



# Restrictive covenants, use of land and the restraint of trade doctrine

David Capper

Queen's University Belfast  
Correspondence email: [d.capper@qub.ac.uk](mailto:d.capper@qub.ac.uk)

## ABSTRACT

The common law doctrine of restraint of trade has a well-established presence in relation to contracts of employment and contracts for the sale of a business. Beyond those specific areas it reared its head from time to time, but the legal test for its applicability was not a model of clarity. Where the covenantor ceded a pre-existing freedom to engage in commercial activity, the decision of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 brought it within the doctrine, but the recent decision of the Supreme Court in *Peninsula Securities Ltd v Dunnes Stores (Bangor) Ltd* [2020] UKSC 36, on appeal from the Northern Ireland Court of Appeal [2018] NICA 7, has discarded that test in favour of one based on the structure of a trading society. *Peninsula Securities* was a case concerned with the applicability of the restraint of trade doctrine to covenants affecting the ability of a landowner and its successors in title to use the land in a way that potentially competed with the business of an adjoining occupier. The decision that the restraint of trade doctrine was not engaged in these circumstances was set against the power of the Lands Tribunal to modify or extinguish covenants affecting land under article 5 of the Property (NI) Order 1978.

**Keywords:** restraint of trade; pre-existing freedom; structure of trading society; use of land.

## INTRODUCTION

*Peninsula Securities Ltd v Dunnes Stores (Bangor) Ltd*<sup>1</sup> was a case first heard in the High Court in Northern Ireland and eventually decided by the Supreme Court of the United Kingdom in August 2020. In its decision, the Supreme Court invoked the 1966 Practice Direction of the House of Lords<sup>2</sup> to overrule the 1967 decision of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*<sup>3</sup> on a point of law concerned with the common law doctrine of restraint of trade. With the exception of the *Ashers Bakery* case,<sup>4</sup> there has been

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1 [2020] UKSC 36, [2020] 3 WLR 521.

2 [1966] 1 WLR 1234.

3 [1968] AC 269.

4 [2018] UKSC 49, [2020] AC 413.

no other purely private law case from Northern Ireland determined by the Supreme Court since its opening in late 2009, and *Ashers* might not fit everyone's definition of a private law case in any event. Comment on this decision in this journal is clearly called for.

## FACTS

In 1979, Patrick Shortall, a developer, purchased 5.5 acres of land in Springtown, Londonderry, with a view to developing it as a retail shopping unit. In February 1981, Mr Shortall leased 1.05 acres of this land to Dunnes Stores as the anchor tenant of this development. The shopping centre when built contained a Dunnes supermarket and a number of smaller retail units along a mall leading to the entrance of the Dunnes store. Dunnes paid for the construction of the supermarket and contributed to the cost of the car park. The lease contained a covenant on the part of Mr Shortall that no development on his remaining land would contain a unit in size measuring 3,000 sq ft or more for the purpose of trading in textiles, provisions or groceries. Dunnes paid a premium of £50,000 and a nominal yearly rent of £100 for the lease. Dunnes insisted on the covenant being included in the lease because it wanted to insulate itself against competition from other retailers. The evidence was clear that without this covenant Dunnes would not have agreed to open any retail unit on this site. Without its participation the shopping centre in this part of Northern Ireland, described by Mr Shortall as an economic and political wasteland at that time, would not have been viable.

In 1983, Mr Shortall transferred his interest in the lands subject to the restrictive covenant and the land leased to Dunnes to Peninsula Securities Ltd, a property holding company in which he owns 99 of the 100 shares, the other being owned by his wife. This company was the plaintiff in the case that proceeded to the Supreme Court, with Dunnes Stores being the defendant.

In 2002 the plaintiff obtained planning permission to build a new shopping centre on the land subject to the restrictive covenant. That shopping centre was completed in 2006 and included one or more units exceeding 3,000 sq ft which the plaintiff wished to lease for the purpose of trading in textiles, provisions or groceries. There proved to be considerable difficulty attracting tenants to this development, according to Mr Shortall because of the restrictive covenant. At the time of the proceedings in this case it was largely vacant.

## CASE HISTORY – NORTHERN IRELAND COURTS

The plaintiff made a reference to the Lands Tribunal under article 4 of the Property (NI) Order 1978 seeking a declaration that the covenant represented an impediment to the enjoyment of its land and an order pursuant to article 5 of the 1978 Order that the covenant be modified or extinguished.<sup>5</sup> The plaintiff also challenged the covenant as being in unreasonable restraint of trade at common law but, accepting that the Lands Tribunal had no jurisdiction to adjudicate that claim, instituted proceedings in the High Court for a declaration that the covenant was unenforceable on that ground. A further claim that the covenant was void under section 2 of the Competition Act 1998 was initially added but subsequently withdrawn on receipt of the defendants' evidence on that issue. The High Court proceedings continued as a challenge to the covenant as being in unreasonable restraint of trade at common law, with the Property Order proceedings kept in reserve should this challenge fail.

At each stage of the proceedings in the courts the outcome turned on the effect given to the decision of the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd*.<sup>6</sup> That case concerned a petrol filling station solus agreement where the owner or tenant of a filling station essentially covenanted only to purchase petrol from one specific supplier of petroleum products, the other party to the solus agreement. The House of Lords held that because the purchaser of petroleum products gave up a pre-existing freedom to purchase petroleum products from other suppliers the covenant was subject to the restraint of trade doctrine. The covenant's enforceability depended on whether it was reasonable between the parties and not contrary to the public interest. There were two covenants in that case, one lasting for five years and the other for 21 years. The first of these was held to be reasonable as between the parties and not contrary to the public interest, but the second was declared unenforceable as in unreasonable restraint of trade. Lord Wilberforce, although concurring in the result of the case, took a different approach to the question of whether the restraint of trade doctrine was engaged. He held that this did not depend on whether the party restrained gave up a pre-existing freedom but on whether the covenant was of a kind that had gained sufficient acceptance to become part of the structure of a trading society.<sup>7</sup> Lord

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5 A similar procedure, involving now a reference to the Upper Tribunal, exists in England and Wales under s 84 of the Law of Property Act 1925.

6 [1968] AC 269.

7 He held that it had not become part of the structure of a trading society because solus agreements had not been in use long enough, even though evidence revealed that about 35,000 of the 36,000 filling stations in Britain were subject to solus agreements.

Wilberforce's approach was the preferred approach of the Supreme Court as will be discussed below.

At the outset of her consideration of the issues in this case, McBride J held that the *Eссо* case was of general application to all instances where a party to a contract alleged to be in restraint of trade gave up a pre-existing freedom.<sup>8</sup> She rejected a submission from counsel for Dunnes Stores that it was confined to solus agreements, and it is submitted that the judge's ruling on this point was good law.<sup>9</sup> McBride J distilled three principles relating to the extent and application of the restraint of trade doctrine to covenants affecting the use of land.

First, it applies to all persons who give up a pre-existing freedom when they enter into a restrictive covenant.

Second, the doctrine does not apply to lessees or purchasers of land who accept a restrictive covenant governing what use they may make of the land. These persons give up no pre-existing freedom. On the contrary they acquire ownership or possession of land subject to whatever terms are agreed between the parties.

Finally, the doctrine does not extend to successors in title either to the original covenantor or covenantee as they give up no pre-existing freedom of land use.<sup>10</sup>

At first instance, the decision turned on the third principle above. Mr Shortall had transferred his interest in the lands subject to the restrictive covenant to the plaintiff company more than two years after demising land to Dunnes Stores. The plaintiff company was thus a successor in title to Mr Shortall, and in accordance with the third principle above the restraint of trade doctrine offered no escape from the obligation not to allow a retail outlet rival to Dunnes Stores to open on the adjoining land. The case was different from *Alec Lobb (Garages) Ltd v Total Oil (Great Britain) Ltd*<sup>11</sup> where the solus and lease and lease-back agreements were all part of the one transaction. It had not been suggested that the case was appropriate for 'piercing the corporate veil'.<sup>12</sup> In the judge's view to allow a successor in title to challenge a restrictive covenant as an unreasonable restraint of trade from the time of the original conveyance of land would cause havoc in the conveyancing world.<sup>13</sup> The covenant could be challenged but only under the Property (NI) Order 1978.<sup>14</sup>

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8 [2017] NIQB 59, [50].

9 Ibid. The Court of Appeal also rejected this argument at [2018] NICA 7 at [42].

10 Ibid [52].

11 [1985] 1 WLR 173 (CA).

12 On this see the recent Supreme Court decisions in *Vedanta Resources plc v Lungowe* [2019] UKSC 20 and *Okpabi v Royal Dutch Shell plc* [2021] UKSC 3.

13 [2017] NIQB 59 [67]–[68].

14 Ibid.

The Court of Appeal allowed an appeal from McBride J's judgment, holding that the interests of the public protected by the restraint of trade doctrine did not change after the transfer of Mr Shortall's interest in the lands in question to the plaintiff.<sup>15</sup> The restraint of trade doctrine was engaged, and the case was remitted to the High Court to consider the reasonableness of the restraint as between the parties to the covenant and in the wider public interest.

### THE SUPREME COURT

The Supreme Court allowed an appeal from the Court of Appeal but on grounds very different from those of McBride J. The Supreme Court rejected the *Esso Petroleum Co Ltd v Harpers Garage* test of giving up a pre-existing freedom and accepted Lord Wilberforce's structure of a trading society test. Applying this approach the covenant here satisfied the trading society test and the restraint of trade doctrine was not engaged. It was therefore unnecessary to express a view on the question of whether the doctrine applied to successors in title of the covenantor. The continued applicability of the covenant would depend upon the decision of the Lands Tribunal.

Lord Wilson (with whom Lord Lloyd-Jones, Lady Arden and Lord Kitchin agreed) gave the principal judgment of the Supreme Court. The pre-existing freedom test was found to be most unsatisfactory. It did not explain how petrol filling station solus agreements fell within restraint of trade restrictions but tied public houses did not.<sup>16</sup> In terms of public policy, it did not explain what was objectionable about restraints involving pre-existing freedoms when other restraints did not engage the doctrine.<sup>17</sup> The test had been discarded in Canada and Australia.<sup>18</sup> The trading society test was much better, and applying it produced the conclusion that this covenant was sufficiently integrated into the structure of a trading society that it survived restraint of trade challenge.<sup>19</sup> Lord Wilson was aware that this covenant could potentially affect this land for a very long time but was fortified in his conclusion that the common law did not apply by the existence of the Property Order procedure.<sup>20</sup>

Lord Carnwath drew attention to the capricious results produced by the pre-existing freedom test applying to the grantor of an interest

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15 [2018] NICA 7 [45] (Stephens LJ).

16 [2020] UKSC 36 [29].

17 Ibid [44].

18 Ibid [49]–[50].

19 Ibid [51].

20 Ibid [54]–[57].

in land but not the grantee.<sup>21</sup> He pointed out how restraint of trade conflicted with freedom of contract and the need for clear articulation of the public policy reasons for not giving effect to a freely entered into bargain.<sup>22</sup> This particular transaction was not in essence an agreement between traders, more a transaction in land, and would only affect trade to the extent that it interfered with the right of future occupiers to trade in textiles, provisions or groceries.<sup>23</sup> The ability of Dunnes Stores to offer contract terms to Mr Shortall that included restrictions on competition certainly facilitated trade in that without those terms Dunnes would have walked away from any participation in the development.<sup>24</sup> Lord Carnwath was clearly also of the view that the Property Order procedure was a better way of regulating the use of this covenant because it could better consider how circumstances change over time.

### COMMENT<sup>25</sup>

The common law restraint of trade doctrine requires the court to address the following questions.

First, is the restraint upon the freedom of a contracting party to engage in trade one which itself engages the restraint of trade doctrine? Every contract restricts trade to a degree because, if A contracts to sell certain property to B, A is restrained from selling the same property to C or D. If X is working for Y, then X is likely to be restrained from simultaneously working for Z. If the doctrine is not engaged, ie this is not a restraint that comes within the doctrine at all, questions 2 and 3 do not arise.

Second, if the doctrine is engaged, then the party seeking to restrain the other party's freedom to trade must have a legitimate interest that it is trying to protect otherwise the restrictive covenant will be unenforceable.

Third, the restraint imposed pursuant to that legitimate interest must be no more than is reasonably necessary for the protection of that interest.

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21 Ibid [59]. This drew heavily upon Robert Megarry QC's submissions to the House of Lords in *Esso Petroleum Co Ltd v Harper's Garage (Stourport) Ltd* [1968] AC 269 at 289–290.

22 Ibid [61].

23 Ibid [63].

24 Ibid [65].

25 The outline of the basic framework of the common law doctrine of restraint of trade below draws heavily upon and acknowledges the immense assistance derived from Professor Stephen Smith's essay on the subject. See Stephen A Smith, 'Reconstructing restraint of trade' (1995) 15 *Oxford Journal of Legal Studies* 565.

The doctrine is not about the fairness of the bargain between the parties. The offer of a sum of money the size of a lottery jackpot in consideration of the covenantor never working in competition with the covenantee may well be substantively fair between the parties because it relieves the party restrained from the need ever to work again. But it would be in restraint of trade because it deprives the community at large of the benefit of the restrained party's talents and skills. What the covenantee provides by way of consideration for the covenantor's restraint may inform the court's answer to questions 2 and 3 above. Smith provides the example of the petrol filling station solus agreement where the filling station proprietor agrees not to sell any other supplier's petrol during the currency of the agreement. Smith points out that in return for the restrictive covenant the petroleum supplier will likely be providing loans to the proprietor, guaranteed petrol, reduced prices, help in setting up the station and other things.<sup>26</sup> What the covenantee provides describes the investment it is making and trying to protect. This goes towards identifying the legitimate interest and the reasonableness of the measures adopted to protect it. Indeed, it has been observed that the questions whether the restraint of trade doctrine is engaged and the legitimacy of any restraint imposed involve considerable overlap.<sup>27</sup>

As Lord Carnwath pointed out in *Peninsula*,<sup>28</sup> restraint of trade is an interference with the parties' freedom of contract. It requires justification in any particular case. By far the most common case type where the doctrine is invoked is the contract of employment (or a contract similar to employment) which contains a covenant restricting a departing employee's right to work for a competitor for a period of time and over a geographical area. It is established law that protecting the employer from competition by its former employee is not a legitimate interest capable of justifying restraint.<sup>29</sup> A case type often contrasted with employment restraints is the sale of a business. The purchaser will probably require as a condition of the sale that the seller undertakes not to continue to trade with the business's existing customers because of the likelihood that this would make the purchaser's business a failure from the outset. This restraint on competition is legitimate because it facilitates the sale as few purchasers would agree to the sale without it.<sup>30</sup> Lord Macnaghten explained this approach in terms of 'The homely

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26 Ibid 589.

27 *Proactive Sports Management Ltd v Rooney* [2011] EWCA Civ 1444, [2012] FSR 16 [59] (Arden LJ) and [156] (Gross LJ).

28 [2020] UKSC 36 [61].

29 *Mason v Provident Clothing and Supply Co Ltd* [1913] AC 724 (HL); *Herbert Morris Ltd v Saxelby* [1916] AC 688 (HL).

30 *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535 (HL).

proverb current in [this] part of the country which says you may not “sell the cow and sup the milk”.<sup>31</sup> It is not entirely clear whether this means restraint of trade is not engaged or that the restraint is very likely to be reasonable.<sup>32</sup>

Covenants to which the restraint of trade doctrine applies are not confined to the above two case categories. Those that do not fall into those categories would engage the doctrine if they fell foul of the structure of a trading society test. Examples of this kind of potentially unenforceable covenant include *McEllistrim v Ballymacelligott Co-Operative Agricultural and Dairy Society Ltd*,<sup>33</sup> *Dickson v Pharmaceutical Society of Great Britain*,<sup>34</sup> *A Schroeder Music Publishing Co Ltd v Macaulay*<sup>35</sup> and *Proactive Sports Management Ltd v Rooney*.<sup>36</sup> However, it may be wise, as the Court of Appeal has recently cautioned, not to think of trading society as the only test to be applied for engagement of the restraint of trade doctrine.<sup>37</sup> A novel agreement would not be one that easily found acceptance within the structure of a trading society, so something more like a broad and flexible rule of reason might be preferable.<sup>38</sup> The inevitable lack of precision in this test gives to the courts considerable discretion in regulating market transactions. One could perhaps question the constitutional legitimacy of the courts’ role in this area. But the bottom line is that the statutory test of unlawful competition under section 2 of the Competition Act 1998 grounding both a Competition and Markets Authority investigation and a civil action on the part of a party affected by the agreement is also broad and malleable. The same may also be said of the Sherman Anti-trust Act 1890 in the USA. Legislatures have not been able to construct detailed and specific criteria for regulating these contracts, and courts have been making these heavily policy-based

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31 Ibid 572.

32 *Bridge v Deacons* [1984] AC 705 (PC) 713–714 (Lord Fraser).

33 [1919] AC 548 (HL). The case concerned restrictions on a member of an agricultural cooperative society selling his milk to a creamery outside the society. See David Foxton, ‘McEllistrim v Ballymacelligott Co-operative Agricultural and Dairy Society Ltd: in retrospect’ (2019) 62 *Irish Jurist* 150.

34 [1970] AC 403 (HL). In this case an ultimately unsuccessful attempt was made to change the rules of the Pharmaceutical Society to prevent pharmacists from selling non-pharmaceutical goods.

35 [1974] 1 WLR 1308 (HL). This case was about an agency contract between a young musician and a publishing company that did not permit the musician to terminate the contract and try selling his compositions elsewhere.

36 [2011] EWCA Civ 1444, [2012] FSR 16. This case was about an image rights representation agreement that secured quite handsome benefits for both parties but was considered to be too long (eight years).

37 *Quantum Actuarial LLP v Quantum Advisory Ltd* [2021] EWCA Civ 227.

38 Ibid [73]–[75] (Carr LJ).

judgments for a very long time, so the argument from constitutional legitimacy is unlikely to gain much traction. Mary Catherine Lucey has even defended the common law doctrine on the basis that its ability to develop case by case enables it to reach anti-competitive arrangements that the less flexible statutory regime may miss.<sup>39</sup>

None of the above means that the presence of a statutory regime is immaterial to the courts' decision whether or not to subject a restrictive covenant to scrutiny under the common law restraint of trade doctrine. In *Peninsula* the restrictive covenant undoubtedly 'sealed the deal' between Mr Shortall and Dunnes Stores at the inception of the shopping-centre development in this case. Whether it was past its 'sell by' date 40 years on might be quite a difficult question. But the prospect that it might remain binding on the land adjacent to the land leased to Dunnes Stores for 999 years is pretty mind-boggling.<sup>40</sup> This took the case beyond the sale of business category to which it shared some similarities. However, the restriction on the use of land for centuries beyond the passing of all the parties involved in this case was the true issue and was much better left to the Lands Tribunal to resolve. The question for it will be not whether the covenant was in restraint of trade in 1980 or 2020, but whether the covenant unreasonably impedes the enjoyment of the land going forward.

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39 Mary Catherine Lucey, 'Restraint of trade doctrine: a traditional tool fit for the modern economy?' in Robert Merkin and James Devenney (eds), *Essays in Memory of Professor Jill Poole* (Routledge 2019) 164.

40 Aidan Robertson QC, 'The common law doctrine of restraint of trade – will it rise up again unshackled by Brexit and reformed by the Supreme Court?' (2021) 42(2) *European Competition Law Review* 62.