

# Restraint of Trade in Commercial Contracts

16 March 2021

In *Quantum Actuarial LLP v Quantum Advisory Limited* [2021] EWCA Civ 227, the Court of Appeal set out the principles relevant to establishing whether covenants in a commercial contract engage the doctrine of restraint of trade. The Court held that the doctrine of restraint of trade did not apply to the commercial agreement at issue and that, in any event, the covenants in the agreement were reasonable. The decision reinforces the fact that, where sophisticated parties of equal bargaining power enter into a contract, the Courts will be slow to interfere with the parties' freedom of contract by finding aspects of that contract unenforceable on the grounds of restraint of trade.

Quantum Actuarial LLP (the "Appellant") was formed in 2007 as part of a reorganisation of three businesses providing pension fund-related services. The Appellant executed a bespoke services agreement (the "Services Agreement"), to which one of the three entities was party (the "Initial Party"). Shortly after execution, the Services Agreement was novated from the Initial Party to Quantum Advisory Limited (the "Respondent"). The Services Agreement contained covenants (the "Covenants") which were to apply throughout the 99-year duration of the Services Agreement and a further 12 months beyond, preventing the Appellant:

- from soliciting or enticing away any of the Initial Party's clients in connection with defined services;
- from obtaining instructions from or undertaking those services for any of those clients; and
- from undertaking any services in relation to what was described as "pipeline" business or in relation to new business introduced before 31 March 2008.

In June 2018, after operating under the Services Agreement for several years, the Respondent informed the Appellant that, having taken legal advice, it intended to proceed on the basis that the Covenants were in unreasonable restraint of trade and that they were unenforceable. The Respondent further indicated that the term of the Services Agreement would be treated as amended to a period of time "*deemed reasonable*,"

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a period between 5 and 10 years”, which meant that the Appellant was “free to contract with whoever it wishe[d] without restraint.” Further to this letter, the Respondent commenced the present proceedings seeking, inter alia, declaratory relief to establish that the Services Agreement was fully enforceable between the parties.

The current appeal concerns the application of the doctrine of restraint of trade in the context of the Services Agreement. The High Court held that this doctrine did not apply to the Covenants and that, even if it did, the Covenants were reasonable. The Appellant argued that the High Court judge was wrong on both counts. The Respondent maintained that the High Court judge reached the right conclusions and also sought to uphold the judgment on a further basis, including the fact that the Covenants were reasonable in that they reflected the fiduciary obligations owed to the Respondent by the Appellant as agent.

**Restraint of Trade.** The judge summarised the legal principles relevant to the doctrine of restraint of trade at paragraph 60 of the judgment. In particular:

- The doctrine “[was] not confined to immutable boundaries or rigid categorisation”, but there were certain categories of covenants to which the doctrine traditionally applied, in particular those by which an employee undertook not to compete with his employer after leaving the employer’s service and those by which a trader who had sold his business agreed not thereafter to compete with the purchaser of the business. The doctrine had been held to apply to franchise agreements, share-purchase agreements and the assignment of a patent.
- There were no clear limits on the scope of the doctrine and no precise or exhaustive test could be stated. The doctrine was to be applied to “factual situations with a broad and flexible rule of reason”. The question was whether or not in all the circumstances, the contract should be excluded from the application of the doctrine or whether it was appropriate to dispense the contract “from the necessity of justification under a public policy test of reasonableness”.
- Contractual restraining provisions which were of a sort which had become part of the accepted machinery of a type of transaction which had generally been found acceptable and necessary (reflecting the accepted and normal currency of commercial and contractual conveyancing relations) would generally fall outside the scope of the doctrine, following the “trading society” test approved by the Supreme Court in the case of *Peninsula Securities Ltd v. Dunnes Stores (Bangor) Ltd* [2020] UKSC 36.
- Determining whether contractual restraints fell outside the range of a normal commercial contract imposing restrictions on a contracting party’s ability to carry on

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a business activity was a question of evaluating all the relevant factors, to be assessed cumulatively.

- The assessment of application of the doctrine was to be carried out by reference to the position at the time that the contract was made.
- The application of the doctrine was a question of substance, not form.
- The doctrine could apply to restraints operating during the currency of the contract, as well as post-contractually. However, the fact that a restraint was limited to the period of the contract may be a factor in favour of excluding the doctrine.

Where the doctrine applied, the contractual restraints were prima facie unenforceable, unless they were reasonable.

**Reasonableness.** In order for the restraint to be reasonable (i) the restriction had to afford adequate protection to the party in whose favour it was imposed, (ii) while at the same time not being injurious to the public in any way. The Court explained, at paragraph 65 of the judgment, that the party wishing to rely on the restriction had the onus of establishing that the covenant was reasonable. Provided that the party wishing to rely on the restriction proved that the restriction was reasonable, then the onus shifted to the party wishing to attack the restriction to show that the restriction was contrary to the public interest. Reasonableness was to be assessed at the time when the contract was made.

As the judge noted, the concept of what was reasonable might alter with the changing nature of commerce and society. The judge set out some of the factors which may be relevant when assessing reasonableness, at paragraph 65 of the judgment, including:

- The nature of the business.
- The relevance of the consideration for the restraint.
- Inequality in bargaining power.
- Standard forms of contract.
- Whether the restraints operated during or post-contract.
- The surrounding circumstances.

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- The duration of an agreement in restraint of trade, which was a factor of great importance in determining whether the restrictions in an agreement could be justified.
  - The level of compensation might also be relevant.

It is worth noting that the motives of the party challenging the contract were immaterial when assessing reasonableness and therefore not a relevant factor.

**Decision.** The Court of Appeal dismissed the appeal on both grounds and upheld the decision of the High Court. In particular:

- The Services Agreement was “*a bespoke agreement entered into by sophisticated professional parties who (as the Judge found) were of equal bargaining power*”.
- The Court of Appeal noted that a central plank of the Appellant’s challenge on appeal was to criticise the High Court judge’s finding on the equality of bargaining power; however, the Court of Appeal agreed with the decision of the High Court and stated that, on the facts of the case, it would seem “*wholly unreal to suggest that there was any substantive inequality of bargaining power such as to justify engagement of the doctrine (either alone or as part of an overall consideration of the circumstances)*”.
- Absent an inequality of bargaining power, the Court stated that on the facts of this case “*it [was] very difficult to see on what basis public policy would justify engagement of the doctrine [of restraint of trade]*”.
- The High Court judge had been entitled to take into account the commercial background to and rationale for the creation of the Appellant and the Services Agreement.
- The Covenants “*were not oppressive, but rather fairly and properly ancillary*” to the appointment of the Appellant to provide the services under the Services Agreement.
- Furthermore, “*there [was] no sensible suggestion that the practical effect of the Covenants [had] any adverse impact on the public interest*”.
- There was no special feature of the Services Agreement, set in its proper context, such as to justify requiring the covenantee to establish that the covenants were reasonable.

In light of the above, the High Court was not wrong to conclude that the doctrine of restraint of trade was not engaged on the facts. The public interest in holding the parties

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to a freely negotiated contract outweighed the effect of restricting the Appellant in its ability to trade. There was therefore no basis for interfering with the conclusion that the covenants were reasonable and the appeal was dismissed.

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Please do not hesitate to contact us with any questions.

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