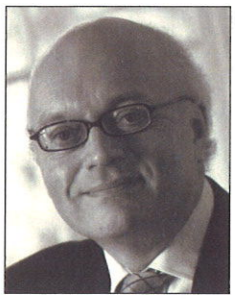
Restrictive covenants considered

Will restrictive covenants pass the tests under Chapter 1 of the Competition Act 1998? Andrew Francis outlines a recent case



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Hot on the heels of the decision of HHJ Dight in *Martin Retail Group Ltd v Crawley Borough Council* [2013] (reported on in 'The fire and Furnace of land covenants', *PLJ*322, p10), the decision of Henderson J in the Chancery Division of the High Court in *Carewatch Care Services Ltd v Focus Caring Services Ltd* [2014] is another example of how competition law issues require consideration in the context of restrictive covenants affecting land.

Most advisers dealing with property matters should by now be aware that, since 6 April 2011, land agreements (whenever entered into) are subject to rules prohibiting anti-competitive agreements within Chapters 1 and 2 of the Competition Act 1998. These chapters mirror the terms of Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU).

Carewatch concerned a number of issues over the meaning and enforceability of post-termination anti-competition covenants (the covenants) given by franchisees in franchise agreements relating to the provision of care home services. The relevant issue for the purposes of this article is whether the covenants infringed s2 of the 1998 Act, and if so whether there was any defence to that infringement. Henderson J held that there was a *prima facie* case that the covenants fell within s2(1) of the 1998 Act, given that:

- the covenants had as their object the prevention or restriction of trade within the territories of the agreements, and;
- following termination of the agreements there would be scope for competition between Carewatch and the former franchisee, and the object of the covenants was to protect Carewatch's goodwill by preventing or limiting such competition for a period of 12 months from termination, so the Chapter 1 prohibition was engaged.

But Henderson J held that the covenants were necessary to protect the know-how and assistance provided by the franchisor, and to maintain its identity and reputation: 'the *Pronuptia* defence' (*Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis* [1986]). By reference to the *ServiceMaster* [1998] decision, Henderson J applied the *Pronuptia* defence to the franchise agreements at issue as service franchises, as opposed to distribution franchises. Further, by reference to *Pirtek (UK) Ltd v Joinplace Ltd* [2010], Henderson J adopted what Briggs J said there about the need to adopt a cautious and fact-specific analysis of how far the post-termination restraint is necessary to protect the know-how and assistance given by the franchisor to the franchisee, which will be used post-termination to aid the franchisor's competitors. In the result, Henderson J found that the *Pronuptia* defence succeeded and the covenants did not infringe upon Chapter 1 of the 1998

Carewatch Care Services Ltd v Focus Caring Services Ltd & ors [2014] EWHC 2313 (Ch)
Martin Retail Group Ltd v Crawley Borough Council [2013] EW Misc 32 (CC)
Pirtek (UK) Ltd v Joinplace Ltd & ors [2010] EWHC 1641 (Ch)
Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis [1986] EUECJ R-161/84
ServiceMaster [1988] Decision IV/32.358 (88/604/EEC) OJ L332/38

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Act. That conclusion was consistent with his earlier finding that the covenants were valid and enforceable at common law, as reasonable to protect Carewatch's legitimate business interests. He did not need to consider the factually complex question of whether exemption under s9 of the 1998 Act provided a defence.

Why is the decision in *Carewatch* of relevance and importance to real property advisers?

- First, on a technical point, the parties and the judge accepted that the covenants could be severed from the franchise agreements, and if void, those covenants did not invalidate those agreements as a whole. This can be important where, for example, there is a series of covenants each designed to protect a trading interest, such as in a shopping centre lease. Unless the 'blue pencil test' of severance can be applied, there is a risk that all the covenants will fail, even if only one of them is void under Chapter 1. When drafting covenants to protect trading interests, take care to express the terms as severable.
- Secondly, whether covenants will be void under s2 or can survive by way of a defence, such as the *Pronuptia* defence or exemption under s9, is a highly fact-specific question which must not be underestimated. A landlord's covenant in a shopping centre, designed to protect an anchor tenant, maintain its identity and goodwill, and promote the economic success of the centre, may well fall within s9, even though it is outside the *Pronuptia* defence.
- Thirdly, the force of an allegation that the land agreement (eg a trading covenant) is void under Chapter 1 or 2 of the 1998 Act should also not be underestimated. If successful, the covenant will be void. If it is void there may be an issue about whether recourse to indemnity covenants may be had, given that as between the original parties there is no covenant to enforce and the indemnifier may be able to rely on that fact.
- Finally, after three-and-a-half years, the importance of the realisation that land agreements are now subject to Chapters 1 and 2 of the 1998 Act cannot be over-emphasised. At both the drafting and the advice stages, care needs to be taken to recognise the issues and their strengths or weaknesses. ■

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