



Covenants

A covenant is a legal promise. There are two types of covenants in a purchase agreement: affirmative and negative.

1. An affirmative covenant is a promise to do something. An affirmative covenant in a purchase agreement generally obligates a party to complete a specific action.
2. A negative covenant is a promise not to do something or not take specified action. A negative covenant in a purchase agreement generally prohibits a party from engaging in a specific action.

Example – Negative Covenant

The most common negative covenant in a purchase agreement is a non-compete covenant. The main objective of the buyer is to transition into the company without losing customers. If the seller opens a new company next door, then the buyer's company will lose customers to the seller's new company. The buyer will want to ensure that the seller does not interfere with the transition. This is accomplished through a non-compete covenant. A non-compete covenant is a promise between the buyer and the seller that the seller will not engage in competition with the buyer's company after the sale. A non-compete covenant is designed to protect the buyer's company after the sale.

Exceptions

There are two types of covenant exceptions: carveouts and baskets.

1. A carveout creates a specific exception to the covenant. For example, a typical non-compete covenant is "the seller shall not practice dentistry within ten miles of the company." The carveout is "but the seller will be permitted to practice dentistry part-time at his father's company located nine miles from the company."
2. A basket is an exception that creates the limited ability to deviate from the covenant by some specified amount (usually expressed in dollars). In the example above, the exception could be converted into a basket by allowing the seller to practice dentistry within ten miles up to a certain revenue amount.

Remedies

A purchase agreement usually provides for specific remedies in the event of a breach of a covenant. The most common remedy is specific performance, which merely requires the covenant to be performed. The party seeking to enforce the covenant may ask a court to issue a judicial order, which is an order that requires the covenant to be performed. The court, however, has the discretion to grant equitable remedies (e.g., money damages) instead of specific performance.