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Discussion Meet  
on  
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Restraint On Trade

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"It is unfortunate that Section 27 of the Indian Contract Act has been moulded upon the New York Draft Code and consequently trenches upon the liberty of the individual in contractual matters affecting trade."<sup>1</sup>

The above observation made as early as 1930 is much more true to-day in the present economic condition of the country when one remembers that the said provision represents the mid 19th century law. In 1930, one could say that India was not an industrially and commercially advanced country but a backward agricultural country. That is not the case to-day when we are well set on industrialising the country at a rapid pace, but unfortunately the legal provisions continue as they were about a century ago. In the early days it would have been correct to observe that "trade was in its infancy and the legislature may have wished to make the smallest number of exceptions to the rule against contracts whereby trade may be restrained."<sup>2</sup>

Sir Frederic Pollock observed"....The Contract Act unfortunately copies the wilfully narrowed version of Common Law rule as understood more than half a century ago from the draft Civil Code of New York."<sup>3</sup>

The history of the law in relation to restraint of trade under the Common Law of England may be considered at this stage. According to the earliest cases,

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1. I.L.R. 53 Allahabad 316 at 322 Bholanath Shankar v. Lachmi Narain & others.
  2. Oakes & Co. v. Jackson (1876) 1 Mad. 134.135.
  3. Pollocks Principles of Contract -12th Edn.  
P.331-332.

"to prohibit or restrain any person to use a lawful trade at any time or place" had been held to be "against benefit of Commonwealth."<sup>4</sup> It was soon realised that such a contract may not be against the Commonwealth and that the Commonwealth would not suffer if a man who sold the goodwill of a business bound himself not to enter into immediate competition with the buyer. Thus it was held that "a man cannot bind one that he shall not use his trade generally but for a time certain, and in a place certain, a man may well bound and restrained from using of his trade."<sup>5</sup> Thus it was clear that contracts in general restraint of trade were invalid but the contract in partial restraint, if reasonable and not contrary to public interest would be upheld.

With technological advances and developments in the communication system the theory of partial restraint confined to any particular locality could not hold water. It was true to say in the early days "what does it signify to a tradesman in London, what another does at New castle."<sup>6</sup> But in the present conditions it would be apparent that it matters very much to a merchant at one place say London not only what another does in New Castle but in any part of the Globe. In recent times we have seen the fluctuations in the gold price throughout the world and this could be an instructive example.

Trade with all its modern development provided a challenge to the Common Law and in fact as Sir Frederic Pollock rightly said "this class of cases presents a singular example of the Common Law, without aid from legislation and without any manifest discontinuity, having practically reversed its older doctrine in difference to the changed conditions of society and the requirements of modern commerce."<sup>7</sup>

The foundation of the modern doctrine in England is the decision of the House of Lords in Nordenfeldt v. Maxim Nordenfeldt Guns and Ammunition Co.<sup>8</sup> Where Lord Macnaghten observes "All interferences with individual

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4. Golgate v. Bachelor (1596) Cro.Elix.872.
  5. Rogers v. Parry (1613) Bulst. 136.
  6. Mitchel v. Reynolds (1711) 1 Peere Wrms 181 at 191.
  7. Pollock's Principles of Contract 12th Edn.p.319
  8. 1894 A.C. 535.

liberty of action in trading, and all restraint of trade of themselves, if there is nothing more, are contrary to themselves, if there is nothing more, are contrary to public policy and therefore void. That is the general rule. But there are exceptions: restraints of trade .... may be justified by the special circumstances of a particular case. It is a sufficient justification, if the restriction is reasonable-reasonable, that is, in reference to the interests of the parties concerned and reasonable in reference to the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public."<sup>1</sup>

Thus the present state of the English Common Law may be briefly stated as follows:

1. Every restraint whether partial or general would be contrary to public policy and would PRIMA FACIE be void.
2. The presumption of initial invalidity could be rebutted by proof that the restraint is reasonable.
3. The restraint must be reasonable not only in the interest of both the contracting parties but also in the interest of the public.
4. The restraint must not afford to the covenantee more than adequate protection.
5. The burden of proof that the covenant is reasonable would initially lie upon the covenantee and it is thereafter for the covenantor to prove that the contract, if enforced, would tend to injure the public good.

The agreements or covenants in restraint of trade might arise in any one or more of the following circumstances.

i) Agreements by persons selling the goodwill of a business agreeing to carry on a similar business which would compete with the business that was sold. Such restraint would be upheld if it is reasonable.<sup>1</sup> Of course, if the restraint affords more than adequate protection, it would be unreasonable and hence would be void.<sup>2</sup>

1. 9. Nordenfeldt. v. Maxim Nordenfeldt Guns & Ammunition Manufacturing Co. 1894 A.C. 535.
2. 12. Vancouver Malt & Sake Brewing Co. Ltd. v. Vancouver Breweries Limited. 1934 A.C. 181.

ii) Agreements imposing on one of the parties restriction in the exercise of his profession or trade after the determination of partnership, apprenticeship or service. In such case there would be greater freedom than the sellers of the business with goodwill and unless the restraint is absolutely necessary to protect the interests of the erstwhile Master, employer or Partner, such agreement will not be held to be reasonable. Consequently such restraints would be void.<sup>3</sup>

3. Mason v. Provident Clothing Co. 1913 A.C. 724

An agreement not to engage in a similar business by a salesman was held to be unreasonable.

Herbert Morris Ltd. v. Saxelby 1916 1 A.C. 688

A restraint on Manager held to be unreasonable.

Commercial Plastics Ltd. v. Vincent 1964 3

A.E.R. 546-Worldwide restriction on an employee in relation to manufacture held to be unreasonable.

Gledhow Autoparts Ltd. v. Delaney 1965 3 All E.R.

288-Restraint on a travelling salesman - held to be unreasonable.

Bull v. Pitney Bowers Ltd. and others. 1966 3 All

E.R. 384 - Condition that the pension of a retired employee would be stopped if he was engaged in a similar business was held to be unreasonable.

On the other hand in Ronbar Enterprises Ltd. v. Green 1954 2 All E.R. 266, the restraint upon a retiring partner was held to be reasonable.

Scorer v. Seymour Johns 1966 3 All E.R. 347 - An agreement not to carry on a similar work within a particular radius was held to be reasonable.

Fitch v. Dewes 1921 2 A.C. 158 - Restriction on the Managing Clerk of a solicitor held to be reasonable.

Forster & Sons Ltd. v. Suggett (1918) 35 T.L.R. 87  
Restraint on a works Manager of glass factory was held to be reasonable.

W. Strange Ltd. v. Mann 1965 1 All E.R. 1069 - Restraint on manager not to carry on similar business within 12 miles held to be reasonable.

Macfarlane & others v. Kent 1965 2 All E.R. 376 - Partnership deed providing restrictions on practice of partners after determination of partnership was held to be reasonable.

iii) Agreements by which a certain group of persons undertake among themselves to regulate prices of commodities or the mode of carrying on their business. If such a contract read as a whole appears on the face of it not to be unreasonable in the interest either of the parties or of the public, then only, it would be valid. Otherwise it would be void. An agreement in relation to retention and transfer system in respect of professional players had been held to be unreasonable.<sup>4</sup> Again refusing a trainer's license on the ground of sex was held to be unreasonable.<sup>5</sup> Resolution that the members should confine their business within certain limits was held to be unreasonable.<sup>6</sup>

iv) Agreements by which certain wholesalers enter into contracts with the retailer to the effect that they should not deal in the products of a competitor viz. agreements like the Solus agreements. These agreements will not be excluded from the ambit of reasonableness in relation to restraint of trade merely because there is restriction imposed in relation to land or that the agreement was by way of a covenant in a mortgage of land. The solus agreements are therefore within the mischief of the reasonableness rule and in determining reasonableness the length of the period for which each agreement was to last would be taken into consideration.<sup>7</sup>

v) Agreements by which a number of workmen agree only to work on certain terms and strike work if called upon to do so by a majority. In such cases if an attempt is made to enforce the agreement which contains a covenant to strike or to work in a particular manner, it is a good defence to take that the rules of the particular trade union are such that its performance would have been unlawful in Common Law as being in restraint of trade.<sup>8</sup>

vi) Agreements by which the employers bind themselves to give employment or employ persons on certain terms and conditions. Unless such contracts are absolutely necessary for the protection of the

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4. Eastham v. New Castle United Football Club & Ors. 1963 3 All E.R. 139.

5. Nagle v. Feildon & Ors. 1966 1 All E.R. 689.

6. Dickson v. The Pharmaceutical Society of Great Britain 1966 3 All E.R. 404.

7. Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd. 1967 1 All E.R. 699.

8. Gozney v. British Trade & Provident Society 1909 1 K.B. 901 *Russel v. Amalgamated Society of Carpenters* 1910 K.B. 506 1912 A.C. 421.

trade, they will be held to be unreasonable and consequently would be held void.<sup>9</sup>

Thus it would be quite clear that whatever may be the type of restraint, the enforceability of the same depends purely on the reasonableness of otherwise of the same.

In America, where we have Anti-Trust and Anti-Cartel Laws and where business houses of gigantic proportions are in a position to swallow the new competitors, the position of the restraint clauses are again viewed in relation to reasonableness of the same.

In Great Atlantic And Pacific Tea Company v. Cream of Wheat Company(10) the conditions published by the defendant stated that they could refuse to sell to consumers, retailers or chain or departmental stores who fail to comply with any request made by the manufacturer. The defendant requested that the retail prices be kept at the prices indicated by it and this request taken in conjunction with the right to stop selling would amount to a monopoly. Held that such a provision was not unreasonable and that the plaintiff could not get rid of those provisions in the contract.

In Mentor Company v. Brock ET AL(11) it was held that the provision that the defendant who was an employee should not compete with the business of the plaintiff after determination of the employment was held to be unreasonable and that the restraint could not be enforced.

In Standard Oil Company of California v. United States(13), a suit brought by the United States under the Anti Trust Laws, the District Court held that the Oil Company and its wholly owned subsidiary could not enforce or enter into exclusive supply contracts with independent dealers in petroleum products and automobile accessories and this decision was affirmed by the Supreme Court of the United States.

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9. Kores Manufacturing Co.Ltd. v. Kolok Manufacturing Co. Ltd. 1958 2 W.L.R. 566.  
10.244 Fed.566.  
11.118 N.W. 20.  
12.337 U.S. 293.

In *Dr. Miles Medical Company v. John D. Park & Sons Co.*<sup>13</sup> the manufacturer of proprietary medicines entered into a restrictive agreement with a restriction limiting trade in the agreement to those who maintain the prices. The defendant was a wholesale drug concern which had refused to enter into the required contract and was charged with procuring medicines at cut prices by inducing those who had made contracts with the manufacturers and to violate the restrictions. The validity of this restriction was questioned and it was held that the restrictions sought to be enforced were invalid both at Common Law and under the Sherman Anti Trust Act.

Let us examine the position in Indian Law. In India, as pointed out earlier we are governed by section 27 of the Indian Contract Act, 1872 copied from the draft Code of New York. Under the section any agreement by which anyone is restrained from exercising a lawful profession, trade or any kind of business is void and the exception is that a person who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business within specified local limits so long as the buyer or any other person deriving title to the goodwill carries on a like business and provided the limits appear to the court to be reasonable regard being had to the nature of the business. Thus the Indian Contract Act follows the antique theory that partial and reasonable restraint can only be valid. There are also other exceptions in the Indian Partnership Act which deal with the sale or transfer of a goodwill of a business.

Further with reference to agreements by Trade Union Members, Section 19 of the Indian Trade Unions, Act 1926 provides as follows:

"Notwithstanding anything contained in any other law for the time being in force, an agreement between the members of a registered Trade Union shall not be void or voidable merely by reason of the fact that any of the objects of the agreement are in restraint of trade:

Provided that nothing in this section shall enable any Civil Court to entertain any legal proceedings instituted for the express purpose of enforcing or recovering damages for the breach of any agreement concerning the conditions on which

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13. 220, U.S. 373.

any members of a Trade Union shall or shall not sell their goods, transact business, work, employed or be employed."

Barring these exceptional cases, any restrictive agreement so far as Indian Law would be absolutely void. The state of the Law would be incongruous particularly when ours is a developing economy. The law should move with the times and if the law does not provide the necessary rules for the changing times, it would cease to serve the community and its own purpose. Further as could be appreciated the object and purpose of the law of Contracts would be to uphold the sanctity of Contracts negotiated by parties at arms' length, subject to the condition that the contract would be void if it is against the interest of the public.

In our country, we have various manufacturers who have entered into collaboration agreements with overseas manufacturers. It is felt that most of our collaboration agreements have not achieved the expected results by reason of the antique laws. It would appear that the foreign collaborators while giving the technical know how give us only details which had since become outmoded in their respective countries. One of the reasons could well be that if the latest details are given, legally there would not be protection to them in the event of the technical know how being utilised otherwise.

Again in a developing industrial country certain secret formula might be given to the employees for the manufacturer of a particular type of product and under law restrictive covenants not to engage themselves in similar activity after determination of their employment would be void. With the result the employee can get out of the organisation and start a competitive business with the help of the research made by the previous employers and for the previous employers unless they are protected by patent laws, there would be no protection. Further for the subsequent manufacturer, the costs would be very much cheaper than the person who had made the research.

Again various organisations, companies and particularly governments spend large sums of money on the training of proper personnel to man the various projects. In fact more often large foreign exchange resources are spent on such persons. While so a contract with restrictive covenants is being



entered into and the legal validity of such agreements are yet to be tested in Courts of Law with particular reference to section 27 of the Indian Contract Act, and under the existing law, such an agreement would be void.

The rigour of section 27 may be sought to be mitigated by the Courts in applying the law and even so there are limits for the judicial creativity in the presence of the status. The Supreme Court of India in *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Company Ltd.*<sup>13</sup> (has held that an agreement by an employee with the employer to the effect that the employee during his service period would not engage in trade or business or would not get himself employed by any other master for whom he would perform similar or substantially similar duties was not in restraint of trade and that such an agreement would not be hit by section 27 of the Indian Contract Act. It may not be out of place here to refer to section 42 of the Specific Relief Act 1963 which empowers the Court to enforce a negative covenant express or implied, even though the positive covenant cannot be enforced.

The Madras High Court has held in *Tiruvenkada Moopanar & another v. Subbiah Moopanar*<sup>14</sup> that an agreement by a grower of betel vine to sell the betel leaves grown by him only to the plaintiff and to none else was **not a restraint of trade** within the mischief of section 27. On the other hand the Calcutta High Court has held *Shaik Kallu v. Ramsaran Bhagat*<sup>15</sup> that an agreement to sell the comba manufactured by a person to another only would be one prohibited by section 27 of the Indian Act.

The above discussion would show that the present section 27 is grossly inadequate to meet the situations in relation to restraints that could be imposed on an employee or apprentice involving restraint on the exercise of profession, trade or employment. Further restraints imposed on agreements like solus agreements cannot be dealt with.

It is therefore desirable that in order to mitigate the hardship and to adapt the law to the needs of the present social conditions, suitable amendment should be introduced to section 27. Such amendments should naturally be in conformity with the provisions of Art. 19(1) g and 19(6) in so far as the State may make a

13. A.I.R. 1967 S.C. 1098.

14. 1967 1 M.L.J. 117.

15. 13 C.W.N. 388.

law imposing in the interests of the general public reasonable restriction on the right to practice any profession or to carry on any occupation, trade or business, or monopolies in favour of the State or any Corporation owned or controlled by the State.

The 'reasonableness' rule could be adopted for the purpose which would give adequate powers in the armoury of the judiciary to give necessary relief according to the circumstances of each case.

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