

Restrictive covenants – how long is too long when purchasing a business?



Restrictive covenants are often inserted into a share purchase / business purchase agreement and are an important part of the negotiations relating to the sale. They are typically aimed at preventing the seller(s) from setting up a new business in competition, poaching staff or targeting key suppliers / customers, so as to preserve the goodwill of the business that has been acquired – why pay significant value for a business, if the previous owner can set up a competing business next door the day after the sale?

The problem

There is an inherent problem, however, with such clauses because as a matter of public policy they will be unenforceable and struck out of a contract unless the buyer can establish that:

- they protect a legitimate business interest;
- are no wider than reasonably necessary to protect that interest; and
- are not contrary to the public interest.

When assessing reasonableness, the Court will need to consider the duration of the restriction and the scope and geographical area that the restriction covers – so how long is too long?

Reasonable term

While it is impossible to lay down a hard-and-fast rule about a “reasonable term”, it is clear that the longer the

duration of the restraint, the more likely a Court is to find the clause to be unreasonable. Each case will ultimately turn on its own facts and the context of the agreement, including the sector the parties operate in, any established commercial practices, the companies/parties involved and the circumstances surrounding the transaction (e.g. if legal advice was obtained and the terms have been specifically negotiated).

A recent case

In the recent case of *Quantum Actuarial LLP v Quantum Advisory Ltd* [2021] EWCA Civ 227, the Court of Appeal has upheld an unusually long restriction (99 years), which the Court felt was not unreasonable when viewed in the context of pension funds and other organisations that subsist for a similar time frame. Conversely, in the recent case of *Dwyer (UK Franchising) Ltd v Fredbar Ltd and another* [2022] EWCA Civ 889, the Court of Appeal dismissed a franchisor's appeal against a High Court decision that had declared that a twelve-month restriction in a franchise agreement was unreasonable and unenforceable. The Court viewed the inequality of bargaining power between the parties as a significant factor when determining reasonableness together with the short period of time that the franchise had been in operation.

What should you consider?

The duration of a restriction can vary dramatically depending on the circumstances relating to the purchase and it is important for the buyer in any transaction to carefully consider the duration and scope of the covenants that are proposed before the deal is concluded. Too short and this will impact on the value of the business, while insisting on too long a restriction will render it unenforceable. It is therefore important for the buyer of any business to take specialist legal advice on the scope and duration of any restrictions to ensure they are enforceable and the value of the transaction is preserved.

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