"You know what we meant!"

Supreme Court guidance on non-compete clauses

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Harcus Sinclair LLP and another (Respondents) v Your Lawyers Ltd (Appellant) [2021] UKSC 32

Introduction

1. On 23 July 2021 the Supreme Court handed down its unanimous judgment[1] on the issues of restraint of trade and solicitors' undertakings. This article considers the central issue before the court, namely whether a non-compete undertaking within a non-disclosure agreement was an unreasonable restraint of trade and therefore unenforceable.

2. This article does not address the second issue: the test and applicable principles for what amounts to a solicitor's undertaking (and, if so, whether it was enforceable against the individual solicitor and/or his firm).[2]

Background

3. In September 2015 allegations came to light that certain Volkswagen Group ("VWG") diesel vehicles had been fitted with "defeat devices", which detected standardised emissions tests and altered the engine output to create artificial results. The "Volkswagen emissions scandal" (as it became known) surfaced in the United States but has led to litigation in several countries including the United Kingdom. In January 2016 the Appellant ("YLL") issued a test claim and took steps to obtain a Group Litigation Order ("GLO").

[1] Lords Briggs, Hamblen and Burrows, with whom Lord Lloyd-Jones and Lady Arden agreed.
[2] See paragraphs 93ff of the judgment; in particular paragraphs 102-108 and 112.

4. As part of the process for obtaining funding, YLL approached the First Respondent ("HSLLP") in April 2016 for their expertise in conducting group claims and with a view to potential collaboration. The parties signed a non-disclosure agreement ("the NDA") to protect the confidential information that YLL would need to share. Under the NDA, HSLLP undertook for six years not to accept instructions for or to act on behalf of any other group of Claimants in the contemplated group action without the express permission of YLL ("the non-compete undertaking"). The solicitor who signed for and on behalf of HSLLP did so without reading it, although a qualified colleague did read it and suggest changes to it. Significantly, the NDA contained no express references to any consequent collaboration (whether as a legal obligation or a mere stated intention to do so) between HSLLP and YLL.

5. YLL and HSLLP collaborated informally from April to October 2016 but this yielded no written agreement. Having recruited its own claimants in the interim, on 19 October 2016 HSLLP issued its own proceedings against VWG entities and (for reasons unrelated to any involvement with YLL) subsequently assigned the litigation to the Second Respondent ("HSUK").

6. Upon discovering these developments, YLL raised objections with HSLLP, asserting that HSLLP could not accept instructions from any claimants without their authority. YLL contended that HSLLP's involvement in the October 2016 litigation was contrary to the non-compete provision of the NDA. YLL later argued that the non-compete undertaking was a solicitor's undertaking.

7. The Respondents sought a declaration that the court should not exercise its supervisory jurisdiction to enforce this undertaking; YLL sought *inter alia* injunctive relief for breach of the non-compete undertaking.

Legal principles

8. The key issues before the court could be summarised in three questions:

   (1) Did the non-compete undertaking amount to an **unreasonable** restraint of trade?

   (2) Did the non-compete undertaking amount to a **solicitor's** undertaking?

   (3) If it was a solicitor's undertaking, was it enforceable against HSLLP, a partnership?

9. Because the first question was answered in the negative, the appeal was allowed and the latter questions were not determinative. This article is therefore similarly limited in scope, though solicitors are referred to the helpful guidance on undertakings.

10. An agreement in restraint of trade will not be deemed unenforceable where:

    (1) the promisee can establish that it was reasonable as between the parties, in that:

        (a) it protects the promisee's legitimate interests,

        (b) it goes no further in doing so than is reasonably necessary, and

        (c) it arises in consideration for commensurate benefits to the promisor;[3] and

    (2) the promisor then fails to establish that it was unreasonable as against the public interest.

Lower courts

11. The High Court[4] held that the non-compete undertaking was enforceable. (It also implied a term that HSLLP undertook to ensure that HSUK did nothing which would be a breach if done by HSLLP.) The scope of this undertaking was no more than was reasonably necessary to protect YLL's legitimate interests. When assessed at the time the NDA was signed, those interests flowed from the intended collaboration in anticipation of which the parties negotiated the NDA. Further, the High Court considered that the scope of the non-compete undertaking was commensurate with the benefits secured to HSLLP under the NDA, particularly when considering this intended collaboration. YLL was therefore entitled to an injunction for six years from the date of the NDA precluding HSLLP and HSUK from acting in any UK VWG emissions litigation.

12. The Court of Appeal[5] held that the non-compete undertaking was unenforceable as an unreasonable restraint of trade, considering it crucial that the NDA did not include a collaboration agreement. Because it decided that YLL's legitimate interests could only be determined on the basis of the NDA's actual provisions, it found YLL's only legitimate interest was to protect the confidential information that it disclosed; it followed that the undertaking was not reasonably necessary to protect that interest. It also followed that the

[3] YLL argued that the third 'commensurate benefits' limb was immaterial where both parties had equal bargaining power. Whilst the respective bargaining position of the parties was informative for the determination of reasonableness generally, it proved unnecessary to determine this point in this appeal.
[4] Mr Edwin Johnson QC sitting as a deputy High Court judge: [2017] EWHC 2900 (Ch); [2018] 1 WLR 2479.
[5] Sir Geoffrey Vos C, Henderson and Asplin LJJ: [2019] EWCA Civ 335; [2019] 4 WLR 81.

benefits expressly secured by HSLLP under the NDA did not include any form of collaboration. Accordingly, the restraint of trade was too broad as to be reasonable.

Legal issue

13. The critical question of law in this appeal was therefore whether, in determining a promisee's legitimate interests, a court can take into account what the parties intended or contemplated (assessed objectively at the time it was signed) would occur as a consequence of entering into a contract in restraint of trade, in addition to the express and implied provisions of the contract itself.

> *"Put another way, does the fact that the NDA did not include any legally binding obligations to collaborate mean that it is irrelevant, in deciding on Your Lawyers' legitimate interests, that the parties intended, or contemplated, at the time the NDA was made, a process of informal collaboration consequent on the NDA?"*[6]

Decision

14. The Supreme Court restored the trial judge's decision on the restraint of trade issue, holding that non-contractual intentions and/or contemplations could be taken into account when assessing legitimate interests. The Court approved the *obiter dicta* of Diplock LJ in *Gledhow Autoparts Ltd v Delaney* [1965] 1 WLR 1366, that non-compete clauses are either valid or invalid *ab initio* – they cannot be subsequently rendered otherwise – and must be "determined at the date at which the agreement was entered into and … in the light of what may happen"[7] over the lifetime of the agreement. Examples of these dicta being applied in recent case law relating to restrictive covenants in employment contracts, *Allan Jones LLP v Johal* [2006] EWHC 286 (Ch)[8] and *Egon Zehnder Ltd v Tillman* [2017] EWHC 1278 (Ch),[9] were cited with approval.

15. It followed from this decision that the Court of Appeal's criticism of the High Court's approach towards defining YLL's legitimate interests was fatally flawed, as it was too narrowly constrained to the letter of the NDA. It was clear from the factual context that both YLL and HSLLP actively contemplated future collaboration when the NDA was signed, even if the parties did not spell out this intention in the agreement; and this purpose

[6] Paragraph 62.
[7] At 1377.
[8] *Per* Bernard Livesey QC at paragraphs 38-39.
[9] *Per* Mann J at paragraph 27.

could not be ignored. YLL therefore had legitimate interests to protect, and the six-year moratorium was reasonably necessary to prevent HSLLP and its assignees competing against YLL in the emissions litigation. HSLLP's commensurate benefits were analysed using the same wider contextual approach as YLL's legitimate interest.[10]

16. The non-compete undertaking was also held not to offend the public interest. The Court of Appeal did not go on to expressly decide this point, having already found that the undertaking was unreasonable as between the parties. The Supreme Court nonetheless approved the judge's findings. Accordingly, the non-compete undertaking was valid and enforceable, and the appeal was allowed on this basis.

Analysis

17. This decision sits easily within the jurisprudential trend away from a strict literal interpretation of the letter of agreements and towards objective construction of contractual terms. The court already construes a contractual term according to what its words naturally mean to a reasonable person with all relevant background knowledge reasonably available to the parties at the time; it makes logical sense to apply this approach more holistically.

18. Moreover, on one view this is not new: whilst not referred to in the judgment, parallels can be drawn with the seminal case of *Hadley & Anor v Baxendale & Ors* [1854] EWHC J70. Losses arising from a breach of contract are not too remote if either (1) they do arise naturally from the contract *or (2) they are reasonably in the contemplation of both parties, at the time they made the contract, as the probable result of breach*. If losses arising from a breach of contract can be assessed by reference to the parties' contemplations on entering into that contract, then surely a contract specifically entered into *for the purpose of preventing the type of losses which would occur upon breach of it* should also be assessed by reference to the parties' contemporaneous reasons for contracting.

19. The Supreme Court considered the circumstances "rare" in which an issue of this nature will arise again, but the practical implications of this decision may be far-reaching for both commercial and employment law. Whilst it is always good practice to keep a written record of pre-contractual negotiations, and expressly to note in recitals or correspondence any particular considerations and motivations that would help to interpret a contract should a

[10] Paragraph 79.

dispute arise, employers and commercial competitors alike should be aware of the possibility that a court will look beyond the four corners of the contract to infer meaning from context.

20. Whilst in this case the parties' intentions for their future relationship at the date of the NDA was readily discernible, in other scenarios the parties' intentions may not have crystalised in their minds or been discussed to any significant extent. This may occur in circumstances where an NDA is executed as a precautionary measure at a much earlier stage in a commercial relationship; in which case its scope must be limited to protecting reasonably foreseeable legitimate interests with the least feasible restraint.

21. It will always be a factual exercise for the court to determine what was in the parties' reasonable contemplation at that moment in time. A new employee potentially getting promoted in years to come, or a business partner periodically updating their intellectual property, is likely a foreseeable development in most circumstances. But if a post-contractual business relationship evolves unrecognisably following an agreement in restraint of trade, such as an entirely new regulatory regime or market-disrupting technological innovation rendering previous arrangements obsolete, then a court may take a different view. Businesses may therefore wish to consider periodically reviewing their non-compete provisions to clarify (but not necessarily limit) their legitimate interests and stay up to date.

22. As a final thought: this case is also an edifying reminder to legal practitioners everywhere to read any document carefully before signing it.

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