contrast



Company takeovers and non-compete clauses

Imagine . . .

...just a few months after you purchased a company, a new, competing company opens up right across the street. You make a few inquiries, and what do you discover? The owner is the very same person who recently sold you his prior company.

Naturally, this worries you. The seller had clearly specified that he was planning to get out of the business. For that reason, he had no problem including a non-compete clause in the purchase contract. Under that clause, the seller was absolutely prohibited for 20 years from developing any competing activity within a radius of 100 kilometres of your company. Since you can see that you are starting to lose customers, you decide to talk to him about the situation.

The seller reacts coolly. He says that it is his good right to start up a new company and that you have to comply with the rules of the free market. When you draw his attention to the non-compete clause, he responds that, in his lawyer´s considered opinion, it is not worth the paper it was written on . . .

A brief clarification.

A company can be acquired in two ways. Either the buyer takes over all the assets and acquires the business in question directly *(asset deal)*. Or the buyer takes over the shares and, through them, indirectly acquires control over the business in question *(share deal)*.

The Belgian Civil Code contains several warranty obligations that protect every buyer. In an *asset deal*,

these warranty obligations relate directly to the business. Even without a non-compete clause, the purchaser enjoys a limited protection vis-à-vis the seller, but the precise period and scope of the protection will be uncertain. With a *share deal*, the shares form the legal object of the transaction, not the underlying business. Thus conventionally there is no implicit non-compete obligation in *share deals*.

As a consequence, a buyer always does well to include an explicit non-compete clause in the acquisition contract. However, such a clause can be in conflict with the freedom of trade and industry and the competition law, so it has to be carefully delimited in time, space and with regard to the excluded activities.

The duration of the clause may not be longer than the period that is necessary in order to bring in customers or bind them to you. This will differ from case to case, and in particular will depend on the type of business and the market in which the acquired company is active. In practice, a period of three years is common.

The non-compete clause must be territorially limited to the area within which the activities can actually be competitive with the acquired company.

Finally, the clause may only exclude activities that are directly associated with the activities of the transferred company. In principle, protection against competition by the seller on markets where the transferred company was not active is not authorized.

A non-compete clause that does not satisfy these parameters is invalid and null and void, so the buyer will not be able to rely on it.

Concretely

How do you draw up a good, effective non-compete clause?

- A carefully-drafted non-compete clause is recommended for both *asset deals* and *share deals*.
- Make sure that the clause is carefully limited in time, space and with regard to the excluded activities. An excessively broad clause will be declared null and void and will offer no protection.
- Where possible, provide a lump-sum damages clause. In the event of violation of a non-compete clause, it is often very difficult for the buyer to estimate and prove the exact amount of the damage. It is therefore useful for a purchaser to establish in advance, on a lump-sum basis, what amount is owed for violations of the non-compete clause. In principle, such a contractual damages clause is valid, provided that the established amount reasonably corresponds to the foreseeable harm.

Want to know more?

- The M&A Survey of **contrast** reviews Belgian practice on non-compete clauses and many other aspects of company acquisitions.
- You can find **contrast**´s publications on non-compete clauses in acquisition contracts here.