NON-COMPETE
Limitations and Practical Issues

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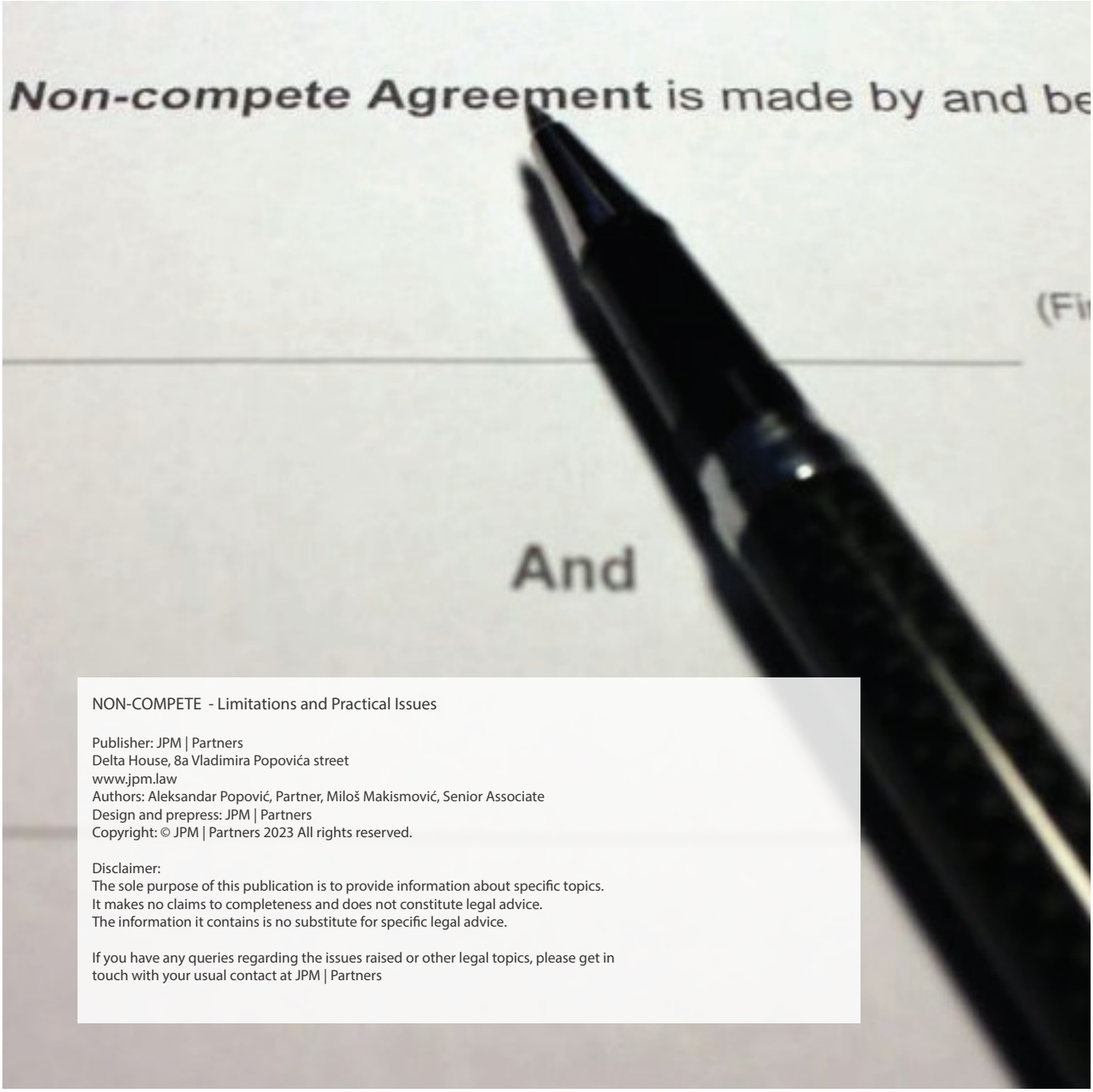

NON-COMPETE - Limitations and Practical Issues

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Everyone is free to choose their work, time, or place of engagement and the profession they will commit to. The Serbian Constitution grants these basic human rights while also envisaging that all jobs are available to everyone under equal conditions.

A similar principle is founded under the Law on Protection of Competition - that the protection of competition on the market of RS is regulated with the aim of economic progress and the well-being of society as a whole, especially to the consumer's benefit. However, these are only the general principles that are subject to numerous constraints with the purpose of either protecting basic human rights, preventing unfair competition, or harboring the whole economic system with the consumers and companies as its vital participants.

The limitation of these freedoms is articulated either within employer-employee relation (employment non-compete), by means of statutory rules under the Companies Law of RS (statutory non-compete), or via an agreement between the parties other than employment (contractual non-compete). Due to the specific nature of each of these relationships, the rules and borders of such constraints are sometimes vastly different.

Employment Non-Compete

Labour Law enables an employment agreement to stipulate activities that an employee cannot engage in, either on own behalf or on behalf of another legal entity or natural person, without the employer's consent. This is subjected to various limitations having in mind the disproportionate and unequal employer-employee relationship where the basic assumption is that the employee is a 'weaker' party in terms of leverage. Hence, the law introduced the following rules as essential for non-compete enforceability:

- the non-compete clause can be applicable only if specific conditions are met, and in particular: that the employee can learn, by working with the employer, new, particularly important technology, know-how, a wide circle of business partners, or learn significant business information and secrets. Therefore, the prohibition of competition is limited in terms of the type or quality of assets or information that employees can acquire during their engagement.
- The non-compete clause can only be determined under the employment agreement and not under the company's bylaws. However, some conditions can be set under the bylaws (territorial validity of the prohibition of competition, depending on the type of activity, can be determined by a company's bylaw – such as the General Employment Rulebook).

- A non-compete clause can be agreed upon for two (2) years after the employment termination provided that the employer is paying such former employee the proper monetary consideration during the respective period. The general rule is that the non-compete clause affects only the period of the employment relationship (where the salary is deemed enough consideration for the employee's loyalty), but, if agreed and under the condition that the 'proper' monetary fee is to be paid by an employer, prohibition period can be prolonged for 2 years after employment termination.
- The non-compete clause must provide the exact or at least more specific jobs and types of engagement from which the employee would be prevented from engaging.

If the clause meets the criteria under the Labor Law, an employee who violates the prohibition of competition can suffer material consequences. For example, the employer can demand:

- reimbursement of damages (*that needs to be proven and require actual damage suffered by the employer*) from the breaching employee or
- the contractual penalty – only if envisaged under the employment agreement irrespective of the actual damage suffered. The contractual penalty must be in accordance with the Law on Contracts and Torts (*the amount is determined at the parties' discretion in total amount, in percentage, or for each day of delay, or in some other manner, but in the practical sense, cannot be disproportionate in relation to the amount of actual damage suffered*). This is an easier solution for employers given that it does not require for the actual damage to be suffered and the employer doesn't need to prove the occurrence of damage itself. Regardless, if the amount of actual damage is greater, the employer can request the difference between the penalty and the suffered damage (*but such difference must be proven by the employer within the respective court proceeding*).

In case the employee breaches the post-termination non-compete (*2 years after employment termination*), the employer can invoke such breach (request damages or contractual penalty) only if the monetary compensation was paid to the employee beforehand.

Mistakes that can lead to unenforceability of non-compete clause

- The employers (*mostly companies*) are imposing the non-compete clauses on employees without justified reason (*when there is no new, particularly important technology, know-how, a wide circle of business partners, or learning significant business information and secrets*) or without elaborating what those reasons actually are;
- the employers (*mostly companies*) that fulfil the preconditions addressed above are failing to provide 'proper' monetary consideration to employees for the two (2) years period after the employment termination. This is the most common malpractice by employers and occurs either when not stipulating any monetary compensation or only the 'symbolic' amounts thereunder that cannot be considered as the proper fee.

These mistakes come naturally given that employers value the prohibition of competition mostly during the employment period but also having in mind that the Labour Law is not clear on the exact amount (*or criteria to determine such amount*) that should be paid to employees in the post-termination period. Such omissions can result in an unenforceable non-compete clause and thus great risk for the employer.

Statutory Non-Compete

According to the provisions of Article 75 of the Companies Law in RS, persons with special duties (*under the meaning of Article 61 of Companies Law*[1]) cannot, without approval:

- have the status of a person who has special duties in another company with the same or similar business activity (competitor);
- be an entrepreneur with the same or similar business activity;
- be employed at a competitor or be otherwise engaged in a competitor;
- be a shareholder or founder of another legal entity with the same or similar business activity.

By the incorporation act, the company can:

- extend the prohibition to other persons, but cannot affect their already acquired rights;
- determine that the prohibition applies even after the termination of the status of a person who has special duties, but not longer than two (2) years;
- indicate jobs, the way or the place of their performance that does not constitute a violation of the non-compete clause.

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1 General partners; shareholders of a limited liability company who own a significant share in the company's share capital or limited liability company shareholder who independently or with other person/entity acting together with him, owns more than 25% of voting rights in the company); Shareholders who own a significant share in the company's share capital or a shareholder who is the controlling shareholder of the company in terms of Article 62 of Companies Law (if one member, independently or with other person/entity acting together with him, owns more than 25% of voting rights in the company); Directors, supervisory board members, representatives and procurators; Liquidator.

Both employment non-compete and prohibition of competition under the Companies Law are legally valid ways of restraining the freedom of participating in the market or working with competitors. Due to the nature of employment relations on the one hand and between the company and persons with special duties on the other, there are some crucial differences between these two.

- the prohibition of competition under the Companies Law usually is in force while the persons with special duties have their respective functions within the company;
- extensions and changes under the Incorporation Act cannot affect already acquired rights of the persons with special duties (*e.g. the amendments to the Incorporation Act cannot reduce the acquired rights of the current director in the company, meaning that the prohibition of competition cannot be extended, prolonged, nor essentially broaden during the capacity of that person*)
- it can be extended by the Incorporation Act for two (2) years after the special duties of a person-cease, but the Companies Law does not provide the compensation to be paid in such cases as a mandatory rule (*unlike the Labor Law where the monetary compensation for the 2-year post-termination period is mandatory even if the employment agreement does not directly stipulate employee's right to compensation*).

Contractual Non-Compete

Aside from the employment non-compete and the prohibition set out by the Companies Law, the parties can agree upon the prohibition of competition under the general principles of Law on Contract and Torts as a part of one of the contract mechanisms to prevent their engagement with competitors or to establish exclusive provision of goods or services between the businesses. Hence, this mechanism is usually used in commercial agreements and B2B relationships.

Under the Law on Contracts and Torts, the parties are free, within the limits of mandatory regulations, public order, and fair customs, to arrange their relationships under the contract as they wish. Hence, a non-compete clause can be a part of various agreements if agreed under the Law on Contract and Torts and other applicable mandatory regulations. The commercial entities (companies, entrepreneurs, traders, etc.) are usually well-informed, more cautious, and equal between themselves, unlike the employer-employee relationship. Therefore, no explicit rules are set for this prohibition of competition to be applicable unlike for employment non-compete.

Regardless, there are mandatory regulations (other than the Law on Contracts and Torts) that should be addressed. So, to establish the applicable and legally binding non-compete clause under the commercial agreement, it is necessary to articulate the provisions in line with the mandatory regulations.

Unfair market competition

Law on Trade defines unfair market competition as an action by a trader or service provider directed against its competitor, which violates codes of business ethics and good business practices and causes or may cause damage to another competitor, and especially:

- by making untrue and offensive claims about another merchant or service provider;
- by presenting information about another trader or its goods, service provider, or service, which is aimed at damaging the reputation and business of that trader or service provider;
- by selling goods with markings, data, or form, which justifiably creates confusion among consumers regarding the source, quality, and other properties of the goods or services;
- acquiring, using, and disclosing a trade secret without the consent of its owner, to make his position on the market difficult;
- promise, i.e. giving gifts of greater value, property, or other benefits to other merchants or service providers, to provide the giver with an advantage over competitors;
- unauthorized display of the quality mark, trust mark, or similar mark by the trader.

Hence, when contracting the non-compete for commercial agreements, it is required to respect the mandatory rules and not enter the area of conducting unfair competition as provided under the Law on Trade.

Contractual Non-Compete

Restrictive agreements

On the other hand, parties should pay attention to avoid the possibility that the commercial agreement is not deemed restrictive under the Law on Protection of Competition. This law defines restrictive agreements as those made by undertakings with the objective or the consequence to considerably limit, violate, or prevent competition on the territory of the RS. They are prohibited and void, and could be in the form of contracts, particular provisions in contracts, or specified or implicit arrangements, where:

- the purchase or sale prices or other conditions of trading are determined directly or indirectly;
- the production, market, technical development, or investments are limited and controlled;
- unequal conditions of operations are applied in the same activities for different undertakings, through which the undertakings are put into an unfavorable position about their competition;
- the contract or agreement is conditioned to the acceptance of additional obligations. that by their nature and trading habits and practice are not connected with the subject of the agreement;
- the markets or procurement sources are divided.

Therefore, when integrating the non-compete clause within the commercial agreements, the parties must pay attention to specifics, to avoid restrictive clauses and provisions that will be rendered as null and void.

Conclusion

All these rules need to be properly addressed irrespective of their differences, given this legal mechanism seems to be irreplaceable in the dynamic world of constant innovation - especially within the IT sector (*including blockchain, AI-powered platforms, tools, open-source, and interconnected applications, etc.*) where people represent the main capital and growth factor.

Moreover, the companies rely on these legal constraints to protect their most valuable products (*information, know-how, and special knowledge related to working processes*) so it should not be overlooked by any of the market participants, even more so, having in mind that the consequences could be irreparable.

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