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Validity requirements of a non-compete clause included in a share purchase agreement

In a judgment dated October 8, 2013[1], the *Cour de Cassation* (French Supreme Court) has recalled the requirements to be met to ensure the validity and enforceability of a non-compete clause included in a share purchase agreement:

1. Such a clause is valid and enforceable against the shareholders/members who have signed made it insofar it is **limited in its duration** and **in its geographical scope** and **necessary to protect, and proportionate to, the legitimate interests** of the beneficiary;
2. The validity of such a clause is conditioned upon the payment of a **financial counterpart** only if such shareholders/members were, **at the time they signed the non-compete clause, employees** of the company that they committed not to compete with.

The facts of the case are as follows: In February 2007, a share purchase agreement providing for the sale of shares held in Company G was entered into. This agreement included a non-compete clause applicable to the sellers. In April 2007, Mr. G, one of the sellers, became an employee of Company G and, in his capacity as employee, signed a second non-compete clause providing for the payment of a financial counterpart. Shortly after having left Company G and been released from the non-compete obligation set forth in his employment contract, Mr. G incorporated a company that conducted a business activity similar to that carried out by Company G.

Claiming that the non-compete clause set forth in the above mentioned share purchase agreement had been breached, Company G sued Mr. G and the newly incorporated company and sought the payment of damages and the discontinuation of the competing business activity.

The Court of Appeals of Orleans[1] held that the non-compete clause was null and void for lack of financial counterpart and, accordingly, dismissed Company G's claims.

The case was brought to the Supreme Court that eventually overruled the Court of Appeals on the basis of

Articles 1131 and 1134 of the French Civil Code[2]. Specifically, it held that:

"By ruling so, after having noted that as of the date of the share purchase agreement which included the non-compete clause, Mr. G was only a shareholder and became an employee only after the consummation of the agreement that included this non-compete commitment, the Court of Appeals has breached the above-referred Articles."

The position adopted by the *Cour de Cassation* is not new. It follows a famous ruling issued in 2011[3] in which the *Cour de Cassation* had held that:

"When it has the effect of restricting the freedom to start an activity of an ***employee, member or shareholder of the company that employs him/her****, the non-compete clause signed by him/her is only valid if it is critical to protect the company's legitimate interests, limited in its duration and in its geographical scope, takes into account the specificities of the employee's job and imposes on the company the obligation to pay to the employee a financial counterpart, all of these requirements being cumulative."*

In that specific case, the party bound by the non-compete clause was both a shareholder and an employee of the relevant company.

The commented decision confirms this position and specifies to all intents and purposes, that the validity of a non-competition clause signed in the framework of a transfer of shares is conditioned upon the existence of a financial counterpart **only if the shareholders/members were, at the time they entered into the non-compete commitment, employees of the company they committed not to compete with**.

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[1] Commercial Chamber of the *Cour de Cassation*, October 8, 2013, n°12-25.984.

[2] Court of Appeals of Orleans, July 19, 2012.

[3] Article 1131 of the French Civil Code: *"An obligation without cause or with a false cause, or with an unlawful cause, may not have any effect."*
Article 1134 of the French Civil Code: *"Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith*".

[4] Commercial Chamber of the *Cour de Cassation*, March 15, 2011, n°10-13.824.

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