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Restrictive Covenants – The Danger of Being Too Aggressive

The recent case of *Francotyp-Postalia Ltd v Whitehead, Suckling and others* illustrates the need for restrictive covenants in business agreements to be carefully drafted.

The Facts

Francotyp-Postalia Ltd is a company which manufactures, sells and supplies franking machines. It entered into franchise agreements with FP Central Ltd, a company which Mr Whitehead and Mr Suckling were directors of, for the Coventry and Birmingham areas.

The franchise agreements included a number of clauses designed to restrict the activities of FP Central Ltd, Mr Whitehead and Mr Suckling for one year after the agreements had come to an end. The court concentrated on two areas in these restrictive covenants.

The first were "area covenants". These prevented FP Central Ltd, Mr Whitehead and Mr Suckling from competing with Francotyp-Postalia Ltd within the "Restricted Area". The "Restricted Area" was the "Territory" FP Central Ltd was entitled to trade within under each franchise agreement (i.e. Coventry and Birmingham) as well as every other area in the UK covered by Francotyp-Postalia Ltd or any of its franchisees, dealers or distributors. The second were "non solicitation clauses". These prevented FP Central Ltd, Mr Whitehead and Mr Suckling from soliciting clients from Francotyp-Postalia Ltd in the same "Restricted Area" as the "area covenants".

After the franchise agreements came to an end, Francotyp-Postalia Ltd claimed that Mr Whitehead and Mr Suckling had breached the restrictive covenants.

The parties agreed that although the "non solicitation clauses" were valid, the "area covenants" had been drafted too widely and were unenforceable as a restraint of trade. Mr Whitehead and Mr Suckling accepted that had the "area covenants" been limited to the Coventry and Birmingham areas, rather than the "Restricted Area", they would have been valid.

Both franchise agreements had severance clauses, which stated that each of the restrictions and provisions were independent. According to the severance clause, if any provisions were held to be void or ineffective, they could either be deleted from the agreement or amended in such a way as to make them valid and effective.

The Consequences

The only issue the Court had to determine was whether the "area covenant" could be limited to Coventry and Birmingham and thereby made enforceable. For this to occur, the Court had to sever those elements which extended its application to other areas in the UK.

The Court held that the way the restrictive covenants had been drafted made it impossible to sever the unenforceable part of the franchise agreement. For the “area covenants” to be limited to Coventry and Birmingham, the meaning of the term “Restricted Area” needed to be changed. This term had also been used in the “non solicitation clauses”, which the parties and the Court accepted was valid and enforceable. Changing the meaning of the term “Restricted Area” would have had the effect of re-writing the “non solicitation clauses”. As there was nothing wrong with the “non solicitation clauses”, it would have been wrong to vary them to make the “area covenants” valid.

As the Court was only asked to consider this issue, the precise consequences of these findings for the parties were to be determined at a later date.

The Lesson

Both in arrangements like franchise agreements, and other types of contract such as employment and share purchase agreements, a party may have a legitimate interest in including a clause in a contract which restricts the activities of the other contracting party after the contract has ended. These restrictive covenants may, for example, seek to prevent that other party from exploiting the information they acquire as a result of the contract and poaching employees, clients or suppliers.

Although restrictive covenants can be used to protect a legitimate interest, they will only be enforceable if they do not go beyond what is necessary to protect that legitimate interest. This will normally require limits on, for example, their duration, geographical scope and the activities they cover. If a restrictive covenant goes too far, it will be unenforceable and void as a restraint of trade.

For the rest of the contract to survive, the Court must be able to amend or delete the offending clause without effectively making a new contract for the parties. Relying on a severance clause alone is insufficient and should not be seen as a failsafe to fall back on in all cases.

It is very difficult to offer definitive general rules as to what will and will not be enforceable. The courts have said that whether or not a covenant is reasonable is a matter of “impression”, and it will also depend to a large extent on the particular factual context of the relevant contract. However, it is fair to say the more carefully the covenant is drafted, reflecting what is genuinely necessary to protect a party’s legitimate interests, the greater the chance it will be enforceable. This case illustrates clearly the dangers of trying to put the party subject to the covenant in a difficult commercial position by making the restrictions unnecessarily wide.

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