THE SIGNIFICANCE OF CONSIDERATION PAID FOR POST-EMPLOYMENT RESTRAINTS IN ENGLAND AND GERMANY

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1 Post-employment restraints

Post-employment restraints[1] provide employers with obvious benefits. First, such restraints may protect legitimate interests of the employer that are not automatically protected under the general law of a country. Second, post-employment restraints mean that an employer need not wait until the horse has bolted to pursue a remedy against a former employee for using or disclosing its confidential information; she may be restrained from activities in which such use or disclosure is likely to occur in the first place.[2] In this way, restraints may also relieve the employer of the often-difficult task of discovering and proving actual disclosure or use.[3] These are legitimate substantive and procedural advantages for which employers should be able to bargain.

The enforcement of post-employment restraints has, however, presented unique difficulties. In particular, courts and commentators have for a long time expressed concern that employers have a propensity to seek broader restraints than are necessary to protect their legitimate interests;[4] that they abuse the restraint mechanism to avoid competition and to punish departing employees;[5] or that they simply include post-employment restraints as standard terms without any regard to the appropriateness of such terms for the individual employee.[6]

[1] In this note, "post-employment restraint" means any agreement by which the employee agrees to refrain, to some extent, from engaging in employment or business after the termination of the employment relationship, but does not extend to agreements solely to refrain from solicitation of customers or employees, or use or disclosure of confidential information.

[2] *Printers & Finishers Ltd v Holloway* 1965 1 WLR 1; *Poly Lina Ltd v Finch* 1995 FSR 751 764, noting that even an honest person may find it impossible to realise they are passing on protected information to their new employer.

[3] *Littlewoods Organisation Ltd v Harris* 1977 1 WLR 1472 1479; Brooks "The Limits of Competition: Restraint of Trade in the Context of Employment Contracts" 2001 *UNSWLJ* 27 par 5.

[4] *Mason v Provident Clothing and Supply Co Ltd* 1913 AC 724 734; Blake "Employee Agreements Not to Compete" 1960 *73 Harv L Rev* 625 691.

[5] *Mason v Provident Clothing and Supply Co Ltd supra* 741 746.

[6] *Attwood v Lamont* 1920 3 KB 571 596; *Countrywide Assured Financial Services Ltd v Smart* High Court of Justice CD 2004-05-07 Case No HC04C01371 par 13.

Some consider that these conflicting interests will find a natural balance under market forces; that a market analysis will reveal that employers, employees and society can benefit from enforceable post-employment restraints.[7] It is argued that workers who agree to post-employment restraints receive consideration for the restraint in the form of a wage differential that represents the present value of lost future opportunities.[8] Further, post-employment restraints are said to promote efficiency in the market by reducing employee turnover rates[9] and promote productivity by encouraging investment in valuable information[10] while minimising the costs to society of securing such investments.[11] However, these claims are based on the assumption that the labour market is perfectly competitive and that the employee is perfectly informed about future employment opportunities and the value of such opportunities. In some cases, there may be an approximation of these circumstances: a highly-paid, senior employee may be in a position to estimate the value of a proposed restraint and to negotiate with the employer on its scope or inclusion. The employee may also be in a financial position to defend herself in any post-employment dispute over the restraint.

However, many employees, and particularly less experienced employees in times of high unemployment, are not in a position to make such an even bargain.[12] Employees frequently have imperfect information regarding the effect of the restraint, the value of the restraint and even the existence of a restraint. Many employees are not in a financial position to contest the validity of the post-employment restraint through expensive legal battles, but may be intimidated into abiding by unduly onerous restraints which exercise an *in terrorem* effect in the absence of judicial intervention.[13] Post-employment restraints may also have an effect on the broader community, which may be deprived of the employee's services,[14] or suffer from reduced competition in the relevant market[15] or be compelled to support the employee who is prevented from obtaining alternative employment.[16]

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[7] Faulkner "A Market Analysis of Anticompetition Agreements in Labor Contracts" 1991 *BYUL Rev* 1657 1658.

[8] Lester "Restrictive Covenants, Employee Training, and the Limits of Transaction-Cost Analysis" 2001 76 *Ind LJ* 49 61; Faulkner 1991 *BYUL Rev* 1661.

[9] Rubin & Shedd "Human Capital and Covenants Not to Compete" 1981 10 *J Legal Stud* 93 95 cited in Faulkner 1991 *BYUL Rev* 1668.

[10] Posner "John A Sibley Lecture: The Right of Privacy" 1978 12 *GA L Rev* 393 405 cited in Faulkner 1991 *BYUL Rev* 1668.

[11] 1674.

[12] Weiss "Employee Loyalty in Germany" 1999 20 *Comp Lab L & Pol'y J* 237 241.

[13] *Mason v Provident Clothing and Supply Co Ltd supra* 737 745; *JA Mont (UK) Ltd v Mills* 1993 FSR 577 584;Yates "Consideration for Employee Noncompetition Covenants in Employments at Will" 1986 54 *Fordham L Rev* 1123 1140.

[14] *Herbert Morris Ltd v Saxelby* 1916 1 AC 688 713-714.

[15] *Spencer v Marchington* 1988 IRLR 392 393.

[16] Lembrich "Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants" 2002 102 *Columb L Rev* 2291 2298.

Is there then room for "market-correcting" regulatory or judicial intervention?[17] In particular, can the consideration provided by employers for post-employment restraints play a meaningful, balancing role under regulatory or judicial supervision? "Consideration" in this context refers to the performance (monetary or otherwise) promised by the employer in exchange for the post-employment restraint. It is submitted that well-regulated consideration may provide three balancing factors in particular: a curb on employer demand for broad and unnecessary restraints, maintenance of employees during periods of restraint, and an approximation of a fair exchange between employers and employees.

This note provides a comparative analysis of the significance of consideration in respect of post-employment restraints in England and Germany, with particular regard to the manner in which consideration may assist in balancing the conflicting interests mentioned above. In this discussion, "post-employment restraint" means any agreement by which the employee agrees to refrain, to some extent, from engaging in employment or business after the termination of the employment relationship, but does not extend to agreements solely to refrain from the solicitation of customers or employees, or the use or disclosure of confidential information. The definition is limited in this way for two reasons. First, the limited scope of this note demands consideration of a relatively homogenous class of agreement. Secondly, the definition provides a rough lowest common denominator between the two systems considered: while the relevant English law applies to a broader range of agreements in restraint of trade,[18] the German law under consideration applies only to agreements which limit the employee in her business activity and, while it will extend to a variety of obligations which amount to obligations not to compete, it does not extend, for instance, to obligations only to refrain from soliciting customers.[19]

Paragraphs 2 and 3 *infra* provide an overview of the relevant English law and the relevant German law respectively. Paragraph 4 considers the significance of consideration in those systems in more detail with regard to the three balancing factors outlined above.

2 English law

2 1 Post-employment restraints

The English law in this area is almost entirely common law. At the outset, a person is generally entitled to carry on any trade or business she chooses and in such manner as she thinks most desirable in her own

[17] *Cf* Lester 2001 76 *Ind LJ* 61, which presents the view that traditional contract analysis leaves room to scrutinise process defects during contract formation, which is sufficient to redress any actual imbalance in bargaining power.

[18] The English doctrine of restraint of trade extends, eg, to non-solicitation of customers and non-disclosure of confidential information.

[19] Grosjean *Protecting Trade Secrets and Commercial Information* 6 7.

interests.[20] The existence of a contract of employment introduces a number of limitations to this freedom. First, there is an implied duty of fidelity in every employment contract,[21] including an obligation on the employee not to cause harm to her employer by working for a competitor during the course of the employment.[22] That obligation ceases when the contract of employment comes to an end. After the termination of the employment, the employee remains under a limited duty not to use or disclose the trade secrets, or certain confidential information, of her former employer to the detriment of said employer.[23] But the employee is otherwise generally free to undertake employment with the employer's competitors and to solicit customers or staff of the employer.

The employer may extend the employee's common law obligations by agreeing with the employee on an express post-employment restraint. A post-employment restraint is an agreement in restraint of trade. In accordance with the doctrine of restraint of trade, the agreement will only be held valid and enforceable if it is reasonable in the interests of the parties and is not contrary to the public interest.[24] The restraint will be reasonable only if the employer has a legitimate interest requiring protection and the restriction on the employee, in terms of activity, duration and area, is no greater than necessary to protect the employer's interest. If the restraint protects no legitimate interest, it fails entirely. If it is broader than necessary in terms of activity, duration or area, it can be saved by reading down or severance, but only where that can be done simply by excising words or parts, leaving a sensible and reasonable covenant.[25]

It is desirable to pause at this point and trace a related development. The English doctrine of restraint of trade is based on public policy.[26] One consequence of this fact is that different trends in the courts' application of the doctrine emerge over time.[27] By the 20th century, paternalism was the order of the day to such an extent that courts frequently found post-employment restraints unenforceable, particularly in light of concerns over employees' unequal bargaining power. By the late 20th century, this

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[20] *Attorney General of the Commonwealth of Australia v Adelaide Steamship Co Ltd* 1913 AC 781 793.

[21] *Wessex Dairies v Smith* 1935 2 KB 80.

[22] *Hivac Ltd v Park Royal Scientific Instruments Ltd & Ors* 1946 Ch 169.

[23] *Faccenda Chicken Ltd v Fowler & Ors* 1987 Ch 177 135-138; *JA Mont (UK) Ltd v Mills* 1993 FSR 577 587.

[24] *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co* 1894 AC 535 565; *Herbert Morris Ltd v Saxelby supra* 700; *Bridge v Deacons* 1984 AC 705 713; Treitel *The Law of Contract* 11 ed (2003) 454.

[25] *Attwood v Lamont* supra 577-578 593-594; Brooks 2001 *UNSWLJ* 27 par 3.

[26] *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co supra* 553.

[27] The English law swung from an early invalidation of all restraints of trade (*Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co supra* 564), to a gradual recognition that partial restraints for adequate consideration could serve the public interest (*Mitchel v Reynolds* 1711 1 PWms 181), to a "laissez faire" emphasis on freedom of contract and therefore general enforcement of restraints in the 19th century (*Rousillon v Rousillon* 14 Ch D 351; *Attwood v Lamont supra* 581; *Herbert Morris Ltd v Saxelby* 1915 2 Ch 57 81).

tendency became so marked that some began to doubt the efficacy of such agreements altogether.[28] It was in this atmosphere, in 1986, that "garden leave" emerged as another means by which employers could seek to restrain the activities of a departing employee.

Garden leave is generally made possible by the inclusion of a number of express terms in an employment contract. In its simplest form, the mechanism operates as follows. When the employee announces her intention to terminate the employment relationship and commences work for a competitor of the employer, the employer does not terminate the contract but affirms the contract and the employee's continuing employment. It requires the employee to remain in its employment for the duration of a substantial contractual notice period (often three to six months) and to abide by her continuing and express obligation not to undertake employment with any of the employer's competitors during that period. The employer may also quarantine the employee from further contact with its confidential information and clients by excluding her from the workplace for some or all of the notice period, a right that should be expressly included in the contract.[29] The contract includes terms that, should the employer exercise the right to exclude the employee, the employer will continue to pay her full remuneration and refrain from suing the employee for breach for not attending the workplace.[30] The employee is then on "garden leave".

It is clear that garden leave is able to secure many of the objectives that employers seek to attain through post-employment restraints and on numerous occasions since 1986[31] the English courts have granted injunctions to enforce such arrangements where the employer's legitimate interests would otherwise be harmed. While courts may still apply restraint of trade principles in testing the reasonableness of garden leave clauses,[32] one significant difference between garden leave and post-employment restraints is that if the non-competition clause is worded so as to be unreasonably wide, all is not lost. Since the employment contract is still on foot,[33] the employee's *implied* obligation of fidelity continues to apply and the courts may grant an injunction in more restricted, and therefore reasonable, terms to enforce the implied obligation, rather than holding the clause entirely unenforceable.[34]

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[28] Brooks 2001 *UNSWLJ* 27; *Credit Suisse Asset Management Ltd v Armstrong* 1996 ICR 882 891-892.

[29] *William Hill Organisation Ltd v Tucker* 1999 ICR 291 301.

[30] *Provident Financial Group v Hayward* 1989 ICR 160; *William Hill Organisation Ltd v Tucker supra.*

[31] *Evening Standard Co Ltd v Henderson* 1987 FSR 165; *GFI Group Inc v Eaglestone* 1994 IRLR 119; *Euro Brokers Ltd v Rabey* 1995 IRLR 206; *Symbian Ltd v Christensen* 2001 IRLR 77; Outeur??? "Employment: Please Release Me" 2002 *The Lawyer* 52.

[32] *Symbian Ltd v Christensen supra*; *William Hill Organisation Ltd v Tucker supra.*

[33] *Cf* the widely criticised view of the Vice-Chancellor at first instance in *Symbian Ltd v Christensen supra.*

[34] *Provident Financial Group v Hayward supra*; JA *Mont (UK) Ltd v Mills supra* 587 591; *GFI Group Inc v Eaglestone* 1994 FSR 535 543; *Credit Suisse Asset Management v Armstrong* 1996 IRLR 450 455.

2 2 English law: consideration and post-employment restraints

As with all English contracts, post-employment restraints must generally be supported by valuable consideration before they will be enforceable. It should be noted that this is not a requirement that the parties agree on specific or monetary consideration in respect of the restraint but only that the obligations under the contract be supported by consideration, in the sense of a price, detriment or forbearance given as value for a promise.[35] As a result, most English employment contracts do not specify separate, monetary consideration for post-employment restraints.[36]

Early in the history of English restraint of trade law there was an additional requirement that the consideration provided be "good and adequate" so as to ensure "a proper and useful contract",[37] but by the late 19th century, the English courts had rejected this principle.[38] Lord Mcnaghten explained the change in approach in *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co:*[39]

> "[I]n time it was found that the parties themselves were better judges of [the adequacy of consideration] than the Court, and it was held to be sufficient if there was a legal consideration of value; though of course the quantum of consideration may enter into the question of the reasonableness of the contract."

In this way, the reasonableness of restrictions specified in the restraint as to time, area and activity are determined, at least in part, by the amount of consideration provided to the employee. However, courts do not generally "weigh the details of the advantages and disadvantages with great nicety" but only "appreciate the consideration at least in its more general aspects".[40] Consideration is rarely the central factor in the outcome of a case. Rather, courts tend to mention the consideration received by the employee in terms of the length of the notice period,[41] a fixed term of employment,[42] training and experience provided,[43] the level of salary and benefits[44] and, more rarely, specific consideration paid in

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[35] *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* 1915 AC 847.

[36] Specifically-compensated restraints in severance agreements or pure restraint agreements tend to be the exception: *Turner & Ors v Commonwealth & British Minerals Ltd supra.*

[37] *Mitchel v Reynolds supra* as explained in *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co* 1894 AC 535 565. Some considered that, even then, the requirement that the consideration be "adequate" only required that it was "not . . . a mere colourable consideration": see *Nordenfelt* case *supra* 544.

[38] *Nordenfelt v Maxim Nordenfelt Guns & Ammunition Co supra* 565; *Morris v Saxelby* 1916 AC 688 707; *Attwood v Lamont supra* 589.

[39] *Supra* 565.

[40] *Esso Petroleum Ltd v Harper's Garage (Stourport) Ltd* 1968 AC 300 318 323.

[41] *Mason v Provident Clothing and Supply Co Ltd* 1913 AC 724 741; *Eastes v Russ* 1914 1 Ch 468 476; *Attwood v Lamont supra* 592.

[42] Cf Yates 1986 54 *Fordham L Rev* 1123.

[43] *Eastes v Russ supra* 487; *Hartleys Ltd v Martin* 2002 VSC 301 par 121 130, an Australian case based on English principles.

[44] *Badische Anilin und Soda Fabrik v Schott, Segner & Co* 1892 3 Ch 447 453; *Eastes v Russ supra* 487.

respect of the restraint,[45] as one of a number of factors supporting the conclusion as to reasonableness.[46]

3 German law

3 1 Post-employment restraints

In Germany, a person is guaranteed "occupational liberty" under article 12 of the German Basic Law. During the employment relationship, an employee is, however, prohibited from carrying on her own business venture or undertaking transactions in the field of the employer's trade other than for the employer.[47] That prohibition ends with the termination of the employment relationship.[48] Upon the termination of the employment relationship, the employee is generally free to compete with the former employer except in so far as she acts contrary to fair competition or makes use of the employer's trade and commercial secrets.[49]

The employer and employee may expressly agree on further restrictions on the employee's post-employment activities. But an agreement that "limits the employee in her business activity"[50] in the post-employment period will only be enforced if it complies with § 74 *et seq* of the German Commercial Code, which impose detailed regulation on post-employment restraints. While on its face the Commercial Code appears to apply only to "clerical employees", the courts have applied the provisions to all other categories of employee by analogy.[51]

The Commercial Code requires that post-employment restraints be in writing and that a signed copy of the restraint be provided to the employee.[52] The restraint is non-binding in so far as it does not serve to protect a legitimate business interest of the employer. [53] It is also non-binding in so far as, with regard to the compensation allowed, the place, time or subject matter, the restraint constitutes an unreasonable interference with the employee's career.[54] The restraint remains effective

[45] *Turner & Ors v Commonwealth & British Minerals Ltd supra.*

[46] In the slightly different matter of post-partnership restraints, the courts have also considered a reciprocal restrictive covenant as relevant consideration: *Bridge v Deacons 1984 AC 705 716.*

[47] 60 German Commercial Code. All legislative references are to the German Commercial Code unless otherwise noted. All translations of the German Commercial Code are taken from Peltzer & Voight *Handelsgesetzbuch: Deutsch-englische Textausgabe mit einer englischen Einleitung* 5 ed (2003).

[48] Federal Labour Court 19 May 1998 AP BGB 611 Treuepflicht Nr 11.

[49] Grosjean *Protecting Trade Secrets and Commercial Information — Rights of Employers and Employees: German Report* (2003) Unpublished paper read at a conference UIA 47th Congress at Lisbon 2003-09-03 5 9; Weiss 1999 20 *Comp Lab L & Pol'y J* 237 247.

[50] See the discussion of the meaning of this term under par 1 *supra.*

[51] Weiss & Schmidt *Federal Republic of Germany* in Blanplain (ed) *International Encyclopaedia for Labour Law & Industrial Relations* (2000) 120.

[52] 74 (1).

[53] 74 a (1).

[54] 74 a (1).

in so far as it does not offend in either of these ways.[55] The restraint cannot extend beyond a period of two years from the termination of employment.[56]

3 2 German law: consideration and post-employment restraints

In contrast to the English law, German law requires that the employer and employee agree on specific monetary compensation for the post-employment restraint. In fact, it has been said that the most important requirement for a valid post-employment restraint is an obligation on the employer to pay the employee *Entschädigung* (compensation) during the period of the restraint. If there is no provision for such compensation in the agreement containing the restraint, the restraint is null and void.[57] Neither the employee nor the employer can derive rights out of such an agreement: the employee has no claim to compensation even if he or she abstains from competition.[58]

The Commercial Code further specifies that the compensation must be at least 50% of the most recent contractual remuneration received by the employee.[59] If the employment contract provides for compensation below this threshold, the restraint is not binding.[60] This means that the employee may elect whether to comply with the restraint and require payment of the compensation, or to ignore the restraint and lose her claim for the compensation.[61]

The level of compensation payable to the employee is also relevant to the enforceability of the post-employment restraint in that the restraint is non-binding in so far as, with regard to the compensation allowed, the place, the time or subject matter, the restraint is an unreasonable interference with the employee's career.[62] There has been substantial academic and judicial discussion as to the juridical nature of the compensation payable under the Commercial Code. These views will be considered under paragraph 4 *infra*.

Interestingly, in Germany, garden leave appears to be used as a means of quarantining misbehaving employees during a notice period or during a period in which they cannot be dismissed, rather than as a means of restraining competing activities.[63] The reason for this seems clear: if the employer can restrain the employee by binding itself to pay 50% of her remuneration, there is no incentive for the employer to place the employee on garden leave and bind itself to pay 100% of the remuneration.

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[55] 9 AZR 884/95, 01-08-1995.
[56] 74 a (1).
[57] Grosjean *Protecting Trade Secrets and Commercial Information 5*.
[58] 9 AZR 929/98, 18-01-2000.
[59] 74(2).
[60] 74(2).
[61] 9 AZR 929/98, 18-01-2000; Grosjean *Protecting Trade Secrets and Commercial Information 18*.
[62] 74 a (1).
[63] Grosjean *Protecting Trade Secrets and Commercial Information 15*.

4 The significance of consideration

4 1 A curb on employer demand for excessive restraints

It is submitted that employers who benefit from restraining their former employees should be made to internalise the cost of that restraint and therefore to police their own demand for excessive restraints. In this respect, Dorndorf[64] explains that the German Commercial Code provisions have a *Regulierungsfunktion* (regulatory function) since they are likely to influence the employer in its decision as to whether or not to seek a post-employment restraint. The requirements appear to have had some success. Grosjean[65] notes that the obligation on the employer to pay at least half of the employee's most recent contractual remuneration has curbed employer demand for post-employment restraints:

> "This is why only a few German employment contracts contain non-competition clauses. On the one hand the employer does not want to pay compensation to low-salaried employees who are not expected to exert serious competitive pressure in the future. On the other hand the compensation payments to relevant senior executives who could be a threat after termination, could, depending on their salary, become an unbearable financial burden for the former employer. Consequently such non-competition clauses are usually only agreed with the key employees within an organisation. A survey . . . indicates that only 16% of German executive staff have such restrictions in their contracts."

Further, the cost of a restraint in Germany will generally increase in direct proportion to its scope. Since the employer must pay the employee a monthly compensation during the period of the restraint, each extra month of restraint sought by the employer is an extra month of compensation to pay. Since the fairness of the restraint's hindrance of the employee's career is judged with regard to the compensation, the broader the time, area and subject matter of the restraint, the higher compensation must be paid to secure that obligation. Thus German employers, aware that they must pay a significant and generally proportionate purchase price for post-employment restraints, may be more circumspect in seeking and framing such restraints.

The disadvantage of this arrangement is that it lacks flexibility. There may well be occasions on which employers wish to protect only one of a number of legitimate interests or a narrow part of a broader legitimate interest. But since employers must always pay at least 50% of the previous remuneration, they will have no incentive to limit themselves to a minimal restraint where that is all they actually require. However, it is submitted that this disadvantage is outweighed by the fact that employees are provided with an objective standard by which the restraint may be judged without resort to litigation.

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[64] *Freie Arbeitsplatzwahl und Recht am Arbeitsergebnis* 1979 194 *et seq* cited in Eisele *Les Conditions de la Clause de Non-Concurrence en Droit du Travail Allemand et en Droit du Travail Français* (1999) par 267.

[65] *Protecting Trade Secrets and Commercial Information* 17.

In England, there is no requirement of a direct "purchase price" to curb employer demand for post-employment restraints. At first blush, the alternative solution proposed by English law is somewhat closer to an all-or-nothing gamble imposed on the employer. If the scope of the restraint is reasonable between the parties and in the public interest, the employer will have the benefit of the restraint without paying an extra sum. But if the scope of the restraint is unreasonably wide, the restraint is entirely unenforceable. Thus the employer's desire for ever-wider restraints is inhibited by the risk of the restraint being unenforceable in its entirety. In practice, the effect of this gamble is diminished to the extent that courts can sever or "read down" the restraint to an enforceable scope. In this way, employees may find themselves forced to submit to the wider clause or to fund legal proceedings to determine the enforceable scope of the clause.

On the other hand, the English garden leave mechanism gives rise to a different dynamic, more in line with the German position, largely because it forces employers to bear the costs of keeping the employee out of work. Lembrich argues that employers are thus much more likely to seek the restraint of an employee only when absolutely necessary to protect their business and then only for the time needed to minimise the potential harm of the departing employee.[66] It is submitted that these arguments are borne out to some extent in reality. For instance, in 40 major English cases in respect of post-employment restraints between 1970 and 1996, the periods of restraint sought by the employers averaged just over one year and ten months.[67] However, where employers have taken advantage of more frequently enforced garden leave clauses by committing themselves to pay their former employees their full benefits for the period of the leave, the periods of leave sought are most often only three or six months.[68] While this may result in part from the courts' demonstrated unwillingness to enforce longer periods as garden leave, it is submitted that the enforced consideration under the garden leave mechanism has the effect that an otherwise avaricious employer will police its own demands since it must bear the financial consequences of the restraint.

4 2 Maintenance of the employee

It is submitted that the consideration paid by the employer should compensate the employee in proportion to the scope of the restraint (and therefore the degree to which the employee is excluded from the range of

[66] Lembrich (2002) 102 *Columb L Rev* 2317.

[67] Based on the cases listed in Appendix I of Mehigan & Griffin *Restraint of Trade and Business Secrets* 3 ed (1996) 329 *et seq*.

[68] See *dicta* of Brown J in *Intercontinental Energy Ltd v Jowitt* HCJ QBD Case No HQ/01/ 0845 2001-11-02 to the effect that garden leave will not "normally be enforced for more than three months and at the outside six months".

productive activity for which she is qualified) and in proportion to the scope of the employee's usual remuneration, while not encouraging employees to remain idle during the period of the restraint.

Under German Law, the legislature has obviously taken into account the maintenance of the employee as a fundamental consideration in the enforcement of post-employment restraints. The employer must provide the employee with compensation at at least half the employee's most recent contractual remuneration for the term of the restraint. The fact that this compensation is intended to maintain the employee in the absence of alternative income is evident from the further regulation of these payments. If the employee earns income through employment elsewhere during the period of the restraint,[69] the employer is entitled to deduct certain amounts from the compensation that it pays. Some commentators have justified this obligation by arguing that the compensation is actually a *Fürsorgeleistung* (aid benefit) and as such only necessary if the former employee is unable to support herself.[70] Further, the Federal Labour Court has specified on occasion that the compensation constitutes an *Ausfluss sozialer Rücksichtsnahme* (the result of taking into account social factors)[71] and that it should not permit the former employee to achieve an elevation in her standard of living at the expense of the former employer.[72]

In England, as noted, the courts recognise that consideration may be relevant in determining the enforceability of the restraint. However, the kinds of consideration generally taken into account in this respect are very often of the "inedible" species: the period of employment or the notice period or training received, none of which will sustain the employee during a period of absence from the relevant field. On the other hand, considerations of the employee's upkeep are to some extent apparent in garden leave cases, where courts have taken account of the continued salary and benefits which will keep the employee from "starvation" in granting injunctions to enforce the leave.[73] While garden leave generally does not permit an employee to engage in any alternative employment, it is interesting to note recent *dicta* that, if such employment were permitted, the contract should indicate for how long the salary should be paid if the employee found alternative, non-competing employment.[74]

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[69] Or if the employee "maliciously fails to earn" such amounts: 74 c (1).

[70] Eisele *Les Conditions de la Clause de Non-Concurrence* par 264.

[71] BAG 20 Jan 1960 AP no. 16 cited in Eisele *Les Conditions de la Clause de Non-Concurrence* par 266.

[72] BAG 20 Apr 1967 AP no. 20 cited in Eisele *Les Conditions de la Clause de Non-Concurrence* par 266.

[73] *Evening Standard Co Ltd v Henderson supra* 170. Note, though, that in some cases (*Euro Brokers v Rabey supra*; *Provident Financial Group v Hayward* 1989 IRLR 84 88) courts appear to have misapplied the "no starvation" principle of the non-compulsion cases (*Rely-a-Bell Burglar and Firm Alarm Co Ltd v Eisler*1926 Ch 609 616; *Warner Brothers Pictures Inc v Nelson* 1937 1 KB 209 216-217 219) as a principle applying to the grant of injunctions against employees generally; Brooks 2001 *UNSWLJ* 27 par 87.

[74] *Symbian Ltd v Christensen supra* per Moritt LJ.

4 3 Approximation of a fair exchange

To what extent does the law in respect of consideration allow an approximation of a fair exchange between the employer receiving the substantial and procedural advantages of a post-employment restraint, and an employee receiving a fair price for that restraint?

In Germany, if a post-employment restraint is non-binding because it protects no legitimate interest, is unreasonable or promises too little compensation, the former employee can nonetheless elect to comply with the restraint and claim the promised compensation. The employer receives the benefit of the restraint and the employee receives the price, which she has presumably determined to be a fair exchange. If the restraint is void for lack of an obligation on the employer to pay compensation, the employer cannot enforce the restraint and the employee cannot claim any compensation. The employer does not receive the benefit of the restraint and the employee does not receive the price.

However, the significance of the German compensation as a purchase price for the restraint falls down at § 74 c of the Commercial Code. As a number of German commentators have argued,[75] if the compensation were a true counter-benefit, the employee should always be entitled to the sum as the value of his or her promise. However, pursuant to § 74 c, the employer is entitled to make deductions from the compensation payable to the employee notwithstanding that there has been no reduction in the value received by the employer. If the employee earns income through employment elsewhere during the period of the restraint, the employer is entitled to deduct certain amounts from the compensation that it pays. In particular, in so far as the compensation plus the amount earned elsewhere would exceed by more than 10% the employee's most recent contractual remuneration, the employer is entitled to deduct the excess from the compensation paid.[76] It is therefore conceivable that the compensation paid by the employer could be reduced to zero.[77] The German employer could receive the full benefit of the restraint without paying any compensation to the employee.

It is submitted that this is the greatest weakness of the German law in respect of consideration for post-employment restraints. Some have argued that the effect of § 74 c can be justified as a feature of a payment that is essentially an *Ausfallgarantie* (guarantee against loss) in the sense that it is an assurance that the employee will not suffer a deterioration of

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[75] Gamillscheg *Gedanken zur Neurelung der Wettbewerbsvereinbarungen* (1975) 13-23 and Schwerdtner *Handelsvertreterrecht und Handelsvertreterwirklichkeit* (1972) 20 cited in Eisele *Les Conditions de la Clause de Non-Concurrence* par 268.

[76] 74 c(1).

[77] The compensation would be reduced to zero if the employee obtained alternative employment at a salary at least 110% of her previous income: $0 = X/2 - ((Y+X/2) - (1.1*X))$, where X is the previous remuneration and Y is the income from new activities.

her standard of living as a result of the restraint.[78] However, it is submitted that even under this justification the concept suffers from two fundamental weaknesses. First, the rule and the justification assume that financial equivalence is the only important factor in the progress of an employee's career: if the employee is able to sustain herself at something of the level to which she has become accustomed, she has no complaint. This ignores the loss that the employee clearly suffers by reason of her exclusion to some degree from the industry in which he or she is qualified to work. If, as the Federal Labour Court has held,[79] the requirement for compensation under the Commercial Code is justified by the constitutional guarantee of occupational liberty, surely the compensation should be something more than a gesture of maintenance. Secondly, the mechanism unfairly enriches the employer who still has the full benefit of the restraint without paying fair value for it. If the employee has been able to avoid some loss by finding alternative employment that is due to his or her skill and effort, he or she should receive the full benefit of it.

The German provisions also limit the flexibility of arrangements that employers may negotiate on an even footing with more highly paid senior employees. However, such employees may often conclude even more favourable terms with their employers. In any event, this matter could be solved by applying the provisions only below a certain salary level.[80]

It is submitted that English garden leave approximates a relatively fair exchange between the employer and employee, with consideration proportionate both to the employee's previous remuneration and the period of the restraint. If anything, the exchange may be excessively costly to the employer, burdened with paying the employee's full remuneration in consideration of the restraint.

On the other hand, the English law on post-employment restraints, taking relatively limited account of consideration with regard to reasonableness, has not been concerned to secure the employee a direct and fair exchange in respect of the restraint. Some have even argued that the kinds of benefit treated as consideration for post-employment restraints by the English courts are not consideration because they are not "bargained for and given in exchange for the promise".[81] Further, from the employers' point of view, the provision of substantial consideration in relation to the restraint will not necessarily secure enforceability for the employer. In particular, the employer will still need to justify the restraint in terms of the public interest. As Lord Justice Simon Brown stated in *JA Mont (UK) Ltd v Mills*:[82]

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[78] Eisele *Les Conditions de la Clause de Non-Concurrence* par 268.

[79] Grosjean *Protecting Trade Secrets and Commercial Information* 4.

[80] There is precedent for such limited application of employee-protective provisions in other jurisdictions: see, eg, s 72(1)(e) Industrial Relations Act, 1999 (Qld) Australia.

[81] *Collier Cobb & Assocs v Leak* 1983 61 NC App 249 253 300 cited in Yates 1986 54 *Fordham L Rev* 1123 1136; Hepple "Employee Loyalty in English Law" 1999 20 *Comp Lab L & Pol'y J* 205 216.

[82] 1993 FSR 577.

> "I cannot accept that the law's only concern underlying the doctrine of restraint of trade is to ensure that employees can earn their living . . . If this were so, such restraints could always be purchased outright and yet the cases clearly show that they cannot be. And in any event, public policy clearly has regard too to the public interest in competition and in the proper use of an employee's skills."

Similar opinions were expressed by the Court of Appeal in *Turner & Ors v Commonwealth & British Minerals Ltd.*[83] Therefore, in England, notwithstanding the level of specific consideration paid by an employer for the post-employment restraint, there remains a further public interest that must be taken into account before the parties' bargain will be enforced.[84]

5 Conclusion

Some have argued that courts should intervene to approximate an ideal bargain between employers and employees in respect of post-employment restraints, having regard to the circumstances pertaining at the time the contract was entered into.[85] However, this envisages a highly undesirable norm that employees will need to fund legal proceedings to obtain justice. It is submitted that the rules in respect of consideration should rather ensure that:

- the employer is made to internalise the cost of the advantage it derives by restraining the employee and therefore to curb its demand for excessive restraints;
- the employer compensates the employee in proportion to the scope of the restraint and in proportion to the scope of the employee's usual remuneration, while not encouraging employees generally to remain idle during the period of the restraint;
- both parties can point to some objective standard in arguing the enforceability of the restraint such that the need for legal proceedings is diminished; and
- the public interest is served by ensuring that the employer cannot bind an employee to a restraint which exceeds the protection of any legitimate interest notwithstanding the consideration paid.

In England, all four of these goals are largely served by the garden leave mechanism, which requires the employer to pay the employee his or her full salary and benefits for the period of leave. In this aspect of

[83] CA Case No CCRTF 1998/1051/2, 1999-10-13.

[84] But *cf Panayiotou v Sony Music Entertainment (UK) Ltd* 1994 EMLR 229 330 where Parker J appears to consider that some restraints can be "bought". See also *Amoco Australia (Pty) Ltd v Rocca Bros Motor Engineering Co (Pty) Ltd* 1975 AC 561 579 to the effect that the covenantor is not obliged to make an election in the event that the restraint is unenforceable. There is also the question of what the actual effect of unreasonableness is on the restraint (Mehigan & Griffiths *Restraint of Trade and Business Secrets* 3 ed (1996) 42-43) and thus what remedies the employer would have in respect of consideration paid *solely* in respect of a subsequently unenforceable restraint but that is a story for another day.

[85] Faulkner 1991 *BYUL Rev* 1657 1677-1678.

English law it is submitted that the courts have, by their tendency to enforce garden leave, indirectly acknowledged the importance of these goals, but at excessive expense to the employer and with insufficient incentive for the employee to seek non-infringing employment. In Germany, the provisions of the Commercial Code serve the first goal partially and the latter three goals more fully, with the further advantage of incurring lower cost to the employer (potentially only 50% of the employee's previous remuneration) and simultaneously creating greater incentive for the employee to find non-infringing employment during the period of the restraint. While it is submitted that the German rules in respect of consideration are superior in these respects, for the reasons outlined in paragraph 4 3 *supra*, the German provisions permitting deductions for other income are ill-considered.

It is submitted that a legislated threshold consideration expressed as a proportion of the employee's usual remuneration, and in proportion to the period of the restraint, would serve the above goals. As noted earlier, more highly-paid employees could be left to negotiate more flexible arrangements with employers by the inclusion of a salary cap on the application of the legislation.

OPSOMMING

Hierdie artikel is 'n vergelykende analise van die belang van teenprestasie betaalbaar vir post-indiensnemingsbeperkings in Engeland en Duitsland. Die skrywer gee dit ter oorweging dat sodanige teenprestasie behoort te verseker dat:

- die werkgewer die koste van die voordeel wat sy deur 'n beperking van 'n voormalige werknemer bekom het, sal internaliseer om sodoende sy of haar (die werkgewer se) aanspraak op buitensporige beperkings aan bande te lê;
- die werkgewer die werknemer in verhouding tot die omvang van die beperking sal vergoed asook in verhouding tot die grootte van die werknemer se gebruiklike vergoeding, maar dan sonder om voormalige werknemers aan te moedig om gedurende die tydperk wat die beperking geld, ledig te bly;
- albei partye een of ander objektiewe standaard moet kan uitwys met verwysing waarna die afdwingbaarheid van die beperking beredeneer kan word en dit op so 'n wyse dat die nodigheid vir gedingvoering verminder word; en
- die openbare belang gedien sal word deur te verseker dat die werkgewer die werknemer nie kan bind aan 'n beperking wat die beskerming van enige wettige belang --- selfs al sou 'n teenprestasie betaal word --- oorskry nie.

Die Engelse howe is geneig om nie op die teenprestasie betaalbaar vir tradisionele post-indiensnemingsbeperkings te fokus of die toereikendheid daarvan te bepaal nie. Dit word egter aan die hand gedoen dat al vier die oogmerke hierbo vermeld grotendeels gedien word deur die Engelse "garden leave", 'n kontraksmeganisme waardeur die werkgewer die werknemer haar volle salaris betaal vir 'n gestipuleerde tydperk van verlof wat op die kennisgewing van die beëindiging van indiensneming volg. In Duitsland dien die gedetailleerde regulering van teenprestasie betaalbaar vir post-indiensnemingsbeperkings ingevolge die Kommersiële Kode die eerste oogmerk gedeeltelik en die laaste drie oogmerke meer volledig, terwyl dit laer koste vir die werkgewer meebring (potensieel slegs 50% van die voormalige werknemer se vergoeding) en die werknemer aanmoedig om werk te vind wat nie op die beperking inbreuk maak nie. Die Duitse bepalings wat aftrekkings vir inkomste gedurende die tydperk van die beperking toelaat, is egter minder aantreklik want hulle hou nie behoorlik rekening met die belang van die teenprestasie as 'n téénvoordeel vir nakoming van die beperking nie.