B2B legislation in the spotlight: unfair contractual terms in an M&A context.

New provisions in the Belgian Code of Economic Law (the "CEL") having an impact on the relations between businesses (B2B) will enter into force on 1 December 2020.

Some of these new provisions pertain to the protection of businesses against unfair contractual terms. Although this new legal framework was not earmarked for an M&A context, its broad scope of application creates a potentially far-reaching impact on transaction documentation.

Until the broad call for repair legislation to reduce its scope of application is answered, a period of legal uncertainty beckons.

After a short recap of the key features of the B2B protection regime[1], we will focus on some provisions in key M&A transaction documents.

What are the main features of the B2B protection regime?

The B2B protection regime is based on four major axes.

1. First, contractual terms must be drafted in plain and intelligible language (Article VI.91/2 CEL). This is the so-called "transparency" requirement. This entails that a clause must be drafted in such a way as to allow the parties to understand its scope and economic consequences. The transparency requirement applies to all terms of an agreement, both essential and non-essential provisions.

2. Second, the new rules prohibit non-essential contractual terms (taken individually or read together with other terms or related contracts) from creating a significant imbalance between the rights and obligations of the parties (Article VI.91/3 CEL). This is the so-called unfairness test. An unfair contractual term is prohibited and, as a main sanction, is considered of no effect from the outset. This nullity sanction is by effect of law in principle only partial and implies that the contract may remain binding if it can exist without the voided contractual term. Moreover, any breach of the protection regime can also give rise to non-contractual liability and other criminal sanctions under the CEL (Article XV.84 CEL).

3. Third, the B2B protection regime provides for a black list and a grey list of contractual terms.

   The black list includes four contractual clauses which are in any case regarded as unfair or

[1] For further explanations about the B2B protection regime, please see our B2B legislation in the spotlight micro-site, also containing our interactive guides.

abusive. It covers, among others, contractual terms in which the object is to provide for an irrevocable engagement from the other party, while such engagement solely relies on the will of that party. We will review the black list clauses in more detail later in the newsletter.

The grey list targets eight clauses that are deemed to be unfair unless proof to the contrary is provided. It covers, among others, contractual terms which involve (i) a unilateral alteration of the price, characteristics and terms of the contract without a valid reason, (ii) an excessive penalty clause, (iii) the placing of the economic risk without compensation on the other business, (iv) the complete exoneration from fraud, serious misconduct or an essential contract obligation.

4. Fourth, the B2B protection regime (with the exception of the transparency requirement) only applies to the non-core or non-essential contractual terms. Core clauses therefore fall outside of its scope of application provided that they meet the transparency requirement. Core clauses relate to the subject matter of the contract (characteristics such as quality and quantity of the goods/services) and price or consideration.

What type of corporate/M&A contracts fall under the scope of the B2B protection regime?

In principle, every contract concluded between businesses is susceptible to falling under the scope of the B2B protection regime, irrespective of its nature or its object. Therefore, the scope of these rules goes beyond purely commercial contracts. It also applies regardless of whether clauses or contracts have been negotiated.

Indeed, the B2B protection regime will also apply to share purchase agreements (SPAs), asset purchase agreements, shareholders' agreements (SHAs), joint venture agreements, transitional services agreements, option contracts, etc. concluded between businesses.

In this context, the question arises whether articles of association fall within the remit of the B2B protection regime. Legal doctrine is historically divided whether a company's articles of association qualify as a contract or whether the special nature of the articles does not allow for such qualification. If the qualification of the articles of association as a contract would be retained and the parties involved (e.g. the shareholders) qualify as businesses, the articles could in theory fall within the scope of the B2B protection regime.

Applying the B2B protection regime to the articles of association would be far-reaching and would go against the institution-related nature of companies covered by the Companies and Associations Code. However, if a number of provisions are mirrored in both the SHA and the articles of association, the question arises whether a judge would be inclined to apply the B2B protection regime to the articles to also nullify a specific clause therein, should it decide to nullify the same clause in the SHA. If that is not the case, this new B2B protection regime could be an additional argument in the assessment whether or not to include shareholders arrangements in the articles of association rather than in a private shareholders' agreement.

What are 'businesses' under the B2B protection regime? Do the rules apply to natural persons and/or their management companies entering into an SPA or SHA?

The B2B protection regime applies to contracts concluded between businesses, regardless of the size of the businesses involved (small to larger enterprises) and of the existence of a relation of economic dependency between them. The legislator has referred to the functional definition of the notion of business, being "*any natural or legal person, which pursues an economic objective in a durable manner*" (cf. notion of *"entreprise"/"onderneming"* laid down in article I.8, 39° CEL). Therefore, only the nature of the activities conducted by a party to the contract will determine its qualification as a business.

What does this mean in the context of a natural person entering – either directly or via his/her management company – into an SPA or SHA? This can be the case if a founder is selling his/her business.

If a natural person enters into an SPA, it will be necessary to determine whether this natural person acts within the framework of a durable professional activity when concluding the SPA. In other words: does this individual hold, sell and/or purchase equity interests in companies as a durable professional activity? Please note that the mere ordinary management of personal assets would typically not be equal to a professional activity.

A similar case-by-case analysis will be required in connection with the entering into an SHA by a natural person. On the one hand, it could be argued that shareholders always act in order to secure their participation and therefore pursue an economic objective. On the other hand, unless a person acts as an active shareholder in a number of companies, his/her shareholding will likely be qualified as an occasional activity and not as a durable professional activity.

A management company will more likely be qualified as a "business" for the purposes of the B2B protection regime as the very nature of a company consists of the pursuit of an activity with the intention to (directly or indirectly) generate financial gains. Nevertheless, the durable economic objective test applies to management companies as it does to natural persons. Where repeat business (e.g. regular acquisitions and disposals of equity interests or taking up board seats in target companies) is likely to tip the scale towards a 'business'-qualification, it could be generally deemed that the management company is merely assisting its shareholder in the ordinary management of personal assets and would therefore not qualify as such.

Which are the core clauses of an SPA/SHA that fall outside of the scope of the B2B protection regime?

The B2B protection regime only applies to the non-core terms of an agreement. Core terms are excluded from the scope as long as they comply with the transparency requirement. However, what clauses in SPAs or SHAs can be considered as "core terms"?

As a general rule, core clauses are those clauses that determine the object of the agreement, as well as the clauses relating to the adequacy of the price or other consideration and the goods or services to be delivered in return. They set the "essential obligations" of the agreement. Therefore, clauses on the object and price are as a matter of principle considered as core terms. Conversely, the remaining terms of a B2B contract will be considered as non-essential clauses. It is clear that this covers more than just the so-called boilerplate clauses.

Purchase price adjustments under the SPA

Concerning SPAs, a key question is whether purchase price adjustment clauses are considered as essential clauses. This is a key example of the ambiguity created by the law. Where the scope of the law is pillared on the notion of 'essential clauses', the law does not provide for any guidance in this respect. Unfortunately, when it comes to the qualification of purchase price adjustments, neither does legal doctrine.

Some legal scholars do seem to adhere to the view that, for example, earn-out clauses should be viewed as core clauses and therefore fall outside the scope of the B2B protection regime. We concur as, in an M&A-transaction, it is impossible to dissociate the price adjustment from the preliminary price as it forms part of the economic balance. Imagine, for instance, the sale of a medical company where the passing of various drug approval stages is each linked to an earn-out. This earn-out mechanism goes to the core of the agreement reached between the buyer and the seller. Therefore, nullifying an earn-out clause

could unlawfully impact the price agreed between the parties.

In practice, we would expect a judge to consider on a case-by-case basis the intention of the parties to determine which purchase price related clauses were key for them to enter into the deal. In order to enhance the idea that a clause is considered a core provision, it could be helpful for the parties to insert in the recitals indications as to the importance of such clauses in guaranteeing the balance between them. This will not necessarily be conclusive but careful drafting, if supported by further evidence outside the agreement, could provide additional context for a judge.

Core clauses in SHAs

It is up for debate what constitutes a core term under an SHA. Where object and price are at the core of commercial contracts or SPAs, SHAs do not in all cases encompass the same standardised core elements. Indeed, a feature of SHAs is that they often contain agreements on various topics, including, for example, governance rights, exit rights and information obligations. Therefore, the clauses on each major topic could be considered as a separate agreement with their own object. The qualification of essential and non-essential clauses under the B2B protection regime should then be determined on the basis of these separate agreements.

For example, within the category of exit rights of the parties, a call option granted to one of the parties will likely be considered essential. The clause stating that the call option expires if not exercised within a certain limited number of days after a triggering event, could be considered ancillary and therefore subject to the B2B protection regime.

In conclusion, the question as to the (non-) essential nature of a clause will likely be more straightforward in the context of an SPA than in the context of an SHA. Nevertheless, even in the context of an SPA a significant amount of uncertainty remains.

Which clauses in an SPA qualify as "black" under the B2B protection regime?

As mentioned in the introduction, the so-called 'black clauses' under the B2B protection regime are deemed unfair in all circumstances. The list targets the following four clauses:

1. clauses providing that a party is irrevocably bound, while the obligations of the other party are subject to a condition at that party's discretion ('*potestative condition'*);
2. clauses granting a party the unilateral right to interpret any clause of the contract;
3. clauses which, in case of a dispute, lead the other party to waive any legal recourse; and
4. clauses which provide, irrefutably, that a party has had knowledge of provisions which it could not actually have knowledge of before entering into the contract.

In an M&A context, there might be few contracts containing a black clause but the prohibition of potestative conditions ('*conditions potestatives*' / '*potestatieve voorwaarden'*) requires further review.

Example 1: satisfactory completion of confirmatory due diligence

Parties may wish to make the closing of a share deal conditional upon further review by the buyer of certain aspects of the target (so-called confirmatory due diligence) and conclusion by the buyer that no material issues are uncovered during such review. To some extent it can be argued that such condition grants the right to the buyer to pull back from the deal if it, in its discretionary opinion, deems to have uncovered relevant issues. If indeed considered potestative, the condition of satisfactory completion of confirmatory due diligence risks to be nullified. Parties can try to reduce that risk by objectifying the condition, for example by significantly limiting the scope of the confirmatory due diligence to very specific items and defining 'satisfactory completion' as uncovering no issues above a certain monetary

threshold. However, it remains to be seen whether this would prove sufficient.

Example 2: contracts concluded subject to board approval

A contract subject to the approval of the board of directors constitutes a commitment solely relying on the will of one of the parties to the agreement. As such, consent can normally not serve as a condition to the contract, since it is considered as one of its founding elements. Therefore, such a condition is likely to be considered potestative. We note that certain legal scholars propose to address this issue by structuring the contract as a unilateral promise to contract (*'promesse unilatérale de contrat'/'eenzijdige contractbelofte'*) rather than a conditional mutual agreement.

Please note that already under the general rules of contract law, potestative clauses are considered null and void on the basis of Article 1174 of the Civil Code. The parliamentary works highlight the need to insert a provision similar to Article 1174 of the Civil Code to avoid its circumvention as the provisions of the Civil Code apply only by default.

Which clauses can fall under the grey list included in the B2B protection regime?

The B2B protection regime provides for a number of so-called grey list clauses. Such clauses falling within the scope of the grey list are presumed unfair, unless proof to the contrary is provided.

We list below three examples relevant for corporate practice.

Grey list clause 1: the transfer of normal economic risk to the other party without relevant consideration (article VI.91/5, 3° CEL)

Under the B2B protection regime, clauses transferring the economic risk to the other party will be presumed unfair if they satisfy three cumulative conditions: (i) the clause must concern an economic risk, (ii) the economic risk must be transferred to the party who would normally not bear that risk (thereby determining whether the clause is exceptional or market practice) and (iii) the transfer must operate without a significant consideration (meaning that the consideration is not so minimal as to appear fictitious).

This raises questions in the context of representations and warranties included in SPAs. Indeed, representations and warranties directly tackle the distribution of the economic risk between the parties. Their qualification as a grey list clause will thus depend on the assessment of the three above-mentioned conditions, which will raise a number of important challenges for businesses. That being said, in practice, parties have a large margin of appreciation in the negotiation of the representations and warranties, which will be specific to the transaction in question. This negotiated 'package' of representations and warranties will unlikely fall within the scope of article VI.91/5, 3° CEL as it has inherently influenced the purchase price and other terms of the SPA and therefore the shift of economic risk is not without significant consideration. For the sake of completeness, it could even be argued that representations and warranties are a core provision of the SPA and do therefore not fall within the scope of the B2B protection regime.

In general, it is clear that the preparatory works do not offer sufficient guidance as to which clauses amount to a grey list clause within the meaning of article VI.91/5, 3° CEL. To increase legal certainty, the parties should collect sufficient (written) evidence or indications to substantiate that they agreed on the purchase price, taking into account the commercial terms of the SPA, including specifically the representations and warranties.

Grey list clause 2: exoneration from fraud, serious misconduct or an essential obligation (article VI.91/5, 6° CEL)

Clauses which are intended to "*release the company from liability for fraud, serious misconduct on its part or on the part of its agents ('préposés'/'aangestelden') or, except in cases of force majeure, for any failure to perform the essential obligations under the contract*" will be deemed unfair unless proof to the contrary is provided. This grey list clause only covers

situations where there is an exoneration of liability, and not just a modulation of liability. The B2B protection regime does not target clauses limiting the amount of the damages that can be claimed or putting a time limit during which a party can claim for breach of representations and warranties.

Grey list clause 3: inappropriate limitation of a party's rights in case of non-performance of an obligation by the other party (article VI.91, 4° CEL)

If a clause is not considered as exonerating a party from liability, it could still fall under the grey list. The list targets clauses whose purpose is to "*exclude or inappropriately limit the legal rights of a party, in the event of total or partial non-execution or defective execution by the other party of one of its contractual obligations*". This grey list clause concerns exclusions or limitations to legal rights, meaning any right recognised to a party in case of non-execution by the other party by the law in general, as well as by the case law. Furthermore, such exonerations or limitations must be inappropriate or not reasonably justified.

In that regard, SPAs typically contain clauses limiting liability such as, for example, capped amounts for liability. That being said, it is uncertain in the B2B protection regime and in the parliamentary works when such a clause would reach a level so as to be considered as inappropriate.

Closing remarks

Applying to all B2B contracts, the new B2B protection regime also covers M&A contracts. Therefore, to the extent that no correcting legislative action is being undertaken, you should be aware of the potentially far-reaching impact of the law when negotiating and drafting agreements in the context of an M&A deal – even between the most experienced professional parties in the market. In this respect, 1 December 2020 should be marked in your calendar. As from that date, the regime will apply to new contracts as well as to existing contracts being renewed or amended after 1 December 2020.

It is more important than ever to carefully tailor the wording of SPAs, SHAs and other business-to-business agreements to avoid including a black- or grey-listed clause or a contractual term that (taken individually or read together with other terms or related agreements) may create a significant legal imbalance between the parties. Keeping evidence of the understanding between the parties can help to support the arrangements but might itself burden the execution of M&A-processes.

Finally, it is clear that the B2B protection regime and the uncertainty it creates could also be used as a new tool by negotiators. Parties can use it to rebut a request to include certain unfavourable clauses in the transaction documentation or to void a specific unfavourable provision in a post-closing dispute.

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