

**INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES**
[ISSN 2581-5369]

Volume 3 | Issue 6

2020

© 2020 *International Journal of Law Management & Humanities*

Follow this and additional works at: <https://www.ijlmh.com/>

Under the aegis of VidhiAagaz – Inking Your Brain (<https://www.vidhiaagaz.com>)

This Article is brought to you for “free” and “open access” by the International Journal of Law Management & Humanities at VidhiAagaz. It has been accepted for inclusion in International Journal of Law Management & Humanities after due review.

In case of **any suggestion or complaint**, please contact Gyan@vidhiaagaz.com.

To submit your Manuscript for Publication at **International Journal of Law Management & Humanities**, kindly email your Manuscript at editor.ijlmh@gmail.com.

Tracing the Dialogic of Guidance Note vis-à-vis Non -Complete Clause in M&A

SALONI JAIN¹

ABSTRACT

The acquirer purchases the business from seller in exchange of grand amount. But, what happens if the seller rebuilds new business with the same methodology giving highly competitive edge to the acquirer? For such instance non-compete restrictions come into existence. Unfortunately, in India these restrictive clauses were anti-competitive in nature according to Competition Act, 2002. Because of this the acquirer was unable to confidently step into the shoes of seller. Thus, very recently the clause became enforceable and competition commission issued guidance note laying down duration and approved self-assessment scope of non-compete restriction considering duration, subject matter and geographical limitation. In the paper the author endeavors to systematically analyze topical relevance of non-compete clause by narrating the following details interplay role of NRC in M&A, exploring the scope, decoding past judgments, risk reducing advice for companies, analysis and conclusion.

Keywords – Competition Commission of India, Guidance Note, Non-Compete Restriction, Merger and Acquisition, Competition Act 2002, sec 27 Indian Contract Act

I. INTRODUCTION

In this fast globalizing and shrinking world, mergers and acquisitions often lead to complexities and challenges. Non-compete restriction plays a key role which is unparalleled to any other clause. In latter years, control deals have gained popularity in both private equity and strategic investors. Similarly, many family-run businesses that face succession issues are willing to sell their entire businesses. In such a scenario, where the sellers of a business possess valuable customer relationship, intellectual property, know-how or skills, acquirers are insisting non-compete obligations upon the sellers. Strong non-compete clauses can be a source of significant value for businesses. Hence in order to ensure the right value of assets merged or transferred to buyer, the seller is now placed under an obligation not to compete with buyer for certain period. And for this very purpose competition commission of India has issued guidance note to be considered for improvising NRC in their agreement.

¹ Author is a student at DES Navalmal Firodia Law College, Pune, India.

The structure of the paper is as follows exploring the relation between non-compete restrictions in merger and acquisition, where it clarifies the position of NRC and its legal enforceability in India and in M&A. Subsequently, exploring the scope of non-compete clause with the reference to form-1 and sections. Further, decoding past judgments to get acknowledged with reasonable restrictions. The author then provides opinion for companies to reduce risk, analysis of guidance note and conclusion.

II. INTERPLAY ROLE OF NRC IN M&A

Indian Contract Act, 1872 provides framework rules and regulation for non-compete clause within reasonable limit and stipulates an agreement restraining anyone from carrying out similar profession, business, or trade, which it is void to an extent under section 27 of the said act.² In terms of merger and acquisition, enforceability is derived from the exception to sec 27 of Indian contract act, 1872. Non-compete clause put simply, is an ancillary restraints or restrictions imposed by one party to another, allowing the person to sell goodwill of a business by agreeing with the acquirer and prohibiting the latter from competition with the former in terms of nature, form of its business, profession or trade. This restraints are directly related to competitions which in isolation can be viewed as anti-competitive. But, when seen as a whole is very important in achieving economic objectives. Competition commission of India has clarified non-compete clause is anti-competitive in nature, unless it is ancillary to a combination given in guidance note.

Ancillary restraints are restrictions which are entered by parties simultaneously or in close connection with agreement, which prevents competition as per article 4 of Competition Act, 2002 as illegal. Connecting with European community regulations, said agreements were allowed under certain conditions. CCI has also issued guidance note for non-compete restriction clause in India where it has explained the circumstances under which a non-compete restriction would be regarded as ancillary or non-ancillary.

Moreover, in India non-compete restriction is governed by section 27 of Indian contract act, 1872, which identifies all such restrictive contractual terms as being void, except those relating to the sale of goodwill of a business so long as the restriction imposed appears reasonable to the court as regards the nature of the business. Various judicial precedents have also held that negative covenants such as non-compete, non-solicit and non-disclosure would not generally be regarded as being in restraint of trade, unless they are unreasonable or completely one-sided. In the context of M&A transactions, NCR's puts an obligation on the

² Section 27 Indian Contract Act, 1872

seller of a business to not compete with the acquirer of the business for the duration agreed upon between the parties. An NRC thus aims at enabling the buyer of a business to reap the benefits of its investment and protecting it against potential competition from the seller.

These ancillary restraints are necessary for the implementation of the transaction and are directly related to concentration by fully achieving the objectives envisaged in the merger or acquisition transaction. Henceforth, in order to ensure that the value of the right or asset acquired is fully transferred to the buyer, the seller will have to be placed under an obligation not to compete with the buyer for a certain period, limiting geographical restrictions and methods.

III. EXPLORING THE SCOPE WITH LEGAL PROVISIONS

The Competition Commission of India (CCI) is majorly looking at non-compete restrictions while reviewing mergers and acquisitions since its beginning. Commission aims at doing away with ex ante analysis under section 6, 29, 30 and 31. CCI omits paragraph 5.7 from form 1³ on the ground that prescribing a general sets of standard for assessing of non-compete obligation is not appropriate in modern business environment. This streamlines flexibility in determining non-compete restriction by reducing information burden on both the parties. Notifying parties are required to furnish information for the purpose of its examination in ongoing transaction. The guidance note provides circumstances to be called as ancillary and a mere presumption, not leading to any infringement of the act. Diversion direction given under guidance note prescribes parties not required to furnish information directly to CCI under M&A transactions. Moreover, concerns arising, if any, from non-compete restrictions will be examined under section 3 and 4 of Competition Act, 2002. However, great deal of responsibility is entrusted on the parties, not to counterfeit non-compete arrangement with competition complaint.

The guidance note provides that 3 years of non-compete obligation is usually justified in case of transfer of goodwill and know-how, and two years in case of transfer of goodwill alone.

It has been observed that prescribing a general set of standards for assessment of non-compete restrictions may not be appropriate in modern business environments. It is not feasible to conduct detail examination on case by case basis especially when it is followed by timelines of 210 days in combination cases,

Generally, a non-compete restriction must meet 1) general contract law requirements, including the existence of adequate consideration 2) be reasonable (including geographic

³ *Amended Guidance Note, Competition Commission of India*

scope, duration, and type of market) 3) advance a legitimate economic interest of the party enforcing covenant 4) survive a balance of the equities.⁴

Merger and acquisition in India is highly entailed with huge investments and are scrutinized from an anti-trust angle. It becomes imperative to prevent any disruption impacting consumers, market competitors and thus economy. Section 5 of the act states that a transaction shall be qualified as combination when a) control, voting rights, assets or shares of a company are acquired by a person; b) acquisition of control of an enterprise where the acquirer already has direct or indirect control over another entity engaged in identical business; or c) a merger or amalgamation between enterprises. Section 31 gives power to CCI to approve, disapprove or to impose any modification in any transaction.⁵

IV. DECODING THE PAST JUDGMENTS

Contemplating section 27 of Indian Contract Act and guidance notes, the enforceability of non-compete restrictions are subject to scrutiny of judicial decisions. In order to understand how court interprets provisions pertaining to restraints regarding: (i) commercial understanding between two parties (ii) the need for imposing restrictions on transactions.

Case laws

In case of *Affle holdings pvt. limited vs. Saurabh Singh & others*, Delhi High Court,⁶ court passed interim order upholding legal validity of non-compete restriction in share purchase agreement restraining promoter engaging in similar company not to compete with target company for 36 months until 100% share acquisition is done.

In case of *Arvind Singh & another v Lal Pathlabs private limited & ors*⁷, a single bench of Delhi high court held non-compete component there is clear difference between profession and business, in a share purchase agreement it should restrict the selling of shareholders of a company in running a pathology lab or diagnostic center by forming a venture that has the essential attributes of a business (i.e., employing workers, laboratory technicians, paramedics etc.) but allowed the selling shareholders to continue professional activities as a pathologist and radiologist in India for a period of 5 years. Having said that the court did succinctly note that the appellants will not be able to overtly or covertly carry business of running a path lab or an x-ray diagnostic center by forming a venture where the organizational structure has the essential attributes of a business.

⁴ *Delaware Court, July 22, 2015*

⁵ *Section 31, Competition Act, 2002*

⁶ *Affle holdings pvt. limited vs. Saurabh Singh & others, Delhi High Court, 22 January, 2015.*

⁷ *Arvind Singh & another v Lal Pathlabs private limited & ors, Delhi High Court, 26 March 2015*

Pursuant to these observations by the CCI, the parties modified the term of the non-compete obligation, from eight years (on the seller company) and five years (on the promoter) to four years. The parties also revised the scope of non-compete to exclude activities regarding research, development and testing of certain new active pharmaceutical ingredients (apis). This was also seen in the case of Compton graves consumer that the approval of transaction will only be possible when obligation for the number of years is reduce from 5 years to 3 years.

Moreover in case of Mylan Inc. and Strides Acrolab Limited CCI allowed the seller to continue with research work and development with the molecules which were not existed at that time. Henceforth it means the parties should cover only those products which are made and sold by the target company. Here cci has reduced time limit from six years to four years.

On 21st December, 2012 Competition Commission of India for the first time asked to pass order in relation to no- compete restriction in case of orchid chemicals and pharmaceuticals limited (OCPL) vs. Hospira healthcare India private limited (HHIPL). CCI has emphasized on pointers like duration, geographical limitation, business activities and persons affected by such restrictions.

Thus, to make a clear picture of the reasonable restrictions (ancillary restraints), CCI has issued a guidance note determining the necessity and reasonability standards of non-compete clause. This includes geographical boundaries as limitations, scope and duration.

Although these proposed amendments would reduce the information burden on the parties, they will still be required to make sure that the non-compete restrictions in the agreements are compliant with competition law.

V. RISK REDUCING ADVICE FOR THE COMPANIES

Considering the above-mentioned precedents, parties should be extremely careful when drafting, negotiating or agreeing to non-compete obligations. They should keep in mind the following aspects:

- Considering past judgments CCI does not allow more than 3 to 4 year restrictions as time is one of the important essence.
- Reasonable geographical limitation, it should not have clause of worldwide restriction, especially if it operates in one or two states or the boundaries are not clear.
- Parties should look up to the matters of tax implementations on the factors such as amount to be taxed under capital gain or business income? Will the NCR be withholding tax

or not? Geographical location for GST.

- Most importantly the acquiring party should look up to goodwill and shares of party, transferred or not.
- Non-compete clause should restrict streamline of goods and services by the sellers, such that it should not leave the seller with no source of livelihood.
- The scope, aim and definitions should be well defined in the agreement or in internal memorandum, this will reduce the chances of failing into court proceedings.
- A non-compete clause should not prevent the seller from purchasing or holding a small stake in a competing company solely for investment purposes, as long as he/she has no material influence in the operations and management of the company;
- The acquirer should limit the scope to make sure the agreement is reasonable and directly tied to important business justification. For example 1) Limit the period to a reasonable length under circumstances 2) Limit the type of work to which restrictions apply 3) Limit the geographic region to which the restrictions apply e.g. A limited number of miles from the business's location or customer base.
- Agreement should have a survival clause which provides provisions to an agreement to remain in effect after merger or acquisition of business.

VI. ANALYSIS

Taking the closer purview of NCR this part of paper analysis both pros and cons.

To begin with, guidance note offsets information burden from both the parties and CCI. However, it asks commitment from the parties regarding drafting and conducting a detailed report of self-assessment considering non-compete restrictions. This is to be done before the proposed transaction to CCI which by any means do not cause any adverse effect on competition or against Competition Act, 2002. Whereby it can be concluded that it is either ancillary or non-ancillary depending upon the peculiar facts of the case. The guidance note clarifies which is to be presumed as ancillary and which is not, assuming necessity in combination.

The guidance note provide balance between the parties, as assessment is based on case by case basis. This streamlines healthy business transaction and maintains fair business translations.

It provides escape route from onerous advantages by sellers giving relief to the acquirer. It is

best for acquirer as it takes away whims and fancies of the seller locking down period to 3-4 years is commercially impractical. It also shortens time period for the assessment by CCI from 30 days to 20 days.

At the outset, guidance note only underlines general principles considered by competition commission of India without identifying any exceptional circumstances. This will not pave way to any hurdle that may arise when the parties' departure from general principle. Parties will be left with no calibration on any unprecedented circumstances arising in M&A transaction. Henceforth, there is no one stop solution, parties will have to take decisions based on their independent business and legal acumen with no confidence of its legality.

VII. CONCLUSION

In the event of merger and acquisition, non-compete restriction plays a vital role being financial transaction threshold is very heavy. If the non-compete clause is not added to it than the purpose of competition act becomes half-baked remedy. To attain desired result, it is appropriate to set forth ancillary restraints in every transaction. Furthermore, guidance note provided by competition commission of India facilitates the transactions to be considered as non-ancillary restraint and non-ancillary restraints, these restraints will provide balance between both the parties. CCI should holistically ensure the restraints should not go beyond responsibility of it subject matter, geographical limitation and time period. However, position of guidance note will only be clear when CCI achieves its objective. The regulators of CCI being aware of one size would not fit for everyone, approved case by case basis analysis ensuring healthy environment for both the parties.
