Restraint of trade and inequality of bargaining power

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The Court of Appeal's decision in Dwyer is the most detailed consideration yet by the courts of the enforceability of post-termination restrictions in franchise agreements. It is also relevant to employment lawyers and to the doctrine of restraint of trade in general, following Quantum and Credico, both of which were cited.

General principles on restraint of trade

The doctrine of restraint of trade is encapsulated as follows: 'All covenants in restraint of trade are *prima facie* unenforceable at common law and are enforceable only if they are reasonable with reference to the interest of the parties concerned and of the public. Unless the unreasonable part can be severed by the removal of either part or the whole of the covenant in question, its including renders the covenant or the entire contract unenforceable.' (*Chitty on Contracts* 33rd edn). All three cases discussed below focused on the all-important test of reasonableness, including the factors to be taken into account and the weight that ought to be given to those factors.

Quantum and Credico

Quantum concerned an extensively negotiated bespoke services agreement for 99 years which was entered into by two experienced commercial parties following a corporate restructure. The duration of the covenants of 100 years (including one-year, post-termination) was reasonable given the longevity of the blue-chip pension funds to whom the businesses provided services. As the trial judge held, the restraints were 'a matter of free agreement between experienced, intelligent, articulate and highly competent business people, who were properly able to look after their own interests and who expressly agreed that they were reasonable as being necessary to protect the parties' interests' ([2020] EWHC 1072 (Comm) at para 96).

On appeal, Carr LJ noted at para 90 that it was 'wholly unreal' to suggest there was any substantive inequality of bargaining power. Her summary of the applicable principles as to the test of reasonableness at para 65 was relied upon heavily by the court in *Credico* and *Dwyer* and is destined to be cited by anyone seeking to evade a covenant.

Credico also concerned businesses rather than employees. Credico sourced clients requiring direct marketing campaigns, the marketing to be conducted by agent marketing companies. The contract between the marketing company and Credico was in standard form. Cavanagh J upheld both the in-term and post-term covenants. The Court of Appeal overturned Cavanagh J on the post-term covenants only. There is an interesting passage at paras 71-75 about some of the franchise cases upon which the court relied to come to the conclusion that Credico had no legitimate interest which justified the imposition of the particular covenant. Although some of the analysis of those cases in the context of franchising may have to be revisited in light of *Dwyer*, nothing impugns the court's conclusion on the circumstances before it.

Dwyer

The facts in *Dwyer* were notably different from those in *Quantum* (in particular) and *Credico*. The first respondent, Fredbar Ltd, was a franchisee of the Drain Doctor brand licensed by the appellant, Dwyer, which claimed to be the UK's largest full-service network of emergency plumbing and drainage operations and part of the world's largest home service franchise.

Fredbar and the second respondent, Mr Bartlett (the sole director and employee of Fredbar and guarantor under the franchise agreement) purported to terminate by reason of Dwyer's conduct, including a decision not to exercise a force

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majeure clause in spring 2020 following the intervention of Covid-19. As well as the reasonableness of the post-termination restrictive covenants, the case also raised issues of misrepresentation, undue influence, repudiatory breach and affirmation. This meant that the circumstances pertaining in the build up to and at the time of the execution of the agreement were examined in considerable detail, with significant consequences.

For present purposes, however, what is relevant is that the judge found the restrictive covenants preventing Fredbar and Mr Bartlett from working in a competing or similar business within the exclusive marketing territory for one year to be unenforceable. Dwyer appealed this finding.

Prior to *Dwyer,* restrictive covenant cases concerning franchises were relatively few and often sparsely reasoned with little reference to the wider jurisprudence, including the concept of the inequality of bargaining power. Some were interim injunction cases and thus to be treated with caution as authority while one court of appeal case was, properly understood, not about the test of reasonableness at all but purely the construction of the agreement. There had been a consensus of treating franchise cases as closer to sale of business cases as opposed to employment cases (where the courts are more zealous in their scrutiny of the restrictive covenants). This ignored the fact that franchises can vary in scale and operation with some franchisees adopting a management role having employees or independent contractors working under them while some (as in *Dwyer*) undertake the services personally. Unlike most employees, franchisees have significant start-up costs in terms of the initial franchise free and acquisition of equipment. Significantly, all the cases concerned successful, well-established, franchisees operating for several years.

The key factual position in *Dwyer* was as follows. First, there had been no negotiation. As ICC Judge Jones noted critically in [2021] EWHC 1218 (Ch), the franchise agreement was a 'standard form document … drafted in an unnecessarily complicated and lengthy style'. As was apparent from the trial bundle, the Drain Doctor agreement had become lengthier and more pro-franchisor over time. Secondly, as was appreciated by Dwyer, there was a real risk of failure – including the possibility of bankruptcy – for Mr Bartlett in entering into the agreement. At one point he decided not to proceed before signing the agreement in October 2018. Thirdly, the covenants applied equally whether the franchisee had been in post for six months, one year, six years or 10 years. Fourthly, there was a real chance that Mr Bartlett's livelihood could be jeopardised if the covenants were enforceable.

Some general points arising from the Chancellor's assessment of the reasonableness of restrictive covenants will be of interest to employment practitioners as well as those in the business community:

- franchise agreements are not in some special category, nor is there one size fits all for franchise agreements as appeared to be the contention on behalf of Dwyer at para 71;
- citing Carr LJ's summary in *Quantum* (supra) the onus is on the covenantee to justify the restraint on the covenantor (para 72);
- contrary to Dwyer's submissions, inequality of bargaining power between the covenantor and the covenantee will not only be relevant to, but is a significant factor in, determining reasonableness of the restrictive covenant (para 73);
- the court may have regard to the amounts invested and/or the sums paid – not as an assessment of the adequacy of consideration, but as an indication of the degree of risk undertaken by the covenantor and thereby a factor in assessing the inequality of bargaining power (para 81);
- further, there is no general rule that a 12-month restriction in franchise agreements is reasonable. Each case is to be assessed on its own facts (para 82);
- the length of time the franchise agreement has been in operation is relevant. As Arnold LJ noted at para 90, 'it would have been perfectly possible to have a covenant the duration of which depended on how long the franchise agreement had subsisted prior to termination. The longer it had subsisted, the greater the goodwill that would have been expected to have been built up during the currency of the agreement and the longer the period of protection that would have been justified';
- this last point has some precedent in employment cases and highlights that the onus on justifying covenants lies with the covenantee. In *Dwyer,* the agreement was for 10 years. The position of a someone who starts from scratch in a territory where there was no franchisee in post previously is significantly different from that of someone at the end of the agreement turning over £1m (the potential for which

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was contained in Dwyer's marketing material). There is no difficulty in drafting such clauses (and, indeed, the monthly service fee which Fredbar paid to Dwyer was subject to a detailed arrangement of cap and collar which increased substantially over time);

- in *Quilter* (an employment case), Calvert J held the nine-month non-competition covenant unenforceable in part because the restrictions applied irrespective of the length of the time that Ms Falconer worked for Quilter. She was subject to a six-month probation period during which she could be dismissed on two weeks' notice. The judge disapproved of the asymmetry. A tiered covenant, increasing in duration over time, was more likely to have been upheld; and
- lastly, the circumstances of the franchisee are relevant. Where a franchisee is well-established and successful such that there is cogent evidence of the need to protect its goodwill, the court may well conclude that restrictions are reasonable. Again, each case is to be assessed on its own facts (para 87).

Use of franchise model to circumvent employment law

Businesses will have various reasons for engaging people other than as employee, whether as independent contractors, franchisees or the like. A proper examination is beyond the scope of this article. However, the decision in *Dwyer* bringing franchise restrictive covenant cases into line with employment law generally removes a possible incentive to use the franchise model. That incentive is the previous consensus that the test for justifying restrictive covenants is less onerous than in employment cases. As indicated above, there was always an artificiality in this blanket approach given the inevitable upfront costs of franchises and the consequential financial risk.

Conclusion

The above three cases demonstrate that the presence or absence of an inequality of bargaining power is an important factor – potentially *the* most important factor – in assessing whether a restraint of trade is reasonable. As the business community and advisors take stock, it remains to be seen whether there will be any change in practice in drafting such covenants or which agreements covenantees seek to enforce.

KEY:

Dwyer	*Dwyer (UK Franchising) Ltd v Fredbar Ltd & Bartlett* [2022] EWCA Civ 889
Quantum	*Quantum Actuarial LLP v Quantum Advisory Ltd* [2021] EWCA Civ 227
Credico	*Credico Marketing Ltd v Benjamin Gregory Lambert* [2022] EWCA Civ 864
Quilter	*Quilter Private Client Advisers Ltd v Falconer* [2020] EWHC 3294 (QB)