

Competitive actions by employees through intermediaries: imputation of liability and restrictive covenants

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Introduction

Under Section 7 of the Employment Act, employees cannot, while employed and without their employer's consent:

- operate a commercial business; or
- conclude commercial transactions in their employer's line of business.

While the first restriction aims to secure employees' work capacity, the latter seeks to protect employers against competing activities.

In a recent case (OGH 7 April 2020, 4 Ob 234/19 v), the Supreme Court had to decide whether the statutory prohibition also covers such competitive actions by employees through intermediaries or whether only the employees themselves have the standing to be sued by their employer.

Facts

The employer sued a former employee who went on to establish his own legal entity for competing services in the cargo business. Before the employee left his former employer, he had already set up a limited liability company (LLC), which he wholly owned and directed, and through which he then usurped business opportunities and redirected business transactions from his former employer to his own advantage. His former employer sued, requesting that the defendant disgorge all profits gained from the redirected business and disclose diverted transactions not yet perfected.

However, the plaintiff did not sue the former employee personally, but rather the entity wholly owned and directed by him, claiming that the legal entity set up by the employee would take his place so that the legal entity would also be bound by the statutory restrictions.

Both the trial court and the court of appeals dismissed the case on the grounds that clear statutory language would exclude bringing such a claim against non-employees, albeit a legal entity wholly owned by an employee.

Decision

The Supreme Court confirmed and noted that the unambiguous statutory language could not be construed to include legal claims of employers against third parties (ie, defendants other than the infringing employee in person).

The court highlighted a more basic concept of corporate law, explaining that a legal entity and its shareholders are distinct legal persons and must, therefore, be distinguished and kept apart. Therefore, the plaintiff's position that an LLC, even if wholly owned by the employee, would take the employee's position so that the LLC would also be subject to statutory restrictions directed at the employee is unfounded.

According to the Supreme Court, the plaintiff had asserted no legal theory other than Section 7 of the act to support its claim and, in particular, had failed to raise an argument of collusion between the employee and the

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legal entity owned by him. The plaintiff had also not claimed that the entity was used solely as an intermediary so as to allow the employee to evade the legal consequences of an otherwise prohibited transaction. Thus, the Supreme Court concluded that the court of appeals' decision should stand.

Comment

The Supreme Court denied that there was a need to extend the scope of the statutory restrictions to third parties under the control of an infringing employee. According to the Supreme Court, the statutory language does not even suggest a legislative loophole in cases as egregious as this one. All it takes is a plaintiff that knows which legal assertions to make and which legal concepts to invoke, and that can demonstrate what appeared evident from the facts at hand: the employee had used his LLC solely as a tool for the purpose of circumventing the narrow language of a statutory prohibition.

Only once this is shown will the employee's directions be imputed to the legal entity which they control.

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