

Calling it 'legal' does not make it so

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Summary

The European Court of Justice⁽¹⁾ (ECJ) recently dismissed an appeal against a General Court judgment⁽²⁾ which largely upheld the European Commission's prohibition decision taken against Telefónica and Portugal Telecom for a non-compete covenant in a share purchase agreement.⁽³⁾ The share purchase agreement related to the acquisition by Telefónica of the Brazilian mobile operator Vivo, which was until then jointly owned by both parties.⁽⁴⁾ However, the non-compete agreement purported to restrain the parties from competing in Portugal and Spain "to the extent permitted by law".

The ECJ held that:

- the non-compete agreement constituted a market-sharing agreement⁽⁵⁾ and as such constituted a 'by object' (essentially *per se*) violation of competition law – it was so clearly illegal that analysis of whether there were any restrictive effects was unnecessary;
- it was sufficient for the ECJ to "point out that, according to well-established case-law of the Court, market-sharing agreements constitute particularly serious violations of competition"; and
- the categorisation of the clause as a by object infringement was not altered by the fact that it contained the wording "to the extent permitted by law".

Acquisitions therefore cannot be the vehicle of obviously overbroad non-compete agreements. Adding additional language such as 'to the extent permitted by law' to non-compete agreements will not alter their legality. In extreme cases, as here, such overbroad non-compete agreements can lead to substantial fines.

Facts

Telefónica and Portugal Telecom entered into a share purchase agreement through which Telefónica acquired sole control over Vivo Participações, a major mobile operator in Brazil.

The share purchase agreement contained a non-compete covenant which prevented Telefónica and Portugal Telecom "to the extent permitted by law" from conducting business in the telecoms sector that was "liable to be in competition with the other company on the Iberian market".

A non-compete clause is standard in a share purchase agreement to ensure that the buyer receives the full benefit of the target business. However, this is subject to strict limits. Only restraints that are given by the seller to the benefit of the buyer in order to protect the value of the target are permitted. Restraints that are overbroad in scope and cover unrelated businesses or protect the seller from the buyer (rather than *vice versa*) are not permitted.⁽⁶⁾ In this case, the commission found that "the clause provided for a non-compete obligation, amounted to a market-sharing agreement and qualified as a restriction by object within the meaning of Article 101 of the Treaty".⁽⁷⁾

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It imposed a fine of nearly €79.2 million.

Decision

Telefónica argued against the characterisation of the non-compete clause as a 'restriction by object'. That is to say, a restriction that is so pernicious that it is subject to prohibition and fines without any assessment of whether it had an effect on competition.

Telefónica argued that the 'by object' designation was reserved for agreements that were clearly (based on established precedent) illegal. Telefónica claimed that there were no prior precedents in this case.

The ECJ stated that it was "sufficient to point out that, according to well-established case-law of the Court, market-sharing agreements constitute particularly serious violations of competition" (8) and that its categorisation as a 'restriction by object' was not changed by the fact that the clause contained the wording "to the extent permitted by law". If an agreement is clearly illegal it will not be cured by this type of saving language.

Telefónica argued that the Portuguese government had authorised the non-compete clause and that Telefónica had tried to minimise its effects. However, the ECJ found the Portuguese government had not authorised the clause and that Telefónica had not put forward any evidence capable of demonstrating that it had tried to minimise its impact.

Comment

This judgment again highlights that parties to M&A agreements cannot simply hide behind the fact that a non-compete clause forms part of a broader, legitimate M&A transaction to escape antitrust review. Nor can parties attempt to outsmart competition enforcement agencies by adding wording to a clause implying that the clause would be enforceable only insofar as it is permitted by law. Even though a non-compete clause may not be considered as a core element of the M&A agreement in which they are often included, they should not be overlooked and require a thorough antitrust review.

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Endnotes

(1) *Telefónica v Commission*, C-487/16 P, December 13 2017, ECLI:EU:C:2017:961 (available at <http://curia.europa.eu/juris/liste.jsf?num=C-487/16&language=en>).

(2) *Telefónica v Commission*, June 28 2016, T-216/13, ECLI:EU:T:2016:369 (available at <http://curia.europa.eu/juris/liste.jsf?num=T-216/13&language=en>).

(3) The General Court found that the commission had erred in calculating the fine and therefore sent the case back to the commission to recalculate the fine.

(4) Vivo was jointly controlled by Telefónica and Portugal Telecom through Brasilcel NV, a holding company incorporated in the Netherlands. By obtaining sole control over Brasilcel, Telefónica also obtained sole control over Vivo.

(5) Commission decision of January 23 2013, Case AT.39839, *Telefónica/Portugal Telecom*, (available at: http://ec.europa.eu/competition/antitrust/cases/dec_docs/39839/39839_1210_8.pdf), recital 356.

(6) Commission notice on restrictions directly related and necessary to concentrations, OJ 2005 C 56, page 24 (available at <http://eur-lex.europa.eu/legal-content/EN/ALL/?>

[uri=CELEX:52005XC0305\(02\)](#); commission decision of December 12 1983, IV/30.389 (*Nutricia/de Rooij*) and IV/30.408 (*Nutricia/Zuid-Hollandse Conservenfabriek*), OJ 1983, L 376, page 22 (available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31983D0670>) and upheld by July 11 1985 ECJ judgment *Remia BV*, Case 42/84, ECLI:EU:C:1985:327 (available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61984CJ0042>).

(7) Commission decision, *Telefónica/Portugal Telecom*, recital 356.

(8) *ECJ – Telefónica*, paragraph 62.

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