Criteria for Judging whether a Non-Compete Agreement is Valid

I. Introduction

Recently, there have been many cases in which an employee skilled with the core technologies of a small and medium-sized enterprise (SME) has moved to a large company, and the advanced technologies developed by the SME over several years can easily be stolen. To avoid this, SMEs may require professional engineers to sign non-compete agreements to reduce the chance they will end up working for the SME's competitors. However, countering this is the freedom that workers have to choose jobs that provide better working environments.

The non-compete agreement seeks to prevent workers with knowledge of the company's unique trade secrets or important information related to business from transferring to that employer's competitors and damaging the employer. This non-compete agreement is of limited effect due to the fact that it may violate the right to work and freedom of occupation, which are the basic rights of the people under the constitution. Since the employer's unique trade secrets are valuable and worth protecting, the non-compete agreement is valid when certain requirements are met: the company's expertise, production method, or business activities must be trade secrets with protective value, and the company must have made sufficient efforts to keep them secret. When these conditions are satisfied, a company's technology is recognized as a trade secret, and the non-compete agreement with the employee remains legitimate.[1]

In this article, I would like to explain the requirements for a non-compete agreement to be effective, the details of related laws and standard guides, and related labor cases.

II. Protection of Trade Secrets and Non-Compete Agreement

1. Protection of trade secrets

The Unfair Competition Prevention and Trade Secret Protection Act (hereinafter the "Unfair Competition Prevention Act"), defines company trade secrets and also regulates compensation for damages from workers who have acquired trade secrets with protective value and transferred them to competitors. In other words, the term "trade secret" is a product that is not publicly known and has independent economic value, and refers to production methods, sales methods, and other technical or management information useful

[1] Jung, Young-Hoon, "Workers' Obligation to Seize Competitive Employment", 「100 Labor Cases」, Parkyoungsa, 2015, pp. 44-45.

for business activities and into which considerable effort is made to keep them confidential (Article 2). The company may ask the court to prohibit or prevent employment of former workers if they have transferred or are likely to transfer the company's trade secrets (Article 10). In the event of damage due to such transfer, the company may request compensation (Article 11). In practice, when a resigned worker is employed by a competitor, action is taken by the previous employer in the form of a provisional disposition for violating the prohibition against employment with a competitor or a lawsuit for damages.

2. Standard precedent on non-compete agreements

The Supreme Court has stated, “If the non-compete agreement between employers and workers excessively restricts workers' freedom of occupation and work rights, etc., guaranteed by the constitution, or excessively restricts free competition, the good morals and social order set forth in Article 103 of the Civil Act, it is invalid as an act that runs contrary to law. To be deemed in effect, such a non-compete agreement must include the following: ① the interests of the employer worthy of protection, ② the employee's position and job description before resignation, ③ the period and place of the restriction on changing jobs, ④ the presence or absence of compensation for the worker, ⑤ the reasons for resignation, and ⑥ public interests and other circumstances must be comprehensively considered. The term “employer's interests worth protecting” as referred to herein is not only a “trade secret” defined in Article 2 of the Unfair Competition Prevention Act, but also knowledge or information owned only by the relevant employer even if it has not reached the level of trade secret. A non-compete agreement is a pledge not to divulge such secret to third parties, or to maintain customer relations or business credit.”[2]

This precedent explains that the non-compete agreement must be interpreted strictly as it may infringe on the basic rights of workers guaranteed by the constitution, and is effective only when certain requirements are met. Therefore, determining whether or not a non-compete agreement is effective is based on which value is more important: the benefit of the employer who protects trade secrets or the right of the worker to change jobs.[3] In order to compare the weight of these two rights, it is necessary to make a comprehensive and detailed judgment based on the following six considerations suggested by precedents.

III. Specific Criteria and Examples of Non-Compete Agreement Validity

[2] Supreme Court ruling on Mar. 11, 2010: 2009 Da82244; Supreme Court ruling on Oct. 17, 2013: 2013ma1434

[3] Lim, Jong-ryul, 「The Labor Law」, 18th ed. Parkyoungsa, 2020, p. 361; Jung, Young-Hoon, “Workers' Obligation to Non-Competition”, 「100 Labor Cases」, Parkyoungsa, 2015, pp. 44-45.

1. Trade secrets worth protecting

In order for a trade secret to be deemed the interest of an employer that deserves protection, the secret must: ① not be widely known in the same industry and have an independent economic value, and ② be mentioned in a security pledge with the worker as to what is not to be transferred to a third party. Customer information, client company information, and know-how are also employer interests worth protecting if they meet the above requirements. However, even if the worker later uses technical or management information acquired during the time of employment with a previous employer, if the information was known to some extent throughout the industry, and even if some specific information was unknown, if it would not be very expensive to obtain it, it is judged to not constitute an interest worth protecting as it did not require significant effort to obtain it.[4]

In some cases, it is difficult to say that each item of information obtained by a worker in the course of business activities or personal relations between a salesperson and a business partner is an interest worth protecting through a non-compete agreement, or that the protective value is significant.[5]

At the time the non-compete agreement is signed, the employer's legal protection interests were within the scope of the employer's legal protection interests, but currently, if the employer's legal protection interests are said to have lapsed due to changes in business type, region, or trade secret, it can be considered that the resigned worker's obligation to adhere to the non-compete agreement has also lapsed.[6]

2. Worker's position and job description before resignation

Non-compete agreements are based upon the fact that the signing worker acquires valuable information by engaging in work related to trade secrets or interests worthy of protection in the workplace before his or her employment relationship ends. Therefore, the non-compete obligation is very relevant to R&D positions. On the other hand, it is difficult to say that the company's trade secrets were acquired if only simple and repetitive production work was performed.

A worker was employed as a semiconductor-related researcher in 1998 by a certain company. In 2017, he resigned for health reasons after many years in research and development. Just three months after his resignation, he was hired by a competing company for a higher annual salary. This was considered a violation of the non-compete obligation.[7]

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[4] Supreme Court ruling on Mar. 11, 2010: 2009Da82244.
[5] Seoul Eastern District Court ruling on Nov. 11, 2010: 2010 Gahap 10588.
[6] Kwon, Doo-Seop, “Part of the Labor Contract”, 「Annotation of the Labor Standards Act」, 2020, Parkyoungsa, p. 187.
[7] Seoul High Court ruling on July 8, 2019: 2019 Ra 20390.

As a sales manager for a pharmaceutical company, another worker imported and sold peritoneal dialysis solution. Information such as cost analysis data for products acquired by workers during their work, agency margins, discount rates, prices, and new product development plans are important trade secrets. If he was employed by a competing pharmaceutical company that sells similar products, he would be in violation of the obligation to not work for a competitor.[8]

3. Period and place of non-compete restrictions

The period of non-compete restrictions is an important factor in determining the validity of a non-compete agreement. The period of non-compete restriction should be reasonable because it can be directly linked to the right to live and freedom of job choice, and yet remains necessary to protect the employer's trade secrets. In general, if the period is short, it is generally legally recognized, while if the period is long, it can be deemed a violation of rights. The courts may limit the prohibition period to a suitable range if the contracted non-compete period is excessive,[9] and may specifically limit it to 1 to 2 years.

When an employee of a semiconductor company worked in R&D for a long period of time and then was hired by a competitor for the same job 3 months after resigning (due to health reasons), the court ruled that a two-year prohibition period is an appropriate time for trade secrets to be protected.[10]

A worker was employed by a software development company but was hired by a competing company after one year. At the time the labor contract was signed with the employer, the worker signed an agreement prohibiting him from moving to a competitor for one year after resignation. The court ruled that the agreement under which workers were obligated to adhere to a non-compete provision for one year after resignation was valid.[11]

Even considering the importance of the protective value to company profits, technology in the mobile phone market changes rapidly, outdating technologies older than a year. In this reality, prohibiting workers long term for working for a competitor excessively limits their freedom of occupation. A two-year prohibition period stipulated in a non-compete agreement in another case was deemed somewhat excessive for the related employee, and the court ruled that the obligation to adhere to a the non-compete agreement for “two years from the resignation date” was unfair.[12]

Some other plaintiffs worked as academy instructors at Daechi-dong Academy for one

[8] Seoul Central District Court ruling on June 17, 1997: 97 Kahab 758.
[9] Supreme Court ruling on Mar. 29, 2007: 2006 ma 1303.
[10] Seoul High Court ruling on July 8, 2019: 2019 Ra 20390.
[11] Seoul High Court ruling on May 16, 2012: 2011 ra 1853.
[12] Seoul Central District Court ruling on Apr. 29, 2013: 2013 Kahab 231.

year, and signed a non-compete agreement, which stipulated, "You cannot engage in the same kind of work without consent within 5 km from Daechi-dong Academy for one year after your employment with Daechi-dong Academy ends." This was ruled as invalid because the restriction was beyond reasonable, and unfairly restricted the freedom of occupation and threatened livelihood.[13]

4. Whether compensation is provided to workers

Whether or not workers have been paid to adhere to the non-compete agreement is an important factor in determining its validity. There are many court precedents showing that if money is paid in exchange for a non-compete agreement, the worker is obligated to avoid reemployment in the same industry during a reasonable period after employment with the signing employer ends. However, even if there is no compensation made for the non-compete agreement, if the item in question is deemed a company trade secret, the obligation remains.

In the case involving the worker finding employment with a competing semiconductor company after signing a non-compete agreement with the previous semiconductor company, which also paid special incentives in exchange for adherence to the non-compete obligation, the two-year ban against working for a competitor company was deemed reasonable.[14]

A worker who was employed at a software development company signed a non-compete agreement for one year. In exchange for complying with this non-compete obligation, a certain amount of bonus was paid. As the company paid such a bonus, the worker going on to work for a competing company within one year after resignation from the signing company was ruled by the court as the employee violating the non-compete obligation.[15]

A certain defendant worked as a trade manager for a company that manufactures and sells nail clippers. The company had the trade manager sign a non-compete agreement in the labor contract, prohibiting employment with competing companies for two years. In a lawsuit in which the defendant established his own company and entered into a competitive relationship with the company, the court dismissed the non-compete agreement as the period was too long (two years after resignation) and no compensation had been paid for this non-compete period. Here, whether or not the company had provided additional payment to compensate for this non-compete period became an important item in the ruling on this non-compete agreement.[16]

[13] Seoul Central District Court ruling on Jan. 10, 2008: 2007 Gahap 86803.
[14] Seoul High Court ruling on July 8, 2019: 2019 Ra 20390.
[15] Seoul High Court ruling on May 16, 2012: 2011 Ra 1853.
[16] Supreme Court ruling on Mar. 11, 2010: 2009Da82244.

5. Workers' reasons for resignation

The non-compete agreement is a document designed to protect the employer's trade secrets when a worker leaves the company and is rehired by a competitor. However, when a resignation is due to reasons attributable to the employer such as overdue wages, unfair dismissal, or layoff, the obligation to prohibit change of employment cannot be enforced even if the employee moves to a competitor.[17] Therefore, the non-compete agreement is effective only if the reason for resignation is the employee's voluntary decision.

6. Specific and comprehensive review

In order for a non-compete agreement to take effect, the five detailed considerations mentioned above must be reviewed comprehensively and in detail. It is particularly necessary to evaluate the weighting of the secrets in terms of profits by examining specific cases where worker rights to choice of occupation are weighed against the need to protect employer trade secrets through a non-compete agreement. It is also essential to review, before any action in court, which of the company's trade secrets are worth protecting, whether the period of the non-compete agreement is reasonable, whether the company has paid anything to compensate the worker for protecting the trade secrets, and the worker's reasons for resignation.[18]

IV. Conclusion

A company can require an employee to sign a non-compete agreement if the worker will have access to the company's trade secrets. If the worker later voluntarily resigns and is reemployed by a competitor, and the first company suffers damages due to the worker violating this non-compete obligation, the company may claim compensation for damages. In addition, if a competing company intentionally scouts this worker with the company's trade secrets and hires him to acquire the company's advanced technology, the scouted company may claim compensation for damage against this competing company.

However, since workers also have the right to work in a better environment and the right to pursue happiness, this needs to be balanced with the need to protect the company's unique trade secrets. If the worker does not have access to such secrets or has not received a certain amount of compensation in return for keeping the non-compete agreement, the worker's rights should take precedence over the obligation to protect the employer's trade secrets.

[17] Kwon, Doo-Seop, "Part of the Labor Contract", 「Annotation of the Labor Standards Act」, 2020, Parkyoungsa, p. 185.
[18] Supreme Court ruling on Mar. 11, 2010: 2009Da82244.