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Non-Compete Covenants In Latin American Jurisdictions — Enforceability Challenges and Drafting Recommendations

Employment and Labor

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Workplace law in Latin American (LATAM) jurisdictions is notoriously complex. The law on the enforcement of non-compete covenants after the employment relationship terminates is equally complex and in some instances underdeveloped. No uniformity exists among the LATAM jurisdictions. This article explores the enforceability of non-compete covenants and suggests some drafting guidelines to improve the chances of implementing valid and enforceable non-compete covenants.

Implied duty of good faith

In the LATAM jurisdictions, employees may not compete with an employer during the tenure of their employment relationship. In most jurisdictions, employees are under an implied duty of trust and confidentiality. Accordingly, in some jurisdictions no express employment contractual provision is required to protect an employer against unfair competition while the employment relationship exists.

For example, in Brazil, Article 482 of the Labor Code provides the list of employee misconduct that can be considered good cause for terminating the employment relationship. The statutory list of lawful grounds of termination includes competing against the employer and disclosing trade secrets or confidential information. These employee obligations are implied by law, and it is not required to restate these obligations in the employment agreements.

Mexican law, on the other hand, is not as specific. While an employer can terminate an employee for cause if the employee discloses confidential information, there is no specific prohibition against employees having a second job even if with a competing employer. For that reason, it is advisable to include exclusivity of services clauses in the employment agreement for employees in Mexico.

Post-employment covenants not to compete

The implied duty of trust and good faith ends when the employment relationship terminates. Accordingly, any restriction on an employee regarding post-employment activities must be expressly stated in a written agreement. The enforceability of post-employment non-compete covenants is subject to various challenges in the LATAM jurisdictions. In a few countries, such as Colombia, El Salvador, Honduras, Mexico, and Panama, the constitutional right to work bars any post-employment covenant not to compete. In other LATAM jurisdictions, such as Chile and Costa Rica, the law is underdeveloped with a few cases in the civil courts that address the issue in rather vague terms, which could be challenged on constitutional grounds in the constitutional court. In Bolivia and Guatemala, there is no case precedent. As a result, whether non-compete covenants are legal and enforceable is uncertain. In other countries, such as Brazil, several court decisions deal with non-compete clauses, but divergent streams of law have developed that have not yet been settled by the country's highest court, creating uncertainty about the legal requirements and enforceability of non-compete covenants.

The constitutional right to work

In most of the LATAM jurisdictions, employees have some form of a constitutional right to work. For example, under Article 56 of the Costa Rican Constitution, employment is a fundamental right of all individuals. Also, the Costa Rican government must ensure that all have the ability to hold gainful employment and must guarantee the freedom of choice of employment. Similarly, the Constitution of El Salvador guarantees in Article 37 that "Labor is a social function; it enjoys the protection of the State, and it is not regarded an article of commerce" and further that "The State shall employ all resources that are in its reach to provide employment to… workers, and to ensure [workers] the economic conditions for a dignified existence." Further, Article 5 of the Mexican Constitution provides that the state shall not permit the performance of any contract, covenant, or agreement, the object of which would be, among others, prohibitions against, or the temporary or permanent renunciation of, the exercise of a given profession or industrial commercial pursuit.

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The impact of the constitutional right to work ranges from an outright prohibition of any form of post-employment non-competition provisions to permitting reasonable restrictions. For example, in El Salvador, covenants not to compete after the employment relationship terminates are invalid and unenforceable without exception. To that end, the Ministry of Labor in El Salvador has decreed that

employers may not limit a former worker's right to work for another employer using the knowledge and experience he or she has acquired. In other jurisdictions, such as Argentina, a reasonable and narrowly drawn covenant not to compete may survive the constitutional scrutiny if it does not unduly curb the employee's right to work, or freedom of association. In Mexico, the Constitution is clear to bar any post-employment restriction to work. The impact of the constitutional bar can be legally circumvented if compensation is paid to the former employee under a civil law agreement not to compete. If the employee then challenges the civil law agreement and the agreement is declared null and void, the employee would have to return the compensation paid by the former employer.

Requirements of a valid covenant not to compete

In those LATAM jurisdictions where post-employment non-compete covenants are enforceable, the following general guidelines apply.

The geographical scope of the covenant must be reasonable: The LATAM jurisdictions are inconsistent regarding what constitutes a "reasonable" geographical scope. Generally, the narrower the geographical scope, the greater the chances of enforcement. As a default position, the geographical scope should be limited to the location (city or province) where the employee worked or serviced customers. In some instances, where the employee is in a managerial position, a country-wide non-compete may be enforceable, if justifiable.

The restrictive period must be reasonable: Again, no uniformity exists among the LATAM jurisdictions as to what period of post-employment restrictions on competition would be reasonable. Some jurisdictions state a short maximum period (six months in Venezuela), or more commonly, up to two years (in Costa Rica and Brazil), and in others an upper limit of up to five years (in Argentina).

Compensation to employee during restrictive period: Consistent with requirements in many European jurisdictions, a number of the LATAM jurisdictions require that the employee who is subject to a post-employment non-compete covenant must be paid during the restrictive period. The amount varies from a low of approximately 50 percent of the employee's base salary (for example, in Costa Rica) to a more common requirement of payment of full salary for the duration of the restrictive period (for example, in Venezuela). In Brazil, the courts will look into whether the former employee can maintain the same status quo during the restrictive period; in other words, if the employee was highly skilled and compensated and thus the restriction will prevent him from finding a reasonable position that will allow him to continue growing in his career and earn same or better compensation, then the former employer should make the former employee whole during the restriction (i.e., pay full salary). Even if payment is not required by law, in most LATAM jurisdictions, payment during the restrictive period might substantially improve the chances of overcoming a constitutional challenge of the employee's right to work.

See the chart at the end for a summary of these requirements in each of the 17 major different jurisdictions in LATAM.

Drafting non-competes for enforceability

Despite the many restrictions in the LATAM jurisdictions on post-employment non-compete covenants, employers can — with innovative drafting — maximize their protection against unfair competition by departing employees. Below, we describe a few drafting strategies:

The Mexican approach: Given that noncompete covenants are generally unenforceable in Mexico, it has been a common practice to enter into civil-law agreements. Such civil-law agreements are separate and independent from the typical employment agreement and provide the employees consideration in exchange for not competing with the business. These civil-law agreements can be executed during the employment relationship and in addition to the employment agreement or after the employment relationship is terminated. A frequent drafting approach is to pay the consideration in parts during the non-competition period or the entire amount at the end of the non-competition period to act as an incentive against breach of the agreement. Moreover, because it is often difficult to prove a breach to obtain reimbursement of already-paid amounts, this approach places the company in a better position to decline payment in case of a breach. Additionally, these agreements frequently include a liquidated damages provision, called a "contractual penalty." If the employee breaches the agreement, the company can claim from the employee the paid consideration and the payment of a contractual penalty which cannot be higher than the amount paid to the employee as consideration not to compete.

The Brazilian approach: Due to the lack of specific law and inconsistency in the courts' rulings, it is advisable not to use a "one-size-fits-all" template for non-compete agreements. Companies should analyze each case and tailor the provisions accordingly. The following steps should be considered when drafting:

- Offer letters – including an express statement that the employee will be subject to restrictive covenants and will be required to agree to them as a condition of employment;
- Including non-compete provisions in the original employment agreement, which should be signed on the first day of work (there is a presumption that the employee is not free to negotiate a non-compete agreement after he is already employed);
- Imposing non-compete restrictions sparingly. Impose such covenants only on employees in key positions with access to very sensitive information who can truly damage the company's business if they work for a competitor;
- Avoiding overreach by preparing a narrowly tailored restriction from the get-go. Therefore, consider restricting the scope of the non-compete in terms of the line of business, geographical area, and duration, which should be directly related to the business interest that the company wants to protect and the lifecycle of the information the former employee had access to;
- Setting compensation for the non-compete commensurate to the employee's position and restrictions, preferably payable monthly;
- Setting a waiver provision, which will allow the company to waive the noncompete obligation at the time of termination and consequent release of the company from its obligation to pay the employee; and
- Considering whether to include a penalty clause for a violation of the noncompete.

Alternative avenues of protection against unfair competition

In some LATAM jurisdictions, and despite the constitutional bar against covenants not to compete, employers may resort to civil lawsuits and file criminal complaints against former employees who unfairly compete with them. Honduras is an example. If former employees disclose and use confidential business information of their former employer for their own benefit or for the benefit of their new employer, the former employer may commence a civil action under Article 1360 of the Honduran Civil Code. Additionally, if the information disclosed includes trade secrets, the employee could also be subject to criminal prosecution under Article 215 of the Honduran Criminal Code. The availability of these alternative avenues of protection against unfair competition depends on the

evidence of actionable conduct available to the former employer, and frequently is difficult to pursue.

Conclusion

The law in LATAM pertaining to non-compete covenants generally is underdeveloped. The prevalence of a broad constitutional right to work either bars outright the enforcement of non-compete covenants, or has created a reluctance to impose such covenants on employees due to legal uncertainty about the enforceability of such covenants. Despite these challenges, narrowly drawn non-compete covenants for management and other key employees are increasingly being included in agreements. Paying the departing employee during the restrictive period generally weathers the storm of a legal challenge.

Country	Are post-employment non-competes enforceable?	Any restrictions on restrictive period?	Any restrictions on geographical scope?	Must employee be paid compensation during the restrictive period?
Argentina	Yes, if reasonable and does not restrict employee's constitutional right to work.	Must be reasonable under the specific circumstances. Maximum limit is five years.	Must be reasonable under the specific circumstances.	Possibly, if employee's constitutional right to work is unduly restricted.
Bolivia	Enforceability of noncompete clauses is uncertain due to lack of court precedent. Employees have a constitutional right to work, but a narrowly drawn clause might survive a constitutional challenge.	No case precedent. Advisable to have a reasonably short time period of three to six months.	No case precedent. Advisable to limit the geographical scope to the territory where the employee rendered services for the employer, as well as the places where the employer is located or the places where the employer plans to be located in the near future.	Not required by law.
Brazil	Yes, if they comply with the following requirements: 1) agreed to in writing at the beginning of the employment relationship, 2) reasonable compensation is provided, 3) are restricted in time, geographic area, specific activities,	Up to two years, but it will ultimately depend on its reasonableness vis-a-vis the employee's position and access to sensitive information that will not become obsolete soon.	Law is not settled, but generally must be reasonably related to the business activities the employee had access to.	Yes. The amount to pay depends 1) on the scope of the restriction; and 2) the ability of the employee to find alternative employment at which he earns as much as he did at previous job. It is common to pay the equivalent of a

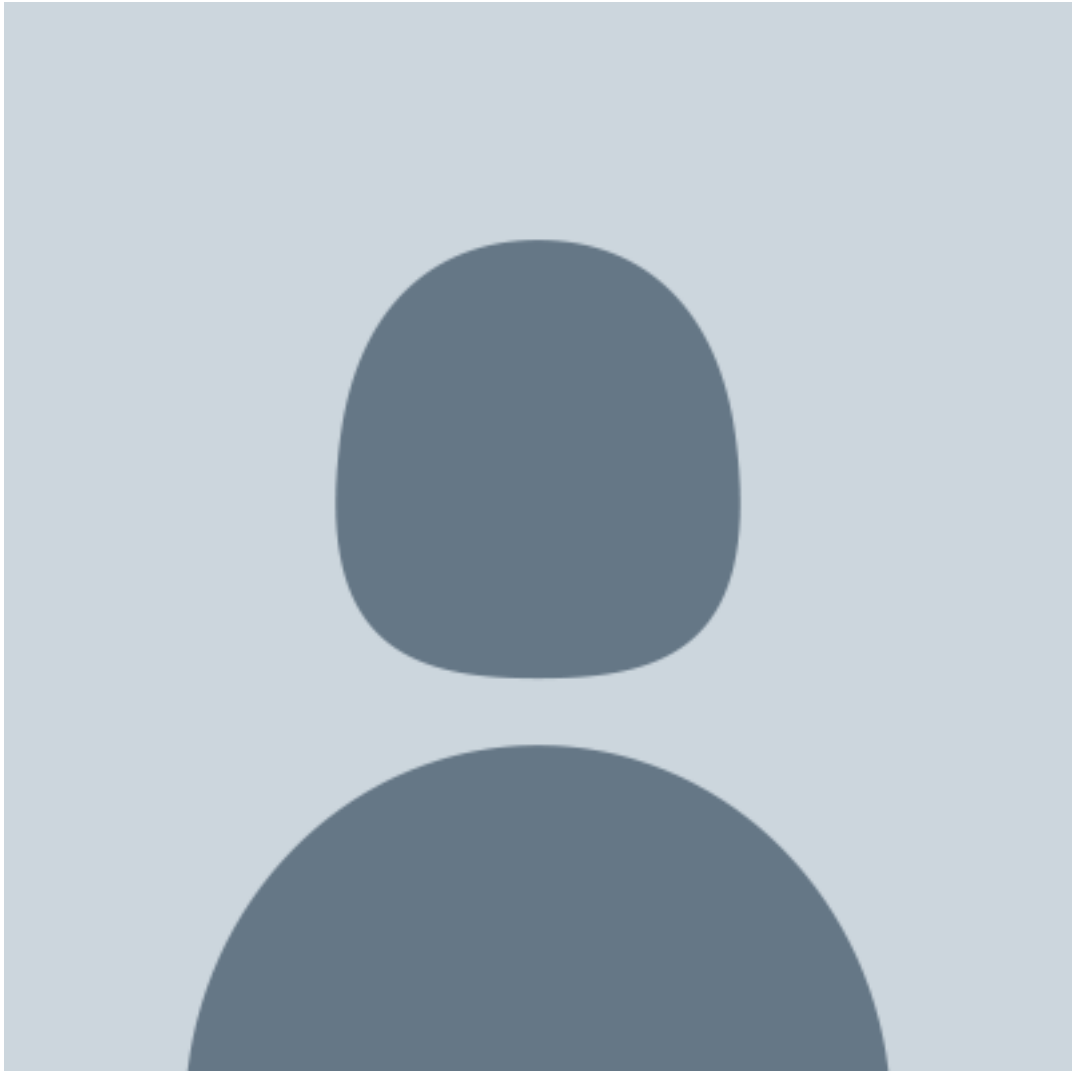
Country	Are post-employment non-competes enforceable? products, and competitors, and 4) are relevant to preserve the former employer's trade secrets.	Any restrictions on restrictive period?	Any restrictions on geographical scope?	Must employee be paid compensation during the restrictive period? monthly salary for period of noncompete.
Costa Rica	Yes, for higher-level job positions or employees who had access to highly confidential strategic business information that could benefit the competition and harm the company.	Must be reasonable and for up to two years, maximum.	Must be reasonable under the specific circumstances. A countrywide restriction might be "absolute" and unenforceable.	Yes, at least 50% of employee's last monthly salary for restrictive period.
Chile	Yes, provided terms are reasonable and do not unduly restrict constitutional right to freedom of occupation. Frequently imposed for managers and executives.	Must be reasonable under the specific circumstances.	Must be reasonable under the specific circumstances.	Not required by law, but if paid, increases enforceability.
Colombia	No, because such agreements violate the constitutional right to work.	N/A	N/A	N/A
El Salvador	No, generally invalid and unenforceable because they violate the constitutional right to work, but there is no case precedent on point. Although enforceability is unlikely, clauses are sometimes included in managers' employment contracts.	If included in employment contract, advisable to have a short time period.	If included in employment contract, advisable to have a limited geographical scope.	None required by law, but probably would increase enforceability if paid.

Country	Are post-employment non-competes enforceable?	Any restrictions on restrictive period?	Any restrictions on geographical scope?	Must employee be paid compensation during the restrictive period?
Ecuador	No, due to unlimited right to work guaranteed under Ecuadorian Constitution. But, like Mexico, possibly enforceable if included in a civil law agreement.	If included in a civil law contract, advisable to have a short time period.	If included in a civil law contract, advisable to limit geographical scope to territory where the employer is located.	Not required by law.
Guatemala	Uncertain due to lack of case precedent.	No case precedent. Advisable to have a reasonably short time period.	No case precedent. Advisable to have a reasonable geographical restriction.	None required by law, but probably would increase enforceability if paid.
Honduras	No, because non-compete clause violates employees' constitutional right to work.	N/A	N/A	N/A
Mexico	No, because they violate employees' constitutional right to work. However if additional compensation is paid, employee would have to reimburse compensation if he/she wants the agreement to be declared null and void.	In principle, restrictive covenant agreements are considered null and void. However, if an agreement is executed with consideration payment, time restrictions must be reasonable under specific circumstances.	In principle, restrictive covenant agreements are considered null and void. However if an agreement is executed with consideration payment, geographical scope must be reasonable under specific circumstances.	Yes, as the compensation will be the tool to guarantee some deterrent for the former employee to compete.
Nicaragua	Yes, primarily for employees in senior management, technical and professional positions if terms of noncompete are reasonable and do not unduly restrict employees' constitutional right	Must be reasonable and for up to two years, maximum consistent with the regional labor doctrine.	Must be reasonable, but limited to the geographical area covered by the company's commercial activity.	Not required by law.

Country	Are post-employment non-competes enforceable?	Any restrictions on restrictive period?	Any restrictions on geographical scope?	Must employee be paid compensation during the restrictive period?
	to work, freedom of association and freedom to choose their profession or trade information.			
Panama	No, because they violate employees' constitutional right to work.	N/A	N/A	N/A
Paraguay	Yes, but very difficult to enforce due to the constitutional right to choose work and the provisions of Section 10 of the Labour Code.	Must be reasonable, but not exceed 12 months.	Must be reasonable.	Not required by law.
Peru	Yes, if provisions are reasonable and do not restrict employees' constitutional right to work.	Must be reasonable.	Must be reasonable, usually limited to the geographical area where employee worked or served.	Not required by law, but if paid, increases enforceability.
Uruguay	Yes, if narrowly tailored and does not unduly restrict employees' constitutional right to work. The higher the position and remuneration, the more justified the obligation not to compete after termination of the employment relationship.	Must be reasonable. Easier to enforce if up to six months.	Must be a reasonable geographical scope such as the territory in which the employee has rendered services for the employer.	Nor required by law, but if restrictive period is more than six months, advisable to pay employee or period in excess of six months (because mandatory termination indemnities under Uruguayan law is up to six months' pay).
Venezuela	Yes, for upper management employees, provided covenant is entered into at the start of employment, and must be narrowly drafted to respect	Up to six months.	Must be reasonable, usually limited to the geographical area where employee worked or served.	Yes, the law does not specify amount of compensation, but usually it is equal to the base salary that employee would have earned if employee continued

Country	Are post-employment non-competes enforceable? employee’s fundamental right to work, the right of association, and the freedom to choose one’s profession or occupation.	Any restrictions on restrictive period?	Any restrictions on geographical scope?	Must employee be paid compensation during the restrictive period? working during the restrictive period.

Johan Lubbe



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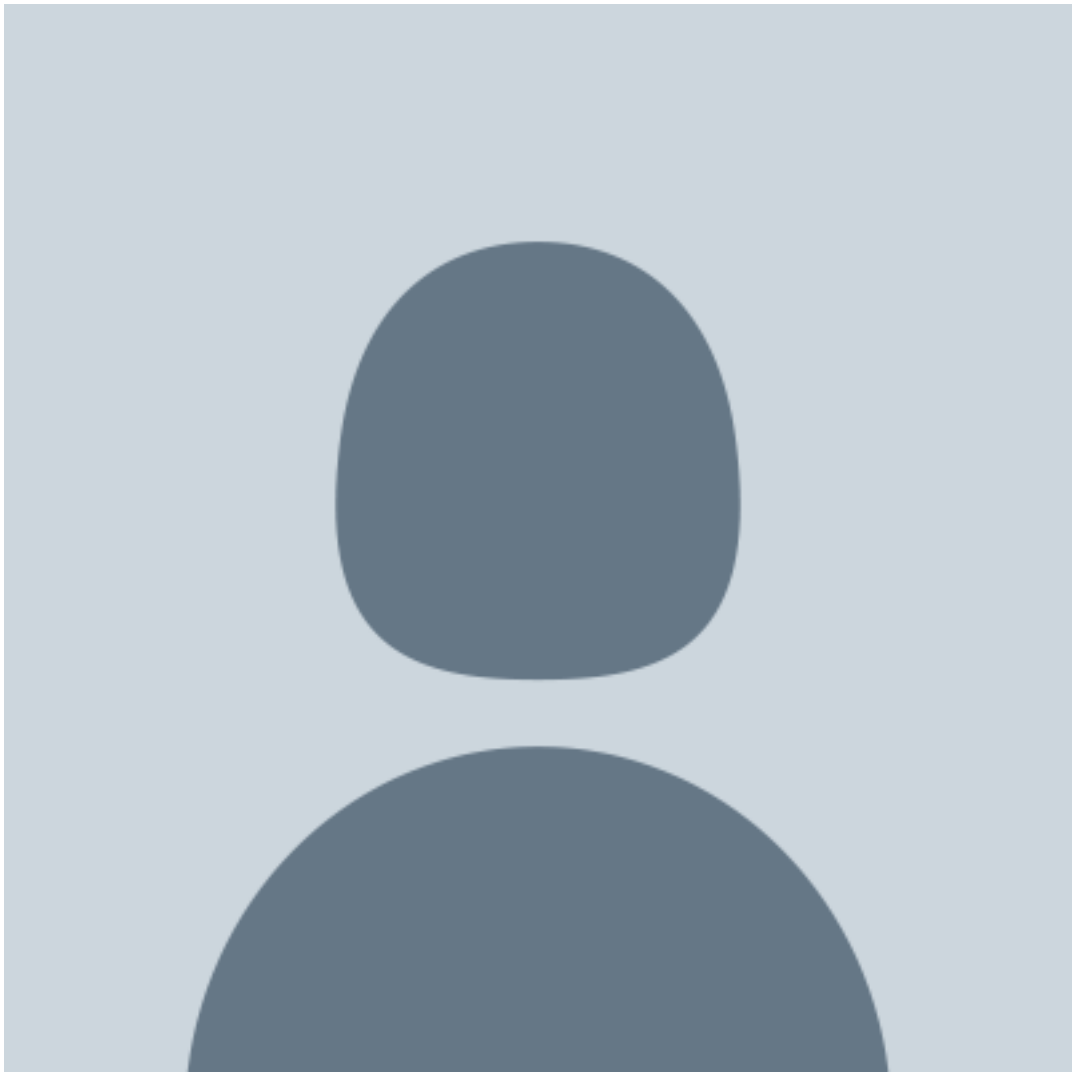

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Monica Schiaffino is a shareholder in Littler's Mexico City and Monterrey, Mexico offices. She is a skilled labor lawyer and experienced employment litigator, and has published extensively and spoken on a range of important labor and employment issues. Schiaffino has also been named one of Mexico's leading lawyers.