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RESTRAINT OF TRADE COVENANTS IN COMMERCIAL AGREEMENTS

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The doctrine of restraint of trade is usually associated with employment agreements. However, it has been applied to a wide variety of commercial agreements in local and foreign cases. This article looks at the enforceability of restraint of trade covenants in three prevalent commercial agreements (namely sale of business, franchise and joint venture agreements) and explains when and why Singapore and English courts have enforced or declined to enforce such covenants.

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I. Introduction

1 The doctrine of restraint of trade has a long history. The earliest reported case on restraint of trade covenants was decided in the 15th century (*John Dyer's* case[1]). There the court held that a bond entered into by an apprentice with his master not to practise the trade of a dyer in a town for six months was contrary to the common law.

2 Four centuries later, the modern formulation of the doctrine was crystallised in *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co*[2] ("*Nordenfelt*"), where Lord Macnaghten held that a restraint of trade covenant was enforceable if it passed the

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1 (1414) Year Book 2 Henry V, fol 5, pl 26. See Eugene McQuillan, "Validity of Contracts in Restraint of Trade" *The American Law Register* (1852-1892) Vol 33, No 4 New Series Volume 24 (April 1885) 217 at 219–220.

2 [1894] 1 AC 535.

twin tests of reasonableness (*ie*, the covenant is reasonable in the interests of the parties and also reasonable in the interests of the public).[3]

3 While the doctrine began life in the field of apprenticeships and employment, it has now been applied in a broad range of commercial agreements and relationships. They include business acquisitions,[4] partnerships,[5] joint ventures,[6] franchises,[7] trade associations,[8] licensing agreements[9] and non-disclosure agreements.[10] At its heart, the doctrine seeks to protect the freedom to trade while balancing the freedom to contract.[11]

4 This article reviews the doctrine's salient principles and the enforceability of restraint of trade covenants in three prevalent commercial agreements, namely sale of business, franchise and joint ventures agreements. It examines what the courts have considered to be legitimate interests deserving of protection and how they have examined the reasonableness of covenants.

II. General principles

5 Restraint of trade covenants often take the form of non-compete and non-solicitation covenants. A non-compete

3 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] 1 AC 535 at 565. Indeed, as the Court of Appeal observed in *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [69], Lord Macnaghten's judgment has stood the test of time and constitutes the legal foundation and starting point for this particular area of contract law.

4 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [42].

5 *Robin M Bridge v Deacons* [1984] 1 AC 705 at 712C.

6 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [292].

7 *ChipsAway International Ltd v Kerr* [2009] EWCA Civ 320 at [22].

8 *Pilkadaris Terry v Asian Tour (Tournament Players Division) Pte Ltd* [2013] 2 SLR 385 at [69]–[70].

9 *National Aerated Water Co Pte Ltd v Monarch Co Inc* [2000] 1 SLR(R) 74 at [29].

10 *Harcus Sinclair v Your Lawyers LLP* [2019] EWCA Civ 335 at [100].

11 *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [45].

covenant usually prohibits the covenantor from getting involved, directly or indirectly, in a competing business in any capacity, whether as partner, shareholder,[12] employee, director or agent. A non-solicitation covenant prohibits the covenantor from approaching customers with a view to appropriating the business or custom of the covenantee[13] or from enticing the covenantee's employees to leave their employment.

6 Restraint of trade covenants operating during the currency of a contract and after its termination are subject to the doctrine.[14] The fact that a party entered into the covenant freely is irrelevant, as the unenforceability of unreasonable restraint of trade covenants is based on public policy and cannot be cured by mutual consent.[15]

7 The basic principles concerning the validity of restraint of trade covenants are trite. All such covenants are *prima facie* void. However, if the covenant: (a) protects a legitimate proprietary interest; (b) is reasonable in the interest of the parties and; (c) is reasonable in the interests of the public, it may be enforced.[16]

8 The categories of legitimate proprietary interests are not closed. Recognised categories include protecting trade secrets,[17] trademarks,[18] goodwill,[19] and maintaining a stable trained workforce.[20] The legitimate proprietary interest(s) sought to be protected by a restraint of trade covenant is a question of

12 However, covenants often include a proviso for passive shareholding. For example, some covenants will provide that holding less than 5% of the shares in a listed company in a competing business would be exempt. For examples, see *Peart Stevenson Associates Ltd v Holland* [2008] EWHC 1868 (QB) at [17] and *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [286].

13 *QBE Management Services (UK) Ltd v Dymoke* [2012] EWHC 80 at [185].

14 *National Aerated Water Co Pte Ltd v Monarch Co Inc* [2000] 1 SLR(R) 74 at [30].

15 *National Aerated Water Co Pte Ltd v Monarch Co Inc* [2000] 1 SLR(R) 74 at [31].

16 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [44].

17 *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [81].

18 *National Aerated Water Co Pte Ltd v Monarch Co Inc* [2000] 1 SLR(R) 74 at [33].

19 *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [80].

20 *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [93].

contractual construction.[21] If the interest to be protected is stated expressly in the contract, the covenantee will not be permitted to justify the covenant by relying on another interest.[22] Further, in court proceedings to enforce a restraint of trade covenant, the legitimate proprietary interest should be pleaded by the covenantee.[23]

9 The court will not enforce covenants that go further than necessary to protect the legitimate interest in question.[24] Even if the covenantor is a sophisticated commercial party this principle stands.[25]

10 To assess the reasonableness of the covenant as between parties, the courts have considered: (a) the scope of the activities restrained; (b) the geographical scope; and (c) the duration of the restraint. Additionally, the courts have considered whether the covenant had been specifically negotiated by the parties, and

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21 *Buckman Laboratories (Asia) Pte Ltd v Lee Wei Hoong* [1999] 1 SLR(R) 205 at [22].

22 *Buckman Laboratories (Asia) Pte Ltd v Lee Wei Hoong* [1999] 1 SLR(R) 205 at [22]. Thus, if a covenantee wishes to specify the legitimate interest(s) he or she seeks to protect with the restraint of trade covenant, it is essential for him or her to identify these interests comprehensively in order to avoid being inadvertently straitjacketed. As one judge put it colloquially, "if the employer [covenantee] nails his colours to the mast, he is stuck to those colours and that mast": *Countrywide Assured Financial Services Ltd v Smart* [2004] EWHC 1214 at [12].

23 Rules of Court (Cap 322, R 5, 2004 Rev Ed) O 18 r 7(1) and O 18 r 12(1).

24 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [44].

25 The recent decision of the English Court of Appeal in *Harcus Sinclair v Your Lawyers Ltd* [2019] EWCA Civ 335 amply illustrates. There the court held that a six year non-compete covenant included in an otherwise typically worded non-disclosure agreement ("NDA") between two law firms was not reasonably necessary to protect the covenantee's interest in protecting confidential information concerning a potential group action that it had disclosed to the covenantor under the NDA. Though the court recognised that the covenantee had a legitimate interest in protecting the confidential information disclosed and the covenantor was a sophisticated commercial party (a reputable London-based firm of solicitors) which was in a stronger bargaining position than the covenantee (a much smaller law firm), the court still held that the covenant was unenforceable as it was not reasonably necessary to protect the said legitimate interest.

whether valuable consideration was received by the covenantor for providing the covenant.[26] In this regard, the reasonableness of the covenant will be adjudged as at the time of contract, not after.[27] The rationale for this rule appears rooted in avoiding uncertainty. If the validity of the covenant could be affected by subsequent events, it would likely leave parties uncertain as to their rights and obligations.

11 The burden of demonstrating that the covenant protects a legitimate proprietary interest and is reasonable as between parties lies with the covenantee. In contrast, the burden of demonstrating that a covenant is unreasonable with reference to the public interest rests with the covenantor.[28] The argument that a covenant is unreasonable with reference to the public interest has rarely succeeded. Examples where such an argument has succeeded include cases where upholding the covenant would have created a monopoly[29] or prohibited a pioneering doctor from developing societally beneficial respirators.[30]

III. Sale of business agreements

12 The courts have long recognised that the purchaser of a business has a legitimate proprietary interest in protecting the

26 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [61]; *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [138]–[139]. In *Harcus Sinclair v Your Lawyers LLP* [2019] EWCA Civ 335 at [86], the English Court of Appeal also considered whether the burden of a restraint of trade covenant was commensurate with the benefits that the covenantor received under the contract when determining the reasonableness of the covenant between parties.

27 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [61].

28 *Thomas Cowan & Co Ltd v Orme* [1961] 1 MLJ 41 at 42.

29 *Thomas Cowan & Co Ltd v Orme* [1961] 1 MLJ 41 at 43, cited with approval in *Man Financial (S) Pte Ltd v Wong Bark Chuan David* [2008] 1 SLR(R) 663 at [74]–[76].

30 *Dranez Anstalt v Hayek* [2002] 1 BCLC 693 at [25]. See also *Pilkadaris Terry v Asian Tour (Tournament Players Division) Pte Ltd* [2013] 2 SLR 385 at [107]–[109].

goodwill of the business that was sold.[31] Simply put, the goodwill of the business refers to its reputation and the connection that customers have with it.[32] Restraint of trade covenants which prohibit the vendor from competing with the purchaser in relation to the business that was sold have been upheld as they enable the purchaser to take the benefit of the business he had purchased. If the vendor could not be restrained by law, the vendor could undermine the goodwill of that business by setting up a competing business after the sale. This would permit the vendor to take back what he had been paid good money for. This would undoubtedly deter the sale of businesses.

13 To protect the goodwill of the business that was sold, English courts have upheld reasonable restraint of trade covenants which prohibited the vendor from dealing with not only the customers of the business that was sold, but also potential customers of that business. This has been justified on the basis that the prospect of obtaining new customers from the referrals of existing customers is part of the goodwill of the business sold.[33]

14 It is trite that the courts take a more liberal approach in assessing restraint of trade covenants in the sale of businesses as compared to employment cases.[34] This has been justified on two

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31 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] 1 AC 535 at 573–574.

32 *Commissioners of Inland Revenue v Muller & Co Margarine Ltd* [1901] AC 217 at 223–224.

33 See *Allied Dunbar (Frank Weisinger) Ltd v Weisinger* [1988] IRLR 60 at [26] and *One Step (Support) Ltd v Morris Garner* [2015] IRLR 215 at [50].

34 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [45]. The two contexts are not mutually exclusive. Often, business acquisitions are accompanied by the employment of the business's former owners/managers for business continuity or development. Under their employment contracts, they would undertake to observe non-compete and non-solicitation covenants during their employment and for a period thereafter. While these covenants may be contained in an employment contract, the English courts have recognised that it would be incorrect to evaluate the reasonableness of these covenants with the more stringent approach reserved for traditional employment cases since these employees are also vendors of a business and its goodwill: *Allied Dunbar (Frank Weisinger) Ltd v Weisinger* [1988] IRLR 60

(*cont'd on the next page*)

key grounds. First, as explained above, the covenants are necessary to protect the subject matter of the sale. Second, there is less likely to be a disparity in bargaining power between parties in the sale of businesses as compared to the employment cases.[35] Further, upholding these covenants is likely to impose less hardship on the vendor of a business as compared to an employee. A vendor would usually have received a significant sum in consideration from the sale. In contrast, most post-termination covenants in employment contracts are not accompanied by any payout to the employee.

15 Despite the more liberal approach towards restraint of trade covenants in sale of business agreements, such covenants will not be upheld if they do not protect a legitimate proprietary interest and satisfy the twin tests of reasonableness. Where the legitimate proprietary interest is goodwill, the courts have made it clear that the covenant should be for the protection of the goodwill of the business *that was sold*. Covenants which prohibited the vendor from competing in businesses which are not the subject matter of the sale have been struck down.

16 In *Goldsoll v Goldman*[36] ("*Goldsoll*"), an imitation jewellery trader sold his business to another imitation jewellery trader and undertook not to be involved in the business of dealing in imitation *or real* jewellery in several countries. The English Court of Appeal held that this restraint was unreasonable since the business sold was one which dealt with imitation jewellery and *not real* jewellery. The court severed the restraint against dealing in real jewellery[37] and severed the restraint to exclude certain countries as the vendor had no imitation jewellery business in those countries.[38]

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at [21]; *Alliance Paper Group v Prestwich* [1996] IRLR 25 at [15]; *TSC Europe (UK) v Massey* [1999] IRLR 22 at [27]–[30].

35 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [45].

36 [1915] 1 Ch 292.

37 *Goldsoll v Goldman* [1915] 1 Ch 292 at 298.

38 *Goldsoll v Goldman* [1915] 1 Ch 292 at 297.

17 In *CLAAS Medical Centre Pte Ltd v Ng Boon Ching*[39] ("*CLAAS Medical*"), a doctor who ran a successful aesthetics clinic and distributorship of certain aesthetic products entered into a joint venture with six other doctors. As part of this joint venture, he transferred his practice and distributorship to a holding company and sold all the shares in this company to a joint venture company for S$3.2m. He undertook not to become involved in any business in Singapore that competed with the business of the joint venture company or the practice of "Aesthetic Medicine" (which definition in the contract included the phrase "all procedures and treatment as understood by aesthetic medicine"[40]) as long as he remained a shareholder of the joint venture company and for three years after he ceased to be a shareholder. The Singapore Court of Appeal found that the non-compete covenant was unreasonably wide as it sought to restraint him from engaging in "all procedures and treatment as understood by aesthetic medicine". This had gone further than protecting the goodwill of the business he had sold.[41]

18 The cases above illustrate that for the non-compete covenant to be valid, the protection against competition must be a means to a legitimate end and *not an end in itself*. A covenant which merely protects the purchaser from competition will not be enforceable. A clear illustration of this principle is seen in the Privy Council case of *Vancouver Malt and Sake Brewing Company v Vancouver Breweries*[42] ("*Vancouver Malt*"). There, a sake brewer contracted with a beer brewer not to undertake the business of brewing beer for 15 years for £15,000. The Privy Council held that this restraint was void, since this was simply a contract not to compete for a sum of money.[43] The protection against competition in that case was not the means to any legitimate end, but an end in itself.

39 [2010] 2 SLR 386.

40 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [51].

41 *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386 at [55]–[57].

42 [1934] AC 181

43 *Vancouver Malt and Sake Brewing Company v Vancouver Breweries* [1934] AC 181 at 192.

19 In relation to the reasonableness of the restraint's geographical scope, the courts in *Nordenfelt*[44] and *Systems Reliability Holdings*[45] have upheld worldwide restraints in cases where the business that was sold and its clientele were genuinely international in nature. However, where the business that was sold has been carried on exclusively in one country, it would not be reasonable to extend the geographical scope of the non-compete to other countries.[46]

20 In relation to the reasonableness of the restraint's duration, the courts have taken the view that commercial parties negotiating at arm's length are the best judges of what is reasonable between them.[47] In *Allied Dunbar (Frank Weisinger) Ltd v Weisinger*,[48] Millet J highlighted that parties can regulate the proportionality of the restraint by adjusting the consideration payable. Thus, the courts have been slow to strike down a restraint for being unreasonable in duration if it was negotiated by parties dealing at arm's length. Non-compete covenants of between three and four years in duration[49] have been upheld and in the seminal case of *Nordenfelt*,[50] the House of Lords upheld a 25-year non-compete covenant. In this connection, Wright J's treatment of the covenantor's argument that a non-compete

44 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] 1 AC 535 at 549 and 559.

45 *Systems Reliability Holdings Plc v Smith* [1990] 1 IRLR 377 at [56].

46 *Goldsoll v Goldman* [1915] 1 Ch 292 at 297.

47 *Reed Exhibitions Pte Ltd v Khoo Yak Chuan Thomas* [1995] 3 SLR(R) 383 at [16].

48 [1988] IRLR 60 at [32].

49 In *One Step (Support) Ltd v Morris-Garner* [2015] IRLR 215 and *CLAAS Medical Centre Pte Ltd v Ng Boon Ching* [2010] 2 SLR 386, a three year non-compete was upheld. In *Emersub XXXVI Inc v Wheatley* (14 July 1988, Queen's Bench Division, unreported), a four year non-compete covenant was upheld. These cases all involved the sale of a business.

50 In *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co* [1894] 1 AC 535, a Swedish machine-gun manufacturer who had customers from most parts of the then developed world sold his machine-gun manufacturing business, its goodwill, and all its stock, plant and patents to another weapons manufacturer for the significant amount of £287,000 in cash and shares (which is worth approximately £36.6m, or S$64.5m, in today's terms).

covenant was unreasonably long arguably typifies the court's approach to such contentions:[51]

> [A] line of attack by [the covenantor's counsel] is the argument that the period of four years restriction is unreasonably long ... The term of four years was not imposed by the covenantees upon the [covenantor]; it was a negotiated figure ... *To quote Lord Macnaghten in [the]* Nordenfelt *case again, the parties are the best judges of the reasonableness as between themselves of the terms they had negotiated, and the court should only interfere if it is convinced that the bargain they have in fact concluded is an unreasonable one* ... [emphasis added]

IV. Franchise agreements

21 Franchising is a business model seen across many industries. Well-known franchises include McDonalds, Marriott International, 7-Eleven, Anytime Fitness, and Modern Montessori International. The franchise model enables franchisees to tap the know-how and brand name of an established business and enables franchisors to expand their distribution network with less capital and in less time. However, a franchisor having shared its know-how and use of its brand name often becomes vulnerable to competition by its former franchisees. Thus, franchisors often require their franchisees to undertake not to compete with them for a limited duration of time in the areas where they had operations.

22 While there appear to be no reported cases on the enforceability of restraint of trade covenants against franchisees in Singapore, this has been considered in several English cases. The English courts have characterised a franchise as a lease of goodwill with an obligation on the franchisee to return this goodwill in whatever state it is in when the lease expires[52] and

51 *Emersub XXXVI Inc v Wheatley* (14 July 1988, Queen's Bench Division, unreported).

52 *Kall-Kwik Printing (UK) Ltd v Rush* [1996] FSR 114 at 119, cited with approval in *Dyno-Rod plc v Reeve* [1999] FSR 148 at 153; *Carewatch Care Services Ltd v Focus Caring Services* [2014] EWHC 2313 (Ch) at [127].

recognised that the franchisor has a legitimate interest in protecting the goodwill to its business that was generated during the course of the franchisee's operations.[53] As explained by Dyson LJ in *ChipsAway International v Kerr* ("*ChipsAway*"):[54]

> [D]uring the term of a franchise, goodwill is built up in the franchise territory with the use of a franchisor's name and branding. Such goodwill is a potentially valuable asset in the hands of the franchisee so long as he continues to trade in the franchise territory, and in the hands of a franchisor at the termination of the franchise agreement. A franchisor's interest in that goodwill is vulnerable to competition from a former franchisee who has knowledge of the area and experience of dealing with particular groups of customers. *The commercial purpose of a post-termination covenant against competition is to prevent the franchisee for a period of time from continuing and competing in his former territory in the same line of business so as to enable the franchisor to exploit the goodwill that he has built up during the term, most obviously by recruiting another franchisee for the same area* ... [emphasis added]

23 Thus, English courts have upheld non-compete covenants which prohibited former franchisees from becoming involved in any business that competes with the franchisor's business in the areas where the former franchisee used to operate.[55] The fact that the franchisor does not appoint a new franchisee in the territory where the former franchisee used to operate does not render the restraint to be unreasonable.[56] This is consistent with the principle that the court will assesses the reasonableness of the restraint at the time it was entered into and not after.[57]

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53 *Dyno-Rod plc v Reeve* [1999] FSR 148 at 156–157; *ChipsAway International v Kerr* [2009] EWCA Civ 320 at [22].

54 *ChipsAway International v Kerr* [2009] EWCA Civ 320 at [22].

55 *Peart Stevenson Associates Ltd v Holland* [2008] EWHC 1868 (QB) at [43]–[44]; *Carewatch Care Services Ltd v Focus Caring Services* [2014] EWHC 2313 (Ch) at [136].

56 *Peart Stevenson Associates Ltd v Holland* [2008] EWHC 1868 (QB) at [44]–[45]; *Pirtek (UK) Ltd v Joinplace Ltd* [2010] EWHC 1641 (Ch) at [74].

57 *ChipsAway International v Kerr* [2009] EWCA Civ 320 at [24].

24 In assessing whether the restraint is reasonable as between parties, English courts have similarly considered the scope of the activities restrained, the geographical scope and the temporal duration of the restraint.[58] In relation to the reasonableness of the geographical scope, the courts have found that if the restraint extends outside of the territory where the ex-franchisee used to operate, this would be unreasonably wide. The following cases illustrate.

25 In *Kall-Kwik Printing (UK) Ltd v Rush* ("*Kall-Kwik*"), the franchisor was in the business of running print and copy centres. In the franchise agreement, the franchisee undertook not to become involved in any competing business within a ten-mile radius of its premises or *any other franchisee's premises* for two years after the termination of the agreement. The High Court found that it was unreasonable for the non-compete covenant to prohibit the franchisee from carrying on a competing business anywhere within a ten-mile radius of *other* franchisees' premises.[59] The High Court severed this portion of the non-compete covenant and upheld the remainder.

26 In *Convenience Co Ltd v Roberts*[60] ("*Convenience Co*"), the franchisor was a supplier of portable lavatories. To expand its business, it granted franchises. In its franchise agreement, the franchisee undertook not to become involved in any competing business for one year after the termination of the agreement. The non-compete covenant did not contain any geographical limit. However, given the contractual context, the High Court construed this to be limited to the UK. Nonetheless, the court held that this was too wide, since it encompassed territories which the franchisees did not operate in.[61]

58 See, for example, *Dyno-Rod plc v Reeve* [1999] FSR 148 at 154–155 and *Carewatch Care Services Ltd v Focus Caring Services* [2014] EWHC 2313 (Ch) at [130]–[137].

59 *Kall-Kwik Printing (UK) Ltd v Rush* [1996] FSR 114 at 120.

60 [2001] FSR 35.

61 *Convenience Co Ltd v Roberts* [2001] FSR 35 at [12].

27 In relation to the reasonableness of the restraint's duration, the English courts have not laid down any hard and fast rules. Given the similarities in the legitimate proprietary interests of a purchaser of a business and that of a franchisor, the courts are likely to regard a franchisor and franchisee negotiating at arm's length to be the best judges of what is reasonable and be slow to strike down a restraint for being unreasonable in duration. In this regard, non-compete covenants of one or two years in duration have been upheld by the English courts against franchisees.[62]

V. Joint venture agreements

28 Unlike the sale of businesses where goodwill is sold to the purchaser, or franchises where there is a lease of goodwill to the franchisee, investors do not acquire any goodwill upon the entry into a joint venture agreement. Where a company is incorporated for a joint venture, that company does not possess any goodwill of its own upon incorporation or in its infancy since it has yet to commence business. However, this did not stop the English Court of Appeal in *Dawnay, Day & Co Ltd v D'Alphen*[63] ("*Dawnay Day*") from recognising that a shareholder of a joint venture company has a legitimate interest in the success of the joint venture and it is permissible to restrain other shareholders from undermining this by competing against the joint venture company.

29 In *Dawnay Day*, the covenantee and the covenantors, who were experienced Eurobond brokers, entered into a shareholders' agreement to set up a jointly owned company to carry on the business of Eurobond brokering and the covenantee provided £650,000 in start-up capital. The covenantors were also employed by the joint venture company and appointed as its

62 In *Dyno-Rod plc v Reeve* [1999] FSR 148 at 154 and *Peart Stevenson Associates Ltd v Holland* [2008] EWHC 1868 (QB) at [46], a one-year non-compete covenant was upheld. In *Kall-Kwik Printing (UK) Ltd v Rush* [1996] FSR 114 at 124, a two-year non-compete covenant was upheld.

63 [1998] ICR 1068.

directors. Under the shareholders' agreement, the covenantors undertook not to get involved in any business which competed with the business of the joint venture company as carried on from time to time by the company or solicit its customers for two years after the date of the agreement and for one year after the covenantor ceased to be an employee or director of the joint venture company.[64] The covenantors left the joint venture company to join a competitor before the expiry of their restraints, and the covenantee sued. The covenantors argued, *inter alia*, that the covenantee had no legitimate interest in enforcing the restraints as it did not own any goodwill, since that belonged to the joint venture company which was not a party to the shareholders' agreement.[65] The Court of Appeal disagreed and held that the restraints were enforceable. In Evan LJ's judgment (which the other members of the court agreed with):[66]

> Each party depended on the other's proposed contribution for the development of the business which they set out jointly to create. *[The covenantee's] undertaking to make the capital contribution, and certainly the contribution after it was made, gave [the covenantee] a clear commercial interest in safeguarding itself against competition from the [covenantors] individually or collectively, for the agreed periods … In my judgment, the judge was correct to describe it as an interest 'of a proprietary nature'… [that] is entitled to protection, where and to the extent that protection is reasonably necessary … I would also be prepared to say more generally that [the covenantee] had a clear commercial interest in the success of the joint venture, by reason of its contribution to it, and that whether or not the interest can be classified as proprietary or quasi-proprietary, [the covenantee] is entitled to claim protection for that interest in the form of the covenants which it now seeks to enforce …* [emphasis added]

64 *Dawnay, Day & Co Ltd v D'Alphen* [1998] ICR 1068 at 1099F–1100A. The three covenantors also entered into employment contracts with the joint venture company, but these did not contain a non-compete covenant, only a non-solicitation covenant: at 1100C.

65 *Dawnay, Day & Co Ltd v D'Alphen* [1998] ICR 1068 at 1108B-C.

66 *Dawnay, Day & Co Ltd v D'Alphen* [1998] ICR 1068 at 1111E.

30 A similar conclusion on the enforceability of restraint of trade covenants against shareholders of a joint venture company was reached by the Singapore International Commercial Court in *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd*[67] ("*DyStar*"). The court recognised that a joint venture company had a legitimate interest in protecting its business and goodwill from being undermined by competition from one of its shareholders, and it is permissible to restrain such conduct through non-compete and non-solicitation covenants.[68]

31 In *Dystar*, two listed dye manufacturers from India and China entered into a joint venture. The Chinese manufacturer, through one of its subsidiaries (the "Chinese Subsidiary"), invested in the joint venture company through the subscription of a €22m zero-coupon convertible bond issued by the joint venture company.[69] Under a "share subscription and shareholders agreement" (the "Shareholders' Agreement"), the Indian manufacturer undertook to the joint venture company and the Chinese Subsidiary not to carry on any business in any country where the joint venture company and its associated companies carried on business for so long as it was a shareholder of the joint venture company and for 12 months after it ceased to be a shareholder. It also undertook not to solicit any of the joint venture company's customers, or "identified prospective customers".[70] About two and a half years after entering into the Shareholders' Agreement, the joint venture company turned profitable, and the Chinese manufacturer converted all debt under the convertible bond into equity, making it the majority shareholder of the company.[71] From then on, the relationship between the joint venture parties soured and litigation followed.

67 [2018] 5 SLR 1.

68 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [293].

69 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [20].

70 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [286].

71 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [33]–[34].

The Indian manufacturer claimed minority oppression while the joint venture company counterclaimed, *inter alia*, that the Indian manufacturer had breached its non-compete and non-solicitation covenants.

32 Kannan Ramesh J (delivering the judgment of the court) stated:[72]

> [A] shareholders' agreement is more akin to the commercial sale of a business, rather than an employment contract. *Each shareholder is buying into the goodwill of the joint venture which may be depreciated unless either shareholder is restrained from competing with the joint venture business* ... [emphasis added]

33 The court found that the non-compete and non-solicitation covenants protected a legitimate proprietary interest, *viz*, the joint venture company's business and goodwill,[73] and were enforceable.[74] In relation to the reasonableness of the covenant's duration, the court in *Dawnay Day* took the view espoused in sale of business cases that parties negotiating at arm's length are the best judges of what is reasonable, and it would be slow to strike down a covenant for being unreasonable in duration.[75] In this regard, restraints that operated for one year after the covenantor ceased to be a shareholder were upheld by the courts in *Dawnay Day* and *Dystar*.

VI. Conclusion

34 The enforcement of reasonable restraint of trade covenants in the sale of business, franchise and joint venture agreements is justified as they facilitate the underlying

72 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [292].

73 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR at [293] and [305].

74 *DyStar Global Holdings (Singapore) Pte Ltd v Kiri Industries Ltd* [2018] 5 SLR 1 at [304] and [313]. While an appeal was lodged to the Singapore Court of Appeal (see *Senda International Capital Ltd v Kiri Industries* [2019] 2 SLR 1), this finding was not challenged.

75 *Dawnay, Day & Co Ltd v D'Alphen* [1998] ICR 1068 at 1109G.

commercial transaction and incentivise trade instead of stifling it. While the courts have taken a less restrictive approach in assessing such covenants in commercial agreements as compared to employment contracts, and acknowledged that parties dealing at arm's length are the best judges of what is reasonable, some of the cases cited above (*Goldsoll*, *CLAAS Medical*, *Vancouver Malt*, *Kall-Kwik*, *Convenience Co* and *Harcus Sinclair v Your Lawyers LLP*[76]) make clear that the courts will not enforce covenants that do not protect a legitimate proprietary interest or go beyond what is reasonably necessary to protect that interest. With covenantees bearing the burden of demonstrating that a restraint of trade covenant protects a legitimate proprietary interest and is reasonable between parties, it is crucial for covenantees to be made aware of the reasonable and enforceable limits of such covenants.

76 [2019] EWCA Civ 335