Labour Law Remark

A hotchpotch of exclusive employment agreements and post-contractual non-competition agreements

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As regards the JSC Madrid of 27 March 2017

In general, moonlighting is permitted under our legal system. Freedom to work is guaranteed in the Constitution (art. 35.1) and the ability to work for two or more employers is a consequence recognised and protected in law, except in cases of unfair competition (arts. 4.1.a, 21.1 and 3 ET).

Nevertheless, **exclusive employment agreements,** which prevent employees from providing their services to another company (moonlighting), are permitted, even when such employment does not constitute unfair competition. Such agreements aim to create an exclusive relationship in which a company can make sole and exclusive use of the capacity of the employee while helping eliminate the risk of unfair competition at the same time, even indirectly.

One essential element of the exclusive employment agreement is the payment of "*express financial compensation (...)*". This should be a specific, clearly-identified supplement to wages, the amount of which is freely set by the parties "*(...) under the terms appropriate for this purpose*" (ET, art. 21.1, *in fine*).

On the other hand, it is also very common for certain jobs and/or positions to be subject to **post-contractual non-competition agreements**, which, among other requirements, require the payment of "*adequate financial compensation*". The parties may establish a penal clause for cases of non-compliance with a non-competition agreement by the employee. This clause can be reviewed in view of the social order of the jurisdiction.

Of course, it is perfectly within the law for the two agreements to co-exist from the start of the employment relationship and expire at different times (the exclusive employment agreement will be valid only for the duration of the employment relationship, while the post-contractual non-competition agreement will enter into force at the end of the employment relationship). However, it must be made clear that the employment contract or subsequent extensions thereto are governed by one or both of these agreements and any explanation must provide a comprehensive description of their components and, in particular, of the process for setting adequate financial compensation for each.

The analysis of the **JSC Madrid of 27 March 2017** (Demag Crans & Components, SAU; RS 92/2017) emphasises that a deficient hotchpotch of both agreements will eventually render one agreement invalid. As will be seen below, in the drafting of an employment agreement between a manufacturer of lifting and handling equipment with a vendor, if financial compensation is provided as a single payment (from May 14 to June 16: €84,449.73), the amount of said compensation should be considered payment for the obligation already met (exclusivity agreement) and not the obligation to post-contractual non-competition.

This is based on the following annex to the employment agreement: *"Non-competition agreement. For the duration of the employment relationship between Mr. (...) and (...), the former will not be able to provide his professional services to any other company, entity, individual or moral person unless expressly agreed to in writing by (...). Once the employment relationship with (...) has ended and for two years after the end of the employment relationship, Mr. (...) will not be able to enter into any type of contractual relationship within a common employment regime, as an independent contractor, as a commercial service provider or within any other framework, either on his own behalf or through a holding company, for businesses, entities, individuals or moral persons engaged in activities that could be deemed to constitute direct or indirect competition to (...) or to the group of companies of which (...) is part. In the event of a breach of this agreement, Mr. (...) must compensate (...) for an amount identical to the whole gross annual salary received by Mr. (...) in his last year at the aforementioned (...), irrespective of the damages claimed by (...) and to which they are entitled. As compensation for this agreement, Mr. (...), will receive 5,800 euros per annum gross, divided into 12 monthly payments which will be recorded on his payslip as payment for the non-competition agreement (...)."*

The judgement of the Labour Court, which upheld the claim of the company and considered that the employee had violated the post-contractual non-competition agreement immediately upon terminating the employment relationship, ordered the employee to pay one year of salary received (€121,306.98) in accordance with the applicable penal clause. However, while upholding the second appeal formalised by the employee, the Territorial Court of Madrid dismissed the claim of the company in full, absolving the employee of the claims made against him.

The arguments that resulted in this judgement of dismissal were as follows:

1.- The parties in fact entered into two agreements. On the one hand, there were the obligations arising from an *exclusive employment agreement* during the term of the employment contract, with the employee prohibited from providing their services to any other company without express authorisation to do so and, on the other, those obligations arising from a *post-contractual non-competition agreement*. The two agreements, which entail different obligations, were inappropriately jointly referred to in the *"non-competition"* agreement.

2.- In order to be valid, both agreements require an agreement to be reached on express financial compensation that, in the case of the post-contractual non-competition agreement, can be described as *"adequate"* (art. 21.1 and 2.b] ET). Instead, the agreement contains only one type of compensation when in fact there should be two different types, since the employee is assuming two different obligations:

one during the term of the contract in relation to employment at any other company and another after the end of their employment relationship in relation to competing companies.

3.- During the term of their employment contract, the employee has met their obligation not to provide services to any other company. As a result, **the sole form of compensation in place must be payment for the obligation met**.

4.- If the agreed compensation is linked to the obligation not to compete with the company post-contract, the employee would have been subject to an obligation that it had met and for which it has nevertheless not received the compensation provided for in law.

5.- If the company believed that it was meeting both obligations with the one payment, it must have expressed this in the agreement, specifying which part of the payment was for meeting the obligations of the exclusive employment agreement and which was for meeting its obligations under the post-contractual non-competition clause. Otherwise, it is not possible to determine whether or not the compensation provided is *"adequate"*.

6.- In any event, unclear terms may not favour those who have given rise to such unclarity (art. 1288 of the Civil Code).

As a result, the comments on this judgement suggest a number of concluding thoughts.

First of all, the company in all probability did not wish to put in place an exclusive employment agreement: surely, what it wanted to emphasise was the obligation of the employee (vendor) not to compete with the company during their employment relationship, an obligation incumbent on the employee under the law and for which no compensation should be paid (art. 5.d. ET). This is a detail we pointed out in view of the "two agreements signed" that appeared under a single heading ("Non-competition agreement").

Secondly, one must not confuse the legal obligation not to compete with their employer during their employment relationship with the same (whether or not it is recalled in an employment contract) with the exclusive employment agreement for any type of activity that results in the payment of financial compensation.

The judgement is very illustrative and is a clear "user warning". The payment of close to €85,000 made over two years until the firm called for voluntary resignations may have led the company to believe that it would be protected with one years' wages if its former employee provided their services to a competitor (which it did the following day as Zone Manager). Furthermore, as we have seen, poor regulation of the agreement has resulted in the agreement being declared invalid.

Finally, as has been the case on so many other occasions, an update is recommended given the ongoing evolution of legal doctrine in this respect and advice in relation to standard workplace agreements (such as post-contractual non-competition, exclusivity and permanence) suited to the specific case depending on the needs of each company, the sector in which it operates, their geographical scope, etc.

For your information and knowledge, you can consult the JSC Madrid of 27 March 2017 here.

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