Dissertation

Post-contractual non-compete covenants of shareholder managing directors of German limited liability companies from an employment-law and corporate-law perspective

Analysis of applicable legal frameworks and statutory limitations with a focus on compensation obligations and maximum permissible term

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Summary:

Agreeing on a post-contractual non-compete covenant with the managing directors of a limited liability company (hereinafter "post-contractual non-compete") is common practice in Germany. However, legal doctrine is somewhat ambiguous as to the legal provisions and frameworks applicable to such covenants, and hence it is uncertain to what extent (in terms of duration, geographic scope and substance) these are permissible under statutory law. This uncertainty also extends to the question whether post-contractual non-competes may be legally permissible without granting some sort of compensation, which under German law goes by the name of *Karenzentschädigung*. The discussion around whether or not a *Karenzentschädigung* is legally required originates from the fact that section 74(2) of the German Commercial Code (*Handelsgesetzbuch – HGB*) provides for a mandatory compensation in the event that an employee (as compared to a director) agrees to a post-contractual non-compete undertaking. The legal minimum for that compensation for each year of the non-compete is 50% of the last annual contractual remuneration of the employee as of the date of termination of the employment contract. While regular employment law is not generally applicable to individuals holding executive positions in Germany, it is being discussed whether the principle of a mandatory compensation should apply *mutatis mutandis* in relation to managing directors and even shareholders of a limited liability company.

The dissertation aims at helping to reduce the ambiguity that companies and individuals currently face in practice when it comes to designing post-contractual non-competes for the directors of limited liability companies. It specifically focuses on shareholder managing directors, who (due to their double capacity as shareholders and managing directors) can agree on post-contractual non-competes as part of both their employment and their corporate relationship with the company. A further focus is on the questions (i) whether a *Karenzentschädigung* is required for a post-contractual non-compete to be enforceable and (ii) what would be the non-compete's maximum permissible term. To answer these questions, in a first step, Part A of the dissertation describes the current legal practice and status quo of (potentially) applicable legal frameworks. To be able to put this into perspective, Part B assesses the underlying private-law and constitutional foundations (as well as, from a high-level point of view, their economic and societal basis) in relation to post-contractual non-competes. In Part C, eventually, the dissertation analyses and challenges the status quo described in Part A against the background of the conclusions found in Part B and thus links the legal frameworks applied in practice with their constitutional and private-law foundations. At the same time, concrete solutions are proposed in relation to the legal boundaries limiting the scope of permissible post-contractual non-competes. The dissertation concludes that, in the absence of further legislative guidance, these boundaries generally need to be assessed in the individual case but, as a rule, any post-contractual non-compete may not exceed a maximum duration of two years. With respect to the question whether a *Karenzentschädigung* is mandatorily required, reasonable differentiators could be the scope of the specific post-contractual non-compete and the extent of the relevant shareholder's participation in the company. Whereas provisions merely prohibiting the solicitation of a company's client base should be permissible without paying a *Karenzentschädigung*, in the event of

a comprehensive non-compete obligation, one should distinguish between majority and minority shareholder managing directors: To reduce the impact of the post-contractual non-compete on their professional freedom (and thus reduce the practical risk of the obligation being unenforceable), the latter should be granted a compensation.