

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE****Competition Issues in Labour Markets – Note by Finland****5 June 2019**

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Finland

1. Introduction

1. Competition issues regarding labour markets have been quite rare in Finland. There have been neither major competition problems nor cases. However, there are two issues, namely the use of non-compete agreements and the status of ‘new self-employed’, which have recently been raised and need to be analyzed more profoundly.

2. Non-compete agreements and competition

2.1. The definition of non-compete agreements

2. This section shortly describes the use of non-compete agreements in Finland, explaining their economic implications, relevant legislation and issues in enforcement of the law.

3. A non-compete agreement is a contract between an employee and an employer, where the employee agrees not to join a rival employer or to launch a competing business for a certain period after the current employment contract ends.

4. From an economic point of view, the purpose of the agreement is to protect relationship-specific investments made by the employer that, for some practical reason, cannot be contracted upon. Without a covenant not to compete, the employer may be unwilling to invest, as there is a risk that the employee joins a rival firm and takes the benefits of the investment there, while leaving the costs of the investment. By making it difficult for the employee to switch jobs, a non-compete agreement restores the employer’s incentives to invest in the relationship.¹

5. Especially in information-intensive sectors, where intellectual property rights are often hard to define, and businesses are linked to few key employees, non-compete clauses may be necessary for the employer to prevent information spillovers to rival firms. In this sense non-compete agreements can improve welfare in the society, by creating incentives to invest in human capital, intellectual property and customer relations.

6. But this is only part of the picture. Non-compete agreements are anti-competitive by definition and may thus have serious implications for the efficient functioning of both labour and product markets.² If non-compete clauses are routinely imposed on employees

¹ Acemoglu, Daron, “Training and Innovation in an Imperfect Labour Market”, *The Review of Economic Studies* 64, 3 (1997), pp. 445–464.

² Garmaise, Mark J, “Ties that truly bind: Noncompetition agreements, executive compensation, and firm investment”, *The Journal of Law, Economics, and Organization* 27, 2 (2011), pp. 376–425. See also Fallick, Bruce, Fleischman, Charles A, and Rebitzer, James B, “Job-hopping in Silicon Valley: some evidence concerning the microfoundations of a high-technology cluster”, *The Review of Economics and Statistics* 88, 3 (2006), pp. 472–481.

without clear justifications, they prevent people from changing their jobs and joining more efficient firms or even starting more efficient businesses.³

7. In the US, where the regulation of non-compete agreements differs from state to state, there has been some empirical work on the subject. In California non-compete agreements are not enforceable, which some argue is partly the reason why Silicon Valley is so dynamic.⁴ But perhaps the most interesting is the so-called Michigan experiment. In 1985 Michigan reformed its antitrust law, which had the seemingly inadvertent consequence of removing the prohibition on enforcing non-compete agreements. Empirical research shows that this reduced worker mobility in Michigan's labour market, especially for inventors and specialists.⁵ Furthermore, there is evidence of a brain drain from Michigan to neighboring states.⁶ These results suggest that the use of non-compete agreements must be carefully regulated, and the law efficiently enforced.

2.2. Regulation in Finland

8. According to the Finnish Employment Contracts Act, during the term of employment, the employee's right to embark on competing activity is limited. Yet this rule does not readily extend to time after the employment relationship. Only for a particularly weighty reason, related to the business of the employer or the employment relationship at hand, the parties can legally sign a non-compete agreement that limits the employee's freedom after the employment relationship ends.

9. Examples include protecting the employer's trade secrets, know-how or existing customer relations, which cannot be protected by other means. The maximum length of the restriction period is six months. If the employee receives a reasonable compensation for the agreement, the period can be extended to one year. Furthermore, the parties may agree on a contractual penalty, which the employee is obliged to pay for breaching the contract.⁷ If the contract includes no such provision, the general principles of tort law apply.

10. From the economic perspective, the requirement that non-compete agreements can be made only for a particularly weighty reason, seems appropriate. To ensure the efficient

³ By analogy, see Aghion, Philippe and Bolton, Patrick, "Contracts as a Barrier to Entry", *The American Economic Review* 77, 3 (1987), pp. 388--401.

⁴ See Gilson, Ronald J, "The legal infrastructure of high technology industrial districts: Silicon Valley, Route 128, and covenants not to compete", *NYUJ Rev.* 74 (1999), pp. 575; Hyde, Alan, *Working in Silicon Valley: Economic and Legal Analysis of a High-velocity Labor Market* (Routledge, 2015); Franco, April M and Mitchell, Matthew F, "Covenants not to compete, labor mobility, and industry dynamics", *Journal of Economics & Management Strategy* 17, 3 (2008), pp. 581--606.

⁵ Marx, Matt, Strumsky, Deborah, and Fleming, Lee, "Mobility, skills, and the Michigan non-compete experiment", *Management Science* 55, 6 (2009), pp. 875--889. These results are verified by Belenzon, Sharon and Schankerman, Mark, "Spreading the word: Geography, policy, and knowledge spillovers", *Review of Economics and Statistics* 95, 3 (2013), pp. 884--903.

⁶ Marx, Matt, Singh, Jasjit, and Fleming, Lee, "Regional disadvantage? Employee non-compete agreements and brain drain", *Research Policy* 44, 2 (2015), pp. 394 - 404.

⁷ The penalty cannot exceed the amount of pay received by the employee for the six months preceding the end of the employment relationship.

functioning of markets, covenants not to compete should be used only when they are necessary for welfare-improving investments, and cannot be replaced by less harmful agreements, such as non-disclosure agreements, payback clauses and non-solicitation agreements.

11. However, in practice, it seems that non-compete agreements are made automatically without assessing the relevant legal requirements. In Finland the use has dramatically increased in recent years. According to a survey, among highly educated people around 37% reports that their employment contract includes a non-compete clause, and such clauses are becoming even more common, being included in almost half of the new employment contracts signed by professionals. Furthermore, non-disclosure agreements are almost always signed together with non-compete clauses.⁸

12. The routine use of non-compete agreements suggests that either the current legislation or the regulatory control needs an update. A report produced by Aalto University economics working group offers several potential solutions.⁹ First, an authority could control the use of non-compete agreements *ex ante* or *ex post*. The problem with *ex ante* control is its administrative burden, which could be reduced by an application fee charged to the employer only if the application is turned down. Alternatively, the law could require the employer to register the non-compete agreement for random inspection.

13. Second, if the employer had to compensate the employee also for restriction periods that are less than six months, this would certainly reduce the incentives to mechanically sign non-compete agreements. Finally, instead of strict non-compete agreements, the law could allow so-called option contracts, where the employer reserves the right to impose a restriction period on the employee by paying a predetermined amount of money when the employment contract ends.¹⁰

3. Self-employed and competition law

3.1. The concepts of worker, self-employed and undertaking

14. This section shortly describes the application of competition law to self-employed in Finland. The rights and obligations of a person depend very much on whether the person's status is a worker or an undertaking.

15. Workers are not as such undertakings within the meaning of competition law. Article 2 (1) of Finland's Competition Act states that the Act shall not be applied to

⁸ The survey was made by Akava, a trade union confederation of affiliates for highly educated people. Collecting information from more than 2,000 members of the union, the survey found that increasingly many of them have difficulties in switching jobs due to non-competes. The report is available in Finnish at <http://www.akavaworks.fi/>.

⁹ Liski M, Nokso-Koivisto O, Pietola M, "Kilpailukieltosopimuksen periaatteellinen tarkastelu. Ajatuksia sääntelyn kehittämisen pohjaksi (In-depth review of non-competition agreements. Reflections for the development of regulation)", available in Finnish at <http://www.akavaworks.fi/>.

¹⁰ The option contract is proposed by Krakel, Matthias and Sliwka, Dirk, "Should You Allow Your Employee to Become Your Competitor? On Noncompete Agreements in Employment Contracts", *International Economic Review* 50, 1 (2009), pp. 117--141.

agreements or arrangements which concern the labour market. The case law regarding Article 2 (1) has been scarce.¹¹ The exemption regarding labour market agreements does not apply to liberal professions. For example, the Finnish Competition and Consumer Authority (FCCA) has prohibited the price recommendations by lawyers¹² and architects¹³.

16. In Finland the concept of self-employed does not have a clear legal definition. It is an umbrella term used to describe a group working alone, without personnel. It includes, for example, solo entrepreneurs, liberal professions, freelancers and grantees.¹⁴ For liberal professions and owners of small businesses self-employment has long been the standard. According to a report¹⁵ published in 2013, there were 152.000 self-employed in Finland, about 6% of the total working age population. The majority of self-employed, around 112.000, were solo entrepreneurs.

17. The application of competition law is determined by whether an undertaking is concerned. According to Article 4(1) of the Finland's Competition Act, an undertaking can be a natural person, or one or more private or public legal persons who engage in economic activity.

18. In 2011, the concept of undertaking was changed in the reform of the Competition Act, so that it now corresponds to the concept of an undertaking under EU competition law. As stated in the Government's bill¹⁶, the effective application of EU competition law requires that the concept of an undertaking, which also defines the scope of the prohibition provisions, is applied in a manner consistent with EU competition law. The amendment sought to ensure a uniform interpretation of the scope of the prohibition provisions of the Competition Act and EU competition law.

19. EU competition law has autonomous definitions both for a worker and an undertaking. Their definitions is a matter of EU law, ultimately determined by the EU courts. In the case-law of the CJEU, the concept of an undertaking is broadly defined and encompasses every entity engaged in economic activity by offering goods or services on a given market regardless of the legal status of the entity and the way in which they are financed.¹⁷ Traditional self-employed, such as doctors¹⁸, lawyers¹⁹, and custom agents²⁰, are typically considered as undertakings.

¹¹ See, however, the prohibition of subcontracting in the paper industry. FCCA decision, 8 October 2010.

¹² FCCA decision, 19 October 1992.

¹³ FCCA decision 14 August 1991.

¹⁴ Pärnänen, Anna & Sutela, Hanna: "Itsensätyöllistäjät Suomessa 2013", 2014, p. 13.

¹⁵ Ibid., p. 3, 7-8.

¹⁶ Government's Bill for Competition Act, HE 88/2010, p. 56.

¹⁷ C-41/90 Klaus Höfner ym. ECR I-01979, paragraph 21; C-180/98 Pavlov, paragraph 75.

¹⁸ C-180-184/98 Pavlov, paragraphs 76-77.

¹⁹ C-309/99 Wouters, paragraphs 48-49.

²⁰ C-35/96 Commission v. Italy, paragraphs 36-37.

20. The FCCA has applied the same principles regarding, for example, lawyers²¹ and architects²² already before the harmonization of undertaking concept; they have long fallen within the scope of the national competition rules.

3.2. 'New self-employed' and bogus self-employed

21. The category of self-employment has become wider. Today it has been said that new kinds of self-employed have emerged.²³ The 'new self-employed' significantly differ from the traditional self-employed. They have not necessarily chosen their position voluntarily but are often forced to work without an employment contract. The 'new self-employed' are not in the same independent and economically secure position as many traditional self-employed, such as lawyers, but they may have to bear a considerable risk. The bargaining position of the 'new self-employed' can be weak. As a result, they may share more characteristics with workers than with entrepreneurs.

22. The so-called 'new self-employed' are the consequence of a platform economy, where matchmaking platforms have arranged work to be contracted on demand. As a result, the income of 'new self-employed' may consist of payments from different platforms.

23. There has also been a public debate on bogus or false self-employment. It refers to a situation where work is formally carried out by self-employed, but in fact the working conditions are comparable to those of the employee and the legal tests would likely define them as employees.²⁴

24. It may also be typical that there is only one client, namely a former employer. The former employer may have outsourced the work and self-employed is carrying out professional activity under the authority and subordination of former employer. Outsourcing may be due to avoidance of taxes, social security contributions or other liabilities.

3.3. In-between an undertaking and a worker

25. The legal effect of competition law regarding the 'new self-employed' cannot be categorically deduced from the concept itself because of its heterogeneity. Some 'new self-employed' appear to be considered as undertakings in competition law, whereas others are workers. As a result, the distinction drawn between undertakings and workers becomes important.

26. Thus far there has been no national case law regarding the 'new self-employed' in Finland. However, the CJEU²⁵ has made a distinction between genuine self-employed and "false self-employed": the latter are not to be considered undertakings when applying competition rules. Thus, a collective bargaining agreement covering them falls outside the

²¹ FCCA decision, 19 October 1992.

²² FCCA decision 14 August 1991.

²³ Daskalova, Victoria: "Regulating the New Self-Employed in the Uber Economy: What Role for EU Competition Law?" 19 German Law Journal 3, 2018, pp. 462-470.

²⁴ Pärnänen, Anna & Sutela, Hanna: "Itsensätyöllistäjät Suomessa 2013", 2014, p. 125.

²⁵ C-413/13 FNV Kunsten Informatie en Media v Staat der Nederlanden

scope of competition rules. It is for the national courts to determine whether the criteria for false self-employed are met. Therefore, the FCCA may face the question in the future.

27. There has been a public debate on the status of ‘new self-employed’ in Finland. Labor unions have wanted to change national competition law so that collective bargaining on behalf of the ‘new self-employed’ would be possible. It remains to be seen whether the Competition Act will be amended.

28. However, it is uncertain how far the concept of a worker can be stretched. Stretching the concept to cover the ‘new self-employed’ could lead traditional self-employed, namely members of the liberal professions, to take unfair advantage of it. Moreover, the amendment of Competition Act could imply that the scope of application of national competition law would differ from the scope of application of EU competition law. This would be against the aim of the Competition Act reform in 2011 as described above.