Competition Law

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Shifting tides: Rethinking non-compete clauses in employment contracts

Non-compete clauses are provisions in employment contracts that restrict an employee from engaging in certain competitive activities after the employment relationship ends within a specific time frame and geographical area. Employers often use them to safeguard their business interests. They aim to prevent former employees from leveraging their knowledge and relationships to benefit competitors while also respecting the employee's right to seek future employment. This balance is crucial, ensuring that the clauses protect the employer's interests without unreasonably restricting the employee's career prospects.

Where the gears shift

In recent years there has been a significant shift in how different jurisdictions view and regulate non-compete clauses. This shift is reshaping the legal landscape and has far-reaching implications for employers, employees, and the business environment.

The UK Government, recognising that there was no provision in their employment statutory framework for non-compete clauses in employment contracts, launched a consultation in December 2020 on measures to reform post-termination non-compete clauses in contracts of employment to maximise opportunities for individuals to start new businesses, find new work and apply their skills to drive economic growth. The purpose of the consultation was to seek views on the following proposals:

- making non-compete clauses enforceable only when the employer provides compensation during the term of the clause;
- placing a statutory limit on the length of non-compete clauses; or
- determining that post-termination non-compete clauses are unenforceable.

Following the consultation, the UK Government ruled out a complete ban of non-competes and made a significant commitment to introduce a statutory limit of three months for non-compete clauses and to bring forward legislation to implement this limit. This commitment signals a significant change in the regulation of non-compete clauses in the UK and underscores the Government's focus on promoting fair competition and individual opportunities.

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In the US, on the other hand, an independent agency of the US Government whose mission is the enforcement of civil antitrust law and the promotion of consumer protection, the Federal Trade Commission (FTC), issued a final rule in April banning non-compete clauses in employment contracts, which commences in September. The FTC made the rule after analysing empirical research on how non-competes affect competition and reviewing public comments it received following a notice of proposed rulemaking issued in January 2023 for the purpose of addressing conduct that harms fair competition. According to the FTC, the current case-by-case and state-by-state approaches to non-compete agreements were inadequate in addressing how these agreements often negatively impact competitive conditions in labour, product and service markets. The rule thus provides that it is an unfair method of competition and a violation of section 5 of the FTC Act for employers to enter into non-compete agreements with employees.

Existing non-compete agreements are not enforceable after the rule takes effect, except for non-compete agreements with senior executives. However, no new non-compete agreements may be entered into after the rule takes effect, including with senior executives. Employers are further required to provide employees with existing non-competes with a notice that the non-competes are no longer enforceable. The FTC projects that the complete ban of non-compete agreements in employment agreements will boost the annual growth of new business formation by 2,7%, leading to the creation of over 8,500 additional new businesses each year. This marks a significant step in the shift of jurisprudence in one of the world's economic superpowers. Following this new rule, the US joins countries like Colombia, Malaysia, Mexico and India, where non-competes are restricted.

Regional perspective: East Africa

Save for Kenya, East African countries have no specific legislation regulating the use of non-compete clauses or restrictive covenants in general. Most of the courts in the region use the reasonableness test: meaning the restrictions placed on an employee's ability to work must be reasonable in terms of geographical scope and duration.

In Kenya, contracts containing non-compete clauses are governed by the Contracts in Restraint of Trade Act CAP 24 (Act). The Act gives the High Court discretion to interpret and enforce restrictive clauses in contracts upon considering the nature of the profession, trade, occupation or business concerned, the period and geographical area within which the restrictive provisions are expressed to apply, and whether or not the provisions are reasonable either in the interests of the parties or in the interest of the public. The Act also provides that non-compete clauses in contracts shall not be enforceable where the employer

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terminates the employment relationship in contravention of the terms of the employment contract. The court in *Mwaura v Taxify Kenya Limited (Employment and Labour Relations Cause 173 of 2019)* [2023] KEELRC 1849 (KLR) held that the non-compete clause in the employment contract between the parties which restricted the claimant from engaging in activities that were deemed to be in competition with the respondent's business for was for a period of 12 months was unenforceable as:

> *"...it sought to keep the claimant away from opportunities in the industry where the respondent operates for the mere reason that he had been in the respondent's employment. The clause is not limited to protecting specific interests of the respondent such as its trade secrets. Enforcing such open-ended restrictive agreement would work injustice against the claimant."*

Conclusion

The prohibition of non-compete clauses in the US and the restrictions on their use in the UK could reshape the perception of non-compete agreements as benchmarks for good practice and economic growth stimulators in the region. From a competition standpoint, these changes enable new market entrants to gain from the expertise of seasoned employees, fostering a dynamic flow of talent and knowledge within the market. This increased job mobility enhances healthy competition across industries. However, there is a counterargument that employees might exploit trade secrets for personal gain, leading to higher turnover rates due to competitive offers, potentially reducing productivity for some organisations.

Given the evolving landscape of non-compete clauses, organisations must meticulously craft these agreements to ensure they are fair reasonable, and protect legitimate interests without incurring excessive enforcement costs. When formulating non-compete clauses, employers should consider factors such as the employee's position, industry specifics, uniqueness of the employee's skills, geographical scope, duration and the employer's exposure to risk. Additionally, employers should have alternative protective measures, such as confidentiality and intellectual property clauses, to safeguard against the misuse of trade secrets if the non-compete clause is deemed unenforceable.

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Navigating the merger control maze: Kenyan Competition Authority imposes pre-implementation penalty for global merger

The Competition Authority of Kenya (CAK) approved and regularised the merger between Sika International AG (Sika AG) and LSF11 Skyscraper Holdco S.a.r.l (Skyscraper) after the parties self-reported that the merger, which triggered a mandatory notification in Kenya, was implemented without the CAK's approval.

Sika AG, incorporated in Switzerland, controls Sika Kenya Limited, a supplier of, *inter alia*, chemical admixtures and construction materials.

Skyscraper, incorporated in Luxembourg, controls Master Builders Solutions Kenya Limited (MBS Kenya), a manufacturer of construction chemicals.

Sika AG's acquisition of control over Skyscraper triggered an indirect change in control of MBS Kenya.

The Competition Act of Kenya (Competition Act) defines a "*merger*" as:

> "*[A]n acquisition of shares, business or other assets, **whether inside or outside Kenya, resulting in the change of control of a business,** part of a business or an asset of a business in Kenya in any manner and includes a takeover*".

Merging parties whose combined turnover or assets, whichever is higher, is over KES 1 billion are required to seek approval from the CAK prior to implementing a proposed transaction.

The transaction between Sika AG and Skyscraper met the statutory definition of a merger as well as the threshold for mandatory notification.

Penalty imposed by the CAK

Penalties for failing to notify a notifiable merger can be severe. The Competition Act provides that:

> "*[A]ny person who implements a merger without approval commits an offense and shall be liable on conviction to imprisonment for a term not exceeding five years or to a fine not exceeding KES 10 million, or both.*"

In the alternative, the CAK may "*impose a financial penalty in an amount not exceeding 10% of the preceding year's gross annual turnover in Kenya of the undertaking or undertakings in question*".

The transaction between Sika AG and Skyscraper was **implemented in Kenya in May 2023** following the closure of the global transaction. In October 2023 (i.e. some five months after implementation), the parties self-reported that the merger in Kenya was implemented following the close of the global deal, while noting that the merger had not been cleared by the CAK.

In calculating an appropriate penalty, the CAK considers mitigating and aggravating factors in arriving at a final penalty percentage, which can be up to 10% of annual turnover.

The Consolidated Administrative Remedies and Settlement Guidelines (Guidelines) provide that aggravating factors include *inter alia*, the impact of the contravention; the duration of the conduct and public interest concerns; and that mitigating factors include co-operation, whether the parties are first-time offenders and other public interest, efficiency, and consumer benefits.

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Regarding the mitigating factors in this matter, the CAK noted that a significant consideration was the parties' co-operation. The parties proactively and voluntarily reported the nonconformance, furnished the CAK with all requested information, and co-operated to reach a settlement. The parties had also not been subject to previous enforcement action. Further, the transaction contributed to foreign direct investment, ensured job retention, and increased consumer choice through enhancement of the merged entity's international and regional competitiveness.

As a result, the CAK ordered that the merged entity pay a penalty of KES 17,492,795 (approximately ZAR 2,4 million) for contravening the Competition Act.

Conclusion

In a global deal, it is often complex to determine which jurisdictions trigger merger notifications. Merger notification obligations can be activated outside of the domiciles of the transacting parties and thresholds for notification can be met based on export sales alone, even without the merger parties owning an operating company on the ground.

This decision from the CAK highlights the importance of merging parties taking advice from competition lawyers early on and prior to engaging in any closing steps. Although the CAK only imposed a penalty in this case, many jurisdictions have the power to unwind a transaction and, in some jurisdictions (including Kenya), cater for the possibility of imprisonment.

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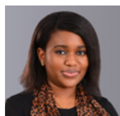

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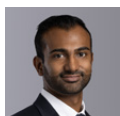

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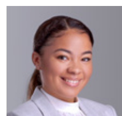

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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