(Non-)Enforceability of Restraint of Trade Covenants between Unequal Commercial Entities – the Court of Appeal in Dwyer v Fredbar, and Credico v Lambert

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1. Two differently constituted Courts of Appeal handed down judgments on the enforceability of restrictive covenants in the latter half of June 2022, both relating to covenants made in the course of a commercial (rather than employment) relationship and both found to be, at least in part, unenforceable.

2. In both cases, the Court held that the traditional deference of the court in upholding contracts of commercial entities even when they involve restraint of trade will carry less weight if the parties were not negotiating on equal terms. In *(1) Credico Marketing Limited (2) PERDM Trading Limited v (1) Benjamin Gregory Lambert (2) S5 Marketing Limited [2022] EWCA Civ 864* the Court emphasised that prevention of competition between businesses is no more in the public interest than preventing competition from (ex-)employees, and that "*a business should be entitled to use its knowledge and experience gained in the course of business dealings in the same way as an employee*" [Paras 66-69].

Dwyer v Fredbar Limited

3. *Dwyer (UK Franchising Limited) v (1) Fredbar Limited (2) Shaun Rowland Bartlett [2022] EWCA Civ 889* concerned a post-termination restrictive covenant arising from a franchise arrangement.

4. The claimant, Dwyer operate a franchise of plumbers under the trading name "Drain Doctor". The defendants were a franchisee company and its owner. Fredbar Limited was established by Mr Bartlett as a vehicle for his own Drain Doctor franchise. There was no Drain Doctor franchise operating in Cardiff, where Mr Bartlett was to work, either at the time or recently.

5. Mr Bartlett had no previous experience as a plumber or as a director of a company. The evidence of one of Dwyer's directors at trial emphasised Mr Bartlett's naivety and the extent to which he was financially vulnerable in the event of his business not being a success, based upon his own interactions with Bartlett prior to the contract being entered into.
6. The franchise agreement, which was for a term of ten years, included covenants that Fredbar and Mr Bartlett would not operate a similar business within the area of the franchise, or a five-mile radius of it, for a year following the conclusion of the contract.
7. The business was not a success. Mr Bartlett sought to sell his business around eighteen months after inception of the same. At trial it was determined that he terminated the contract before setting up as a plumber on his own account and in the same area as his franchise had serviced.
8. Dwyer sought injunctive relief which was rejected by the trial judge on the basis that the restrictive covenants were unenforceable.

The Issues and the Court's Decision

9. It was not in question that Dwyer had a legitimate interest to protect. Most obviously, and in contrast to *Credico* below, Mr Bartlett operated under a trade name associated with Dwyer and benefited from (and generated) goodwill by so doing. The question was of the reasonability of the restrictive covenants.
10. The trial judge's reasoning on this question, repeated at paragraph 23 of the Court of Appeal judgment, may serve as something of a menu of options for those seeking to build arguments against enforceability in analogous cases. However, at the centre of much of the reasoning at trial and in the Court of Appeal was Barlett's relative lack of bargaining power and his inexperience in the business he was engaged in, and Dwyer's knowledge of the same.
11. It was relevant to the question of what the parties, from an objective standpoint, contemplated was likely to be the position under the contract in due course. This is relevant to the reasonableness of restrictive covenants (applying *Harcus Sinclair LLP v Your Lawyers Ltd [2021] UKSC 23*). Most pertinently, Dwyer knew (or should have known) that the likelihood of the franchise failing was rather high. This threw a particular light on the duration of post-termination restrictions, and the fact that those restrictions were to be the same regardless of how long the franchise was in operation for.
12. In circumstances where the goodwill generated (the legitimate interest being protected) increases according to the duration of the contract, so does the extent of a covenant

that is reasonably necessary to protect it. Where the parties objectively had reason to think that the duration of the contract would in fact be quite short, that will be relevant to whether the covenant was reasonable.

13. This would seem to create significant difficulties for those drafting restrictive covenants (or seeking to rely upon those already drafted), which do not usually provide for variation in the period of any restriction in the way which the Court of Appeals appears to suggest.

14. It could be argued that the case should be limited to its own particular facts, and that contracting parties do not normally (from an objective standpoint) have reason to think that the contract will be terminated early.

15. The relative lack of any goodwill pre-dating Mr Bartlett's franchise (there being no previous Drain Doctor operating in the Cardiff area) is also relevant: where significant goodwill pre-dates the covenant being entered into a better case could be made for a "one-size-fits-all" approach.

16. Also striking was the suggestion at 305(f) of the trial judge's judgment, and quoted at Para 23 of the Court of Appeal's decision is that Mr Bartlett or Fedbar working as a sub-contractor would have "no effect" upon Dwyer's goodwill, and by implication it was unreasonable for a restriction to prevent such work. While this was only one factor in a number justifying the decision on reasonability, the Court of Appeal described the contents of sub-paragraphs (f), (g) and (j) as "*entirely justified*" [Para 85].

Credico v S5

17. Also In *(1) Credico Marketing Limited (2) PERDM Trading Limited v (1) Benjamin Gregory Lambert (2) S5 Marketing Limited [2022] EWCA Civ 864*, the Claimant/covenantee was a face-to-face marketing company which operated via a network of smaller marketing companies and self-employed marketers in a structure somewhat analogous to multi-level marketing schemes. The defendants were one such smaller marketing company and its owner.

18. Credico contract with companies such as S5 on standardised terms, under which the marketing companies undertake marketing work on behalf of Credico's clients. Those standardised terms include (1) a restriction on the marketing company doing marketing work other than that provided by Credico during the course of the contract, and (2) a restriction on doing so within a five mile radius of the marketing company's principal place of business for six months after its termination.

19. In return, Credico provide those companies with work (although no minimum level of work is provided for in the contract), and also provide training and significant back-office

support. The trial judge considered that much of the training was either specific to particular marketing campaigns, or was available other than from Credico; it was not confidential information, or know-how specifically attributable to Credico.

20. In circumstances where covid lead to a dearth of work from Credico, S5 undertook work for third parties in breach of the restrictive covenant. Following (lawful) termination of the contract by S5, Credico obtained injunctive relief preventing S5 from trading, pursuant to the covenant.

Credico v S5

21. There are a number of somewhat unusual aspects of this business structure from the perspective of considering a restraint of trade covenant. The arrangement differed significantly from a franchise in which a franchisee traded under the name of the franchisor and in doing so benefited from any prior goodwill already held in that name, and generated further goodwill trading under it.

22. Secondly, the marketing companies did not generate their own custom but were entirely dependent upon work given to them by Credico. They did not build relationships with clients (for whom they were carrying out marketing work) or with those people they were marketing to.

23. The result of the above is that there was no goodwill to protect in this case. Nor, as noted above, was it found at trial that there was confidential information or customer contacts that could be the subject of the legitimate interest being protected.

24. Sir Patrick Elias, in giving the judgment of the Court of Appeal, made clear that the continued investment of resources by Credico into S5 created a legitimate interest in the workforce of S5 being available to Credico to service the work which it obtained for it during the term of the contract. It was not a clause simply preventing competition, but rather was necessary for avoiding the dilution of the purpose of the contract, which was to secure an available workforce for Credico's marketing campaigns [Paras 49, 58 and 60].

25. By contrast, the post-termination restriction was not justified and the Court of Appeal allowed the defendants' appeal in this regard.

26. There being no goodwill, confidential information or customer contacts as legitimate interests to protect, there was no legitimate interest to protect post-termination: Credico could clearly have no expectation of the availability of a workforce in circumstances where the contract between it and S5 has been terminated [Para 66], as it did in the case of the pre-termination restriction. Nor, as discussed above, did the court accept

the weight placed by the trial judge on the fact that the parties were commercial entities where there was a clear inequality of bargaining power.

General Conclusions

27. It is clear, in light of these judgments that parties seeking to benefit from covenants cannot hope to place significant weight on the mere fact that they are between commercial entities, taken to be striking a bargain in each of their interests. Where there is an inequality in arms a covenantee cannot short-cut the need to demonstrate (a) a legitimate interest; which (b) is being protected by a covenant that is no more than adequate to do so.

28. Those who frequently contract commercially on standard terms with much smaller parties, such as franchisers, and who seek to benefit from a restraint of trade covenant in those terms, will need to carefully review the terms of such covenants. A comparison to the extensive list of factors listed by the trial judge as relevant to decision in the *Dwyer* case at Paragraph 305, repeated at Paragraph 23 of the Court of Appeal judgment, may serve as a useful starting point.

29. The reasonability of a restrictive covenant will of course, however, always depend upon the facts of a particular case. As noted by Lord Justice Arnold in his short (assenting) judgment in *Dwyer*, while it is understandable that franchisors would seek to have a standard form of agreement and a standard post-termination restrictive covenant, it is "*inescapable that not all potential franchisees are equal*" and franchisors must act accordingly [Para 90]. The same applies to other commercial relationships between potentially unequal parties involving restraint of trade clauses.

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