101

## Art. 101(1) – prohibition rule

Agreements between undertakings which may affect trade between Member States and have as their object or effect the prevention, restriction or distortion of competition within the internal market shall be prohibited as incompatible with the internal market

The prohibition concerns, inter alia, agreements which: "limit or control production, markets, technical development or investment"(*b*); "share markets or sources of supply" (*c);* make the conclusion of contracts subject to the acceptance of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts (*e*)

*Aim: protection of the competitive process*

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# The legal framework: structure of Art. 101

## Art. 101(2) – nullity rule

prohibited agreements shall be automatically void

## Art. 101(3) – exception rule

the prohibition is inapplicable if 4 cumulative conditions are met:

- the agreement contributes to improving production or distribution or to promoting technical or economic progress
- It allows consumers a fair share of the resulting benefit
- it does not impose on undertakings restrictions which are not indispensable to the attainment of such objectives
- it does not afford undertakings the possibility of eliminating competition in respect of a substantial part of the products in question

*The exception rule is directly applicable with no need of a prior decision of a competition authority to this aim (Reg. 1/2003)*

# The legal framework: a broad scope of application

- Art. 101 applies to any kind of agreement between undertakings, including agreements between suppliers and their counterparts in distribution. It covers **all distribution contracts: distributorship, franchising and, to some extent, also agency contracts**

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# The legal framework: agency agreements

- the determining factor for the application of Art. 101(1) is whether the agent bears any significant contract-related financial or commercial risk
- in this context, an agreement is qualified as agency agreement only if the agent bears no, or only insignificant risks (Commission Guidelines on vertical restraints –GVR, §12-17)
- in case of agency agreements as defined in the GVR, Art. 101(1) does not apply to the selling or purchasing function of the agent; on the contrary, Art. 101(1) remains applicable to the provisions which concern the relationship between the agent and the principal (including single branding and **post-term non-compete provisions**)

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# Non-compete obligations: theories of harm

**Under competition law, any non-compete obligation** - i.e. any direct or indirect obligation causing an undertaking not to manufacture, purchase, sell or resell goods or services - is considered with suspicion

- agreement btw **actual or potential competitors:** equivalent to a market sharing agreement and usually considered a restriction by object (prohibited with no need to prove its actual or potential negative impact on market variables)
- agreement btw undertakings **operating at different levels** of the value chain (e.g. supplier and distributor): the main theory of harm is foreclosure of the market to competing or potential suppliers. Other theories of harm: softening competition; collusion between suppliers

# Further perspectives: freedom of enterprise

- safeguarding the freedom of enterprise (Art. 16 EU Charter of Fundamental Rights) /freedom of action of the buyer, *i.e.* a non impact-based approach, may still play a role, together with the market integration argument, in the application of Art. 101 to post contractual non-compete obligations
- post contractual non-compete obligations may be seen as "limiting production" or anticompetitive supplementary obligations pursuant to Art. 101(1) (b) and (e)

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# Economic justifications for non-compete obligations

For the feasibility of some economic transactions which overall contribute to an effective competitive process (agreements and mergers) the possibility to stipulate some non-competition clauses is extremely important

For **vertical agreements**:

- **a non compete obligation during the contractual relationship** may be justified by the need to preserve the incentives of the buyer to focus on marketing the contract goods or services (GVR, §106-109)
- **post contractual non competition clauses,** limited in scope and duration, may be necessary to protect the supplier from improper competitive harm resulting from the know-how etc.. that the distributor has acquired by means of the contract

# Economic justifications for non-compete obligations

In the area of **mergers,** a temporary non compete obligation on the vendor may be justified by the need to ensure that the value of the acquired business and associated goodwill will not be jeopardized (*Remia* 42/84, Commission Notice on restrictions directly related and necessary to concentrations OJ 2005 C 56/24)

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# Safe-harbour for non-compete obligations during the contractual relationship

Arts. 5.1.a and 5.2 of Regulation no. 330/2010- Vertical Block Exemption Regulation- VBER)

- for non-compete obligations during the contractual relationship, as defined in Art. 1.1.d, safe harbour if the duration does not exceed 5 years =>presumption that even in case they were anticompetitive pursuant to art. 101(1), they satisfy the conditions set forth in Art. 101(3) and thus are compatible with the Treaty
- if the duration is indefinite or exceeds 5 years, full blown competition assessment pursuant to Art. 101, paras 1 and 3

(+ special provisions for products sold from premises and land owned or leased by the supplier)

# Safe-harbour for PCNC obligations

- VBER, Art. 5.1.b + Art. 5.3: safe harbour for "any direct or indirect obligation causing the buyer after termination of the agreement not to manufacture, purchase, sell or resell goods or services" if the following cumulative conditions are met:

a. the obligation relates to **goods or services which compete** with the contract goods or services

b. the obligation is limited to the **premises and land** from which the buyer has operated during the contract period

c. the obligation is necessary to protect **know-how** transferred by the supplier to the buyer (there is a specific value which has been transferred to the buyer because of the contract)

d. the **duration** of the obligation does not exceed 1 year

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# Safe-harbour for PCNC obligations: some remarks

- **Know-how** is expressly defined by the VBER (Art.1.1.g ) as a package of non patented practical information resulting from experience and testing by the supplier which is **secret, substantial and identified**: in this context, secret means that the know how is not generally known or easily accessible; substantial means that the know how is significant and useful to the buyer for the use, sale or resale of the contract goods or services; identified means that the know how is described in a sufficiently comprehensive manner so as to make it possible to verify that it fulfils the criteria of secrecy and substantiality)

  (useful, in particular, for franchising agreements)

- The safe harbour is formulated as a derogation from Art. 5.1.b : it is an **exception**, conditions must be interpreted narrowly

# PCNC obligations outside the safe harbour

- The interesting issue is what happens if not all the conditions of Art. 5.3 are met: how can we ensure compatibility with Art. 101? **Compliance is important**:

a. in 2013 the Commission set huge fines for a non compete obligation which it considered unrelated to a sale of business (see General Court, *Portugal Telecom* and *Telefonica,*28 June 2016, with a focus on non compete obligations); for disproportionate non-compete obligations in joint ventures, see the Commission decision in *Areva-Siemens,* 2012

b. for PCNC clauses in distribution agreements, the Commission may leave the floor to national competition authorities. But significant risk of private action before civil courts (nullity of the clause + damages), now facilitated by Directive 104/2014

# PCNC obligations outside the safe harbour: severability

- On the other hand, since PCNC clauses are not hardcore restrictions pursuant to Art. 4 VBER but excluded restrictions pursuant to Art. 5, if the clause is severable from the rest of the agreement the circumstance that it falls outside the safe harbour does not entail the loss of the benefit of the safe harbour for the whole agreement

# Compatibility of PCNC obligations not covered by the safe harbour

- The need to ensure compliance suggests to stick to the safe harbour set by Art. 5.3 whenever possible
- If use of the safe harbour is not sufficient in a specific situation (the conditions of Art. 5.3 are too narrow), there is some flexibility: falling outside the safe harbour does not necessarily entail that the PCNC clause is prohibited under Art. 101
- 3 possible approaches:

*i. de minimis;*

ii. commercial ancillarity;

iii. individual assessment pursuant to Art. 101(3)

# (i) De minimis: the case-law

- the application of Art. 101(1) may be excluded in case of lack of appreciable impact on the market (due to negligible presence of the parties on the market or qualitative analysis of the restriction)
- according to the ECJ case-law, a restriction by object is always appreciable (de minimis not applicable) (C-226/11, *Expedia*); on the other hand, in order to assess whether a restriction is "by object" the content of the clause, its objectives, the economic and legal context (including market shares), as well as the nature of the goods or services affected have to be taken into account. The aim is to limit the by object category to those restrictions which reveal a sufficient degree of harm to competition that there is no need to examine their effect (C-67/13 P, *Cartes Bancaires*)

# (i) De minimis: the Commission notice

- In the de minimis notice (2014/C 291/01), the Commission presumes the absence of an appreciable impact for vertical restraints when the market shares of the parties do not exceed 15% in any of the relevant markets affected by the agreement
- hardcore restrictions and restrictions by object are not covered
- excluded restrictions, like the ones contemplated by Art. 5 VBER, are not formally excluded from the benefit of the de minimis approach (§ 14 of the de minimis notice).
- Application of de minimis is straightforward for single branding obligation within the contractual period, which are clearly not restrictions by object. For PCNC clauses, the assessment becomes blurred because **it cannot be excluded that in some circumstances they might be considered restrictive by object**

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# Compliance based only on de minimis?

When not strictly justified by the need to ensure the viability of the main agreement (necessary and proportionate), in principle PCNC clauses have only a negative impact on the competitive process: they limit the activity of an undertaking which is no more a commercial partner of the company, establish a barrier to entry etc.. Courts might argue that there is no need to assess the impact on the market on a case by case basis (the clause "limits production", imposes unjustified supplementary restrictions etc.). If the clause were to be considered restrictive by object, the de minimis approach would not be applicable

=> risky to base a compliance strategy only on the absence of market power: the content and scope of the clause are also relevant

# (ii) Commercial ancillarity

- an agreement which is objectively necessary for a legitimate business purpose e.g. to maintain incentive to invest (*Nungesser*, 258/78; *Coditel* 262/81), or to penetrate a new area (*Societè Technique Minière* 56/65) can fall outside the Art. 101(1) prohibition; apparently restrictive clauses in franchising agreements pending the contractual relation are not covered by 101(1) I if necessary to protect IPR and maintain a common identity of the network (*Pronuptia* 161/84)
- restrictions imposed on the vendor of a business including non-compete clauses which are directly related and necessary to the implementation of the main operation, if proportionate, fall outside Art. 101(1) (*Remia* 42/84, *Mètropole Television* T-112/99). Necessary to examine what the state of competition would be in the absence of the restriction

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# (ii) PCNC clauses as ancillary restrictions

Using the commercial ancillarity argument requires focussing on the necessity and proportionality of the PCNC clause with reference to the main contractual relation, to protect the supplier's legitimate business interests (verifying whether its duration and its material and geographic scope do not exceed what it necessary to implement the main agreement)

This approach allows to adopt, on the basis of the circumstances of the case, also PCNC clauses outside the safe harbour: broader geographical scope, longer duration, not only transfer of significant know-how but also customer lists, goodwill etc.
Advantage: it is consistent with the approach to PCNC clauses under civil law. Some national courts have accepted clauses (slightly) broader than the Art. 5.3 model when justified

# (iii) Application of Art. 101(3)

- Where the restriction is not objectively necessary but simply makes the main agreement easier to implement or more profitable, according to the ECJ (*Mastercard* , C-382/12 P), the restriction cannot be considered ancillary and therefore legitimate pursuant to Art. 101(1). If this is the case, the restriction should be tested under Art. 101(3)
- Use of Art. 101 (3) to ensure compatibility of PCNC clauses falling outside the safe harbour is more complicated because of the need to prove that all the four conditions of Art. 101(3) are met

# Interplay of Art. 101, national competition law, general contract rules and sectoral rules

- Art. 101 TFEU is applicable in parallel with national competition rules, with an obligation of converging results (Art. 3 Reg. 1/2003):
- agreements which are compatible pursuant to Art. 101 cannot be prohibited pursuant to national competition rules (reason: market integration)
- other stricter national laws pursuing different objectives – eg protection of the weaker party) are allowed if compatible with the Treaty, e.g. abuse of economic dependence, laws on agency contracts etc.
- agreements prohibited pursuant to art. 101 cannot be authorized by national rules (effet utile of Eu competition law)

# For instance, for agency agreements…

- if EU/national law establishes a maximum duration of PCNC obligations, it is not possible to justify a longer duration on a case by case basis proving that this longer duration is necessary and proportionate  pursuant to Art. 101 TFEU