The Place of Reasonableness in the Restraint of Trade: Just How Much does India Depart from the Common Law?

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Abstract

The popular interpretation of section 27 of the Indian Contract Act, 1872, is that all restraints of trade, howsoever reasonable are void. However, this paper contends that a closer examination of the Indian law indicates otherwise. The Supreme Court jurisprudence is largely inconclusive, and replete with obiter observations on the issue. The drafters' intent argument is largely unpersuasive, given the evolution of the common law, and so is the text of the provision itself. In fact, based on a theoretical understanding of the concept of restraint, it appears that reasonableness cannot possibly be excluded from the framework of analysis, and is an essential aspect of the provision. Thus, the discussion reveals that the long-standing belief that the Indian law on the restraint of trade departs from the common law, is based on rather weak foundations, and deserves to be reconsidered.

I. Introduction

One of the unquestioned premises of Indian contract law is that reasonableness is not a factor to be considered in determining the validity of contracts in restraint of trade. A look at the two leading commentaries on Indian contract law is sufficient to establish this. One commentator observes, "This section (section 27 of the Indian Contract Act) does not say that only unreasonable restraint of trade is void and reasonable restraint of trade is valid".[1] In the opinion of Pollock and Mulla, "In the Indian law, a service covenant extending beyond the term of service is void, whereas in similar cases, the English law would allow restraint which is reasonable".[2] The difference is understood to be that reasonable post-contractual restraints are valid under common law, while all post-contractual restraints are void under section 27 of the Indian Contract Act, 1872 ["Contract Act"].[3] According to this theory, there are

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1 P.C. Markanda, The Law of Contract 586 (Balakrishnan K.G. ed., 2006).

2 Mulla's Indian Contract Act 816 (Bhadbhade N. ed., 12th edn., 2001).

3 S. 27 reads:

"(1) Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Exception 1: Saving of agreement not to carry on business of which good-will is sold. One who sells the good- will 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 person deriving title to the good-will from him, carries on a like business therein, provided that such limits appear to the Court reasonable, regard being had to the nature of the business."

only two accepted exceptions to this rule - the first in the explanation to section 27, which relates to non-compete agreements accompanying a sale of goodwill. The second exception is a judicial creation in *Gujarat Bottling*,[4] where the Court held that some contractual arrangements (like franchise agreements), though restrictive in nature, actually act in 'advancement of trade', and are not hit by section 27.[5]

As the Madras High Court observed in 1876, the object of the section was to protect trade in India, which was then in its infancy.[6] Changes in circumstances since then have led to widespread criticism of the provision[7] and recommendations for its amendment.[8] However, as the provision remains in the form in which it was first drafted,[9] the prevailing assumption today is that section 27 precludes an inquiry into the reasonableness of contractual restraints.[10]

In this paper, I challenge that assumption, on the basis that the supposed statutory departure from common law has been misunderstood, and the Supreme Court decisions on the issue have been misinterpreted. In other words, it is the thesis of this paper that the common law on restraint of trade is not rendered inapplicable by section 27. Given the commercial necessity of incorporating a reasonableness inquiry,[11] and the possibility of doing so even in the current statutory framework, this paper argues that reasonableness can and should occupy a central role in the restraint of trade jurisprudence in India.

II. The Judicial Interpretation of Section 27

Section 27 has been considered by the Indian Supreme Court in four leading cases. To document the misinterpretation of these four cases, and decipher their actual contribution to the Indian law, I begin by examining these cases in turn.

The issue first arose in 1967, in *Niranjan Shankar Golikari*,[12] the *locus classicus* on the subject. It is important to note that the focus of this decision was whether

4 *Gujarat Bottling v. Coca Cola Company*, AIR 1995 SC 2372.

5 I will subsequently discuss how this second 'exception' in fact demonstrates that reasonableness cannot be excluded from the scope of section 27.

6 *Oakes & Co. v. Jackson*, (1876) 1 Mad 134.

7 *Per* Sen J., "... Section 27 ... seriously trenches upon the liberty of the individual in contractual matters affecting trade." *Bholanath Shankar Das v. Lachmi Narain*, AIR 1931 All 83, 85. Also *see* Mulla's Indian Contract Act 816 (Bhadbhade N. ed., 12th edn., 2001).

8 13th Report, Law Commission of India, 1958, para 55.

9 The provision was based on Section 833 of Field's Draft Code for New York, which, ironically, was never applied in New York.

10 Cases which have been cited as authority for this proposition include- *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co.*, AIR 1967 SC 1098; *Superintendence Co. v. Krishan Murgai*, AIR 1980 SC 1717; *Gujarat Bottling v. Coca Cola Company*, AIR 1995 SC 2372; and *Percept D'Mark v. Zaheer Khan*, (2006) 4 SCC 227.

11 13th Report, Law Commission of India, 1958, para 55.

12 *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co.*, AIR 1967 SC 1098 [Hereinafter, "Golikari"].

section 27 applies only to post-contractual restraints, or even to restraints during the subsistence of the contract. In answering this question, the Court held:[13]

> "considerations against restrictive covenants are different in cases where the restriction is to apply during the period after the termination of the contract than those in cases where it is to operate during the period of the contract. Negative covenants operative during the period of the contract of employment when the employee is bound to serve his employer exclusively are generally not regarded as restraint of trade and therefore do not fall under section 27 of the Contract Act."

On this basis, the Court held that the contractual restraints under consideration did not fall foul of section 27, since they acted only during the subsistence of the contract. The decision was silent on when post-contractual restraints are valid, restricting itself to the statement that they are to be treated differently from restraints during the contract. Thus, this decision creates no bar to the reasonableness inquiry under section 27.

The issue was next considered in 1980 in *Krishan Murgai*.[14] Given the role this case plays in subsequent Indian jurisprudence on restraint of trade, it merits a more detailed examination. The employing company carried on business as valuers and surveyors and had established a reputation and earned goodwill in its business by developing its own techniques for quality testing and control. It possessed trade secrets in the form of these techniques and its clientele. The terms and conditions of employment contained a post-service restraint preventing the employee from serving any competitive firm, or carrying on a business himself in the same line as that of the appellant company. His employment was terminated, after which the employee started his own business, which was in competition with that of the employer. The employer sought a permanent injunction against the employee to prevent breach of the terms of the employment, and claimed damages. Thus, the issue before the Court was two-fold- (a) whether the contract was in restraint of trade and hence invalid; and (b) whether the non-compete clause applied only when the employee left voluntarily, or also when his services were terminated. Of the three judges on the Bench,[15] two clearly stated:[16]

> "Since in our view the appeal is capable of being disposed of on the second point we think it unnecessary to decide or express our opinion on the first question which was hotly and ably debated at the bar by

13 *Golikari*, para. 20.
14 *Superintendence Co v. Krishan Murgai*, AIR 1980 SC 1717 [Hereinafter, "Murgai"].
15 The bench comprised of Tulzapurkar, Untwalia and Sen, JJ.
16 *Murgai*, para. 5.

> counsel on either side but we will indicate briefly the rival lines on which the arguments proceeded."

After considering the arguments canvassed by both counsel, the Court proceeded to decide that the term 'leave', as used in the terms and conditions, envisaged only voluntary departure, and not termination. On this basis, the Court held that the injunction could not be granted, and left the appropriate interpretation of section 27 undecided. However, the third judge on the Bench, Justice Sen, chose to discuss the issue in detail, and held that section 27 bars all post-contractual restraints, and does not permit the 'reasonableness' inquiry.[17] While I will return to examine this opinion on merits subsequently, this discussion suffices to establish that the analysis of section 27 was *obiter*. Admittedly, *obiter* observations may be given the force of precedent if relied on and affirmed by subsequent judicial dicta. However, as the following analysis of the subsequent cases reveals, the Supreme Court has consciously refrained from approving these *obiter* observations of Justice Sen.

The third case in this series is *Gujarat Bottling*.[18] At issue was the validity of vertical franchise agreements, and whether they could be considered to be in restraint of trade. The Court proceeded to examine English and Indian jurisprudence, and concluded;[19]

> "We do not propose to go into the question whether reasonableness of restraint is outside the purview of Section 27 of the Contract Act and for the purpose of the present case we will proceed on the basis that an enquiry into reasonableness of the restraint is not envisaged by Section 27."

Thus, the Court chose not to answer the question, proceeding instead on the assumption that section 27 did not permit a reasonableness inquiry. It is unclear whether such an assumption by the Court can be considered to be law laid down by it. The binding value of the assumption would depend on the reason for which it is making the said assumption. If the reason is that the Court believes that the law is settled and that debates would be merely academic, then it may be considered as affirming earlier precedents. However, if it is making the assumption because other circumstances render the question moot, it is not taking a stance on the issue at all, leaving it to be decided on a later date when more appropriate. The above extract does not provide an answer as to which of these was the reason for the assumption. However, reading further, it emerges that the reason was the latter- the question did not need to be decided, since "the said negative stipulation operates only during

17 *Murgai*, para. 11 onwards.

18 *Gujarat Bottling v. Coca Cola Company*, AIR 1995 SC 2372 [Hereinafter "Gujarat Bottling"].

19 *Gujarat Bottling*, para. 24

the period the agreement is in operation".[20] Further, the Court observes,[21]

> "Since the negative stipulation in ... the 1993 Agreement is confined in its application to the period of subsistence of the agreement and the restriction imposed therein is operative only during the period the 1993 Agreement is subsisting, the said stipulation cannot be held to be in restraint of trade so as to attract the bar of Section 27 of the Contract Act."

Thus, since the judges made the assumption because the question did not need to be answered, the assumption cannot be taken to be their opinion on what the appropriate interpretation of section 27 is. This clearly establishes that the *ratio* of the decision was just an application of the decision in *Niranjan Shankar Golikari* and did not involve any interpretation of the post-contractual effect of section 27. It is also instructive to note that inspite of Justice Sen's opinion in *Murgai* being before it, the Court chose not to comment on it at all, deciding the issue on the facts instead. In fact, if at all any positive conclusion can be drawn from the case, it is to the contrary - the Court's reliance on English jurisprudence and some other observations suggest that they leaned towards a broader interpretation of section 27.

The final decision to be analysed is the 2006 decision in *Zaheer Khan*.[22] In this case, the former managing agent of a cricketer had asked the Court for an interlocutory injunction restraining the player from entering into a contract with another agent. The clause in the contract which the prior agent relied on was challenged by Zaheer Khan, claiming that it was in restraint of trade. The counsel for the agency argued that the Court had to depart from Justice Sen's dictum in *Murgai*, pointing out that it was at odds with the decision of the majority.[23] On this basis, it was contended that reasonableness should find a place in section 27. While the Court observed that there seemed insufficient force in this argument, the case was decided primarily on the basis that accepting the argument would require altering a position of law that had been "uniformly and consistently followed"[24] for the last 132 years,[25] and that "such an exercise ought not to be undertaken in the present interlocutory proceedings".[26] Again, in commenting on the decision of the Bombay High Court which was being appealed against before it, the Court stated, "there can be no

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20 *Gujarat Bottling*, para. 34.

21 *Gujarat Bottling*, para. 37.

22 *Percept D'Mark v. Zaheer Khan*, (2006) 4 SCC 227 [Hereinafter, "Zaheer Khan"]

23 *Zaheer Khan*, para. 17.

24 *Zaheer Khan*, para. 31.

25 The 1874 decision in *Madhub Chunder v. Rajcoomar Doss*, [1874] 14 Beng. L.R. 76, referred to by the Court, shall be discussed subsequently.

26 *Zaheer Khan*, para. 31.

manner of doubt that the Division Bench (of the Bombay High Court) was right in coming to the prima facie conclusion drawn by it".[27] This leads to the conclusion that the Court did not hold that reasonableness cannot find a place in section 27, but only that such an inquiry was inapposite in an interlocutory proceeding. This is also affirmed by the fact that, like in *Gujarat Bottling*, the Court consciously refrained from affirming Justice Sen's opinion in *Krishan Murgai*.

This study reveals that the question of a reasonableness enquiry under s. 27 is very much an open one. It is therefore necessary to consider whether the provision can permit a reasonableness inquiry on its language, which I do in the next section.

III. The Text of Section 27

Apart from the binding nature of judicial precedent, the two principal lines of argument against the use of reasonableness under the section are that the drafters intended to depart from common law; and that even if they did not, the language of the provision cannot allow a Court to consider reasonableness. I shall now discuss these in turn.

A. The Legislative Intent Argument

The most persuasive argument for the text of section 27 precluding an inquiry into reasonableness was made by Justice Sen in *Krishan Murgai*. The logic of his opinion was straightforward, and ironically, based on the common law position. Under common law, an inquiry into the validity of a contractual clause is divided into two levels- (a) Can the clause be considered to be a 'restraint'? (b) If so, is it reasonable and justified in public interest? The text of section 27 mentions only the first of these two inquiries, stating that all contracts in restraint of trade are void. According to the learned judge, this omission of the second limb of inquiry clearly suggests that the section precludes a 'reasonableness' inquiry. In order to buttress his conclusion, he relies on the 1874 decision in *Madhub Chunder v. Rajcoomar Doss*[28] in which Sir Richard Couch observed that the Indian position was narrower than common law. Justice Sen also points out that *Madhub Chaner* was subsequently affirmed on this point in *Shaikh Kalu v. Ram Saran Bhagat*.[29] On this basis, he concludes that reasonableness is irrelevant in India. Since the argument proffered by him is based on common law, and on India's departure from it, it would be instructive to briefly lay out the evolution of the common law on restraint of trade, and then determine the accuracy of Justice Sen's assessment.

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27 *Zaheer Khan*, para. 39.

28 *Madhub Chunder v. Rajcoomar Doss*, [1874] 14 Beng. L.R. 76.

29 *Shaikh Kalu v. Ram Saran Bhagat*, (1909) 13 CWN 388

(1) The Evolution of the Doctrine in Common Law

The origins of the law on restraint of trade in common law can be traced back to more than four centuries ago, when the contracts in restraint of trade were almost always void,[30] or even worse.[31] From this very strong stance against such restrictive contracts, the position was relaxed a century later in *Mitchel v. Reynolds*.[32] In *Mitchel*, the Court distinguished between general and partial restraints, holding that all general restraints were void, but that partial restraints could be validated in certain circumstances. Thus began the watering down of the stance against the restraint of trade. As explained by subsequent decisions, the dictates of law in the late 18th century were that "in all cases of restraint of trade, where nothing more appears, the law presumes it to be bad: and that in order to make it good, it must appear to be confined to a particular place, and upon a consideration moving from the obligee to the obligor".[33] Further, it was agreed that "all general restraints are void, whether by bond, covenant or promise, and though with a consideration; and so are also all particular restraints where there is no consideration".[34]

The next major step towards the dilution of the doctrine was taken at the end of the 19th century. In *Nordenfelt*,[35] the Court did away with this distinction between general and partial restraints and replaced it with the reasonableness inquiry. However, what *Nordenfelt* did was less a reduction in the standards by which restrictive covenants were to be judged, and more a change of the standard itself. In the words of the Court,[36]

> "Whether the cases in which a general covenant can now be supported are to be regarded as exceptions from the rule which I think was long recognised as established, or whether the rule is itself to be treated as inapplicable to the altered conditions which now prevail, is probably a matter of words rather than of substance. The latter is perhaps the sounder view. When once it is admitted that whether the covenant be general or particular the question of its validity is alike determined by the consideration whether it exceeds what is necessary for the protection of the covenantee, the distinction between general and particular restraints ceases to be a distinction in point of law."

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30 *Claygate v. Batchelor*, (1602) Owen 143.

31 Treitel cites the decision in *Dyer's case*, (1414) YB 2 Hen. V, Pasch. Pl. 26; where persons who entered into contracts in restraint of trade were threatened with imprisonment. *See* Treitel G.H., The Law of Contract 498 (Peel E. ed., 2007).

32 *Mithchel v. Reynolds*, 1 P. Wms 181.

33 *Chesman ex Ux' v. Nainby*, 93 E.R. 819 (1726).

34 *Ibid.*

35 *Nordenfelt v. Maxim Nordenfelt Guns and Ammunition Co.*, [1894] A. C. 535 [Hereinafter. "Nordenfelt"]

36 *Nordenfelt*, p. 548.

The Court held that the distinction between general and partial restraints was artificial, and needed to be done away with. In its place, the Court advocated that the reasonableness of a restraint, whether general or partial, should determine its validity. Following this decision, the development of the common law has been even, with different categories of contracts gradually being co-opted under the umbrella of reasonableness. There has also been a gradual widening of the interests which can be protected, with the recognition of 'commercial' interests, wider than the traditional idea of 'proprietary' interests.[37] While the course traversed by the common law in other matters relating to restraint of trade is not material to the issue under consideration here, it is important to note that till 1893, reasonableness was not a line of inquiry under common law. In fact, even in *Nordenfelt*, it was only Lord Machnaghten who whole-heartedly supported the reasonableness inquiry, and it was only two decades later in *Mason v. Provident Clothing and Supply Co.*,[38] that the law was finally crystallized.[39]

(2) A Mistaken Understanding of Common Law

This overview of common law reveals that Justice Sen's opinion, while persuasive, proceeds on a misunderstanding of the context in which section 27 was drafted. While *Madhub Chunder* may have been right in holding that the Indian law was intended to depart from common law, there is nothing to indicate that the departure intended was a departure from the concept of 'reasonableness'. In fact, the intention of the drafters could not have been to preclude reasonableness, for the reason that the reasonableness inquiry only originated *after* the Indian Contract Act came into force. At the time the Contract Act was drafted in 1872, and on the date of the decision in *Madhub Chunder* in 1874, the common law position was governed not by *Nordenfelt* but by *Mitchel*. Though *Nordenfelt* may now be considered "the foundation of the modern on the subject",[40] it was not the law in 1872. It was the distinction between general and partial restraints that section 27 sought to avoid, by treating all restraints, whether general or partial, in a uniform fashion. This is also borne out by *Madhub Chunder*, where the Sir Richard Couch observed,[41]

> "The words 'restraint from exercising a lawful profession, trade or business' do not mean an absolute restriction, and are intended to apply to a partial restriction, a restriction limited to some particular place,

37 Treitel points to the opinion of Lord Wilberforce in *Eastham v. Newcastle United Football Club*, [1963] 3 WLR 574, as the origin of this gradual expansion of the idea of legitimate interests. *See* Treitel G.H., The Law of Contract 503 (Peel E. ed., 2007)

38 *Mason v. Provident Clothing and Supply Co.*, [1913] A.C. 724.

39 Cheshire, Fifoot & Furmston's Law of Contract 520 (Furmston M. ed., 15th edn., 2007).

40 Anson's Law of Contract 321 (Guest A.G. ed., 26th edn., 1986).

41 Since the original judgment is not available, this extract is reproduced from paragraph 29 of Justice Sen's opinion in *Murgai*.

> otherwise the first exception would have been unnecessary. Moreover, in the following Section (Section 28) the legislative authority when it intends to speak of an absolute restraint and not a partial one, has introduced the word 'absolutely'... The use of this word in Section 28 supports the view that in Section 27 it was intended to prevent not merely a total restraint from carrying on trade or business but a partial one. We have nothing to do with the policy of such a law. All we have to do is to take the words of the Contract Act, and put upon them the meaning which they appear plainly to bear."

This extract, and especially the comparison with section 28 clearly shows that the crux of section 27 was the general/partial distinction, and not the preclusion of a reasonableness inquiry. Now, as observed in *Nordenfelt*, there is a significant difference between relying on the distinction between general and partial restraints, and relying on the reasonableness of the restraint. A restraint was valid, not because it was reasonable, but because it was confined to a particular place, and was accepted in return for consideration. Even if we accept that section 27 sought to depart from common law, it was this position under common law that it sought to depart from.

Further, even Sir Richard Couch's opinion that the Indian provision was a departure from common law was not uniformly followed, with several Courts adopting a broader reading of section 27.[42] The decision in *Shaikh Kalu*, cited by Justice Sen,[43] is also not of great persuasive value, given that this issue was tangential to the decision there. After expressing their tentative agreement with Sir Richard Couch, the Court acknowledged the existence of contrary views, and finally proceeded to decide the matter before it under common law principles. The judges justified the application of common law on the basis that, on facts, the decision would remain the same irrespective of whether they applied section 27 or common law, since the restraint in question was unreasonable. However, the examination and ultimate application of common law shows that the position under section 27 was far from settled, which takes away from the 'uniform jurisprudence of 132 years' referred to in *Zaheer Khan*. It also shows that section 27 was not intended to preclude the reasonableness inquiry.

B. Whether 'Reasonableness' Can Be Read Into 'Restraint'

The only question that remains now is whether the language of the section can include the 'reasonableness' line of inquiry. The primary argument against such an inclusion is that the text of the provision does not explicitly use the term 'reasonable'.

42 The two decisions cited by the Court which differ from *Madhub Chunder* were *Carlisles Nephews & Co. v. Ricknauth*, ILR 8 Cal. 809 (1882) and *Mackenzie v. Striramiah*, ILR 13 Mad 472 (1890).

43 *Murgai*, para. 48.

Given the theoretical framework of analysis under common law (which involves the two steps of 'whether restraint' and 'whether reasonable'), reading in 'reasonableness' into the section seems a cumbersome task. However, I submit that there is no bar on reading reasonableness into the idea of restraint, indeed it is only by such reading in that the concept of restraint can be given its true meaning.

In this connection, an argument made by Professor Stephen Smith in his 1995 piece in the Oxford Journal of Legal Studies is particularly useful.[44] He argues that the traditional common law classification of the tests into the two stages of restraint and reasonableness is too rigid, and does not work out in practice. In his opinion, the determination of whether a said contract is a restraint cannot be complete without also looking at the concept of reasonableness. Another leading commentary on contract law observes, "Any attempt to classify the categories of contract that are prima facie void (i.e. contracts which are in restraint of trade) is hazardous in the extreme".[45] The problem Professor Smith identifies is that what qualifies as a restraint cannot be appropriately articulated in vacuum. Any contract necessarily involves a degree of restraint. For instance, even a simple contract for the sale of a good is a restraint on the seller from selling the same goods to another party. All such contracts cannot be inquired into, since a roving reasonableness inquiry into normal contracts would violate fundamental contractual principles. It may be argued that this example is incorrect, since the bar is not on all restraints, but only on restraints of trade. Thus, unless the restraint is on a continuing contractual activity, as opposed to a one-off transaction, it cannot qualify as a restraint of trade. But even if this is accepted, there are several agreements which restrain the ability of a person to carry on trade, but are not considered to be restraints on trade. An ideal example is an employment contract. During the period of employment, the employee cannot work for another employer, which amounts to restraint on a continuing activity, and hence a restraint on trade. However, such an agreement has been held not to be a 'restraint' for the purposes of section 27 in India.[46] Similarly, in exclusive franchise agreements, the franchisee cannot enter into a franchise with another party, which restricts his right to trade, and should amount to a restraint. Again, it has been held to not be a 'restraint' under section 27.[47] This anomaly with proceeding on a broad definition of restraint necessitates the articulation of some basis on which appropriate contracts can be identified for the reasonableness inquiry.

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44 Smith S.A., *Reconstructing Restraint of Trade*, 15(4) OJLS 565 (1995). Also see Smith S.A., *Future Freedom and Freedom of Contract*, 59(2) Mod L Rev 167 (1996).

45 Cheshire, Fifoot & Furmston's Law of Contract 523 (Furmston M. ed., 15th edn., 2007).

46 *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co.*, AIR 1967 SC 1098.

47 *Gujarat Bottling v. Coca Cola Company*, AIR 1995 SC 2372.

To achieve this object, Professor Smith advocates the adoption of a more flexible test targeted to identifying contracts where "one or (preferably) more of three features exist: (a) the obligation is onerous; (b) there was a significant risk of cognitive error in the framing of the obligation; (c) the parties' self-interest was a weak safeguard against unreasonableness".[48] The three features he lists all revolve around the present or potential 'reasonableness' of the said restraint. The second and the third features identify circumstances in which it is possible that one of the parties may have taken on an obligation which is unreasonably onerous, while the first identifies the situation in which the obligation is actually unreasonably onerous. This shows that in determining which restraints are to be examined on grounds on reasonableness, one has to examine the potential reasonableness of the contracts to begin with.

Encouragingly, this fluid interpretation of the law finds support in other academic and judicial opinions. Professor Smith reiterates his view in the latest edition of Atiyah's 'Introduction to the Law of Contract',[49] and also finds implicit support in the latest edition of Treitel's 'The Law of Contract'.[50] Most tellingly, the view also seems to find support from decisions of the House of Lords in *Esso Petroleum*[51] and *Schroeder*.[52] In *Esso Petroleum*, Lord Morris observes,[53]

> "It is said, therefore, that there are classes of cases in which the doctrine does not apply, and attempt is made to define those groups of cases in which alone the doctrine does apply. For my part, I doubt whether it is possible or desirable to record any very rigid classification of groups of cases. Nor do I think that any firm inference can be deduced from the circumstance that in respect of certain groups of cases no one has claimed that the doctrine applies or has sought to invoke it. That might be for the reason that there are some situations in which it would not be thought by anyone that the doctrine could successfully be invoked. In some cases it matters not whether it is said that the doctrine does not apply or whether it is said that a restraint would so obviously pass the test of reasonableness that no one would be disposed even to seek to invoke the doctrine."

48 Smith S.A., *Reconstructing Restraint of Trade*, 15(4) OJLS 565, 595 (1995).

49 "In the end there does not appear to be any difference in kind between the kinds of restraints that are subject to the doctrine and those that are not. Rather, the explanation would appear to be that various kinds of restraints are exempt simply because it is unlikely in practice that they will be found unreasonable." *See* Smith S.A., Atiyah's Introduction to the Law of Contract 221 (6th edn., 2007).

50 This implicit support is found in the observation that it is factors like the inequality of bargaining power that govern the question of whether a said contract is considered to be a 'restraint'. *See* Treitel G.H., The Law of Contract 502 (Peel E. ed., 2007).

51 *Esso Petroleum v. Harper's Garage*, [1968] A.C. 269 [Hereinafter, "Esso Petroleum"]

52 *Schroeder Music Publishing Co. v Macaulay*, [1974] 1 W.L.R. 1308 [Hereinafter, "Schroeder"].

53 *Esso Petroleum*, p. 306.

Further, Lord Wilberforce comments,[54]

> "There will always be certain general categories of contracts as to which it can be said, with some degree of certainty, that the "doctrine" does or does not apply to them. Positively, there are likely to be certain sensitive areas as to which the law will require in every case the test of reasonableness to be passed: such an area has long been and still is that of contracts between employer and employee as regards the period after the employment has ceased. Negatively, and it is this that concerns us here, there will be types of contract as to which the law should be prepared to say with some confidence that they do not enter into the field of restraint of trade at all."

In *Esso Petroleum*, at issue were *solus* agreements entered into between two garages run by the defendants, and the plaintiff oil company. The agreements with the two garages were for different durations, but with substantially similar terms. The House of Lords, applying the common law of restraint of trade to the two agreements, concluded that the difference in the durations distinguished the two agreements. Hence, while the agreement for the shorter duration was valid, the longer one (twenty one years) was unreasonable, and consequently, invalid. Against this backdrop, the extracted opinions reveal two significant points: a major factor in deciding that a particular clause is not a restraint, is the possibility that the clause would anyway be considered reasonable in the final analysis; and that judges use commercial practices, and generalisations across types of contracts, to determine which contracts to examine more closely.

In *Schroeder*, the facts involved an agreement between a song writer and music publishers, the terms of which included an automatic contract renewal clause, and one-sided rights of assignment and termination. In determining the validity of this agreement, Lord Reid (also one of the judges in *Esso Petroleum*) stated,[55]

> "The law with regard to the validity of agreements in restraint of trade was fully considered by this House in *Esso Petroleum Co. Ltd. v. Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, and I do not intend to restate the principles there set out or to add to or modify what I said myself. I think that in a case like the present case two questions must be considered. Are the terms of the agreement so restrictive that either they cannot be justified at all or they must be justified by the party seeking to enforce the agreement? Then, if there is room for justification,

54 *Esso Petroleum*, p. 332.
55 *Schroeder*, p. 1309-10

> has that party proved justification - normally by showing that the restrictions were no more than what was reasonably required to protect his legitimate interests."

This again shows that before the party actually shows 'justification' on facts, the Court considers whether the clause is such that can be justified. Thus, whether the said restraint can be considered reasonable is considered by the Court at the very first stage (Lord Reid). If it is very obviously reasonable, the Court will refuse to entertain the question, and hold that the clause is not even an actual restraint (Lord Morris). In determining whether such reasonableness is possible, or whether the reasonableness is obvious, the Court will look at similar transactions in the commercial world (Lord Wilberforce).

Thus, it is clear that in theory, and also in judicial practice as seen in common law, restraint and reasonableness are not water-tight compartments, and reasonableness is a major factor to be considered in determining whether a said contract is a restraint to begin with. One may question the propriety of relying on common law in arriving at this conclusion. Given that my argument is that common law can be relied on in India, relying on common law to buttress the argument may seem circular. However, that impression would be erroneous, since India marks a departure from common law only with regard to whether reasonableness of a contract can be considered in determining its validity. In determining what is a restraint, the Indian Courts have often relied on common law. Thus, by establishing that the common law concept of restraint is necessarily wedded to the concept of reasonableness, I seek to prove that use of only the term 'restraint' in section 27 also makes reasonableness a necessary line of inquiry.

Further, the clubbing of reasonableness and restraint has also been seen in India. I mentioned above, the decision in *Gujarat Bottling*, as an example of a restrictive covenant on the right to trade which is not considered a restraint of trade. At issue there was the validity of franchise agreements. Rejecting a section 27 challenge to their validity, the Court observed,[56]

> "There is a growing trend to regulate distribution of goods and services through franchise agreements providing for grant of franchise by the franchiser on certain terms and conditions to the franchisee. Such agreements often incorporate a condition that the franchisee shall not deal with competing goods. Such a condition restricting the right of the franchisee to deal with competing goods is for facilitating the distribution of the goods of the franchiser and it cannot be regarded as in restraint of trade."

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56 *Gujarat Bottling*, para. 33.

The Court here recognised that the said contract restricted the right of the franchisee to deal with competing goods. If a simplistic definition of restraint was to be applied, the Court should have invalidated the clause on that basis. However, it was held that this restriction was for 'facilitating the distribution of goods' and 'could not be regarded as in restraint of trade'. With due respect, I do not see the difference between the language adopted by the Court, and a line to the effect that 'the condition restricts the right of the franchisee but is reasonable since it facilitates the distribution of the franchiser's goods'. What weighed strongly in favour of holding that the said contract was not a restraint was the fact that it was reasonable on the facts of the case, and given commercial realities.

The decision in *Zaheer Khan*'s case is also instructive in this respect. One of the clauses in the contract which was challenged granted Zaheer Khan's managing agent the right of first refusal with regard to future contracts. In ordinary circumstances, if two parties make identical offers, the acceptor has the absolute discretion as to which contract to accept. The right of first refusal deprives the acceptor of this right, requiring him to accept the present agent's offer, unless it was lower than some other offer. Applying a wide definition of 'restraint', such a clause is also a restraint since it limits the player's right to contract with whoever he wishes. However, the Court opined,[57]

> "This clause does not per se restrict or prohibit respondent No. 1 to enter into any contract with a third party but at best it provides the appellant with an opportunity to gain from the advertisements the appellant has made in the process of marketing and creation of the image of respondent No. 1 which was gradually built up by the appellant."

This is the same as saying that the restriction is justified given the prior investment of the agent, and hence should not be invalidated under section 27. Just recasting it as a question of restraint as opposed to reasonableness does not take away from the fact that what is being undertaken is essentially a reasonableness inquiry.

Thus, there is nothing in precedent or theory which precludes an examination of reasonableness in determining whether a particular clause is a restraint of trade. To the contrary, there appears to be authority, albeit limited, for such a combined reading of 'reasonableness' and 'restraint'. The scope of section 27 could thus include a combined test of reasonableness and restraint, conditioned of course, by commercial realities and trends, which would render some clauses more suspect than others.

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57 *Zaheer Khan*, para. 43.

IV. Conclusion

Whenever the issue of restraint of trade comes up in the Indian context, the first aspect highlighted is that the Indian position differs from the common law, by precluding a reasonableness inquiry. This view is far from unsubstantiated, finding apparent support in the text of section 27, the supposed intent of the drafters, and the Supreme Court jurisprudence on the issue. However, this paper makes the bold attempt to depart from that view, by examining its three bases of support, and concluding that they are inconclusive at worst, and in fact, can possibly be used as authority for the opposite proposition.

As discussed in the first section of the paper, the Supreme Court's consideration of this question has been far from conclusive. The only opinion which specifically considers the issue, and excludes the reasonableness inquiry from Indian law, is an *obiter* decision in *Murgai*, which has been consciously steered clear of in subsequent cases. While the history of the provision does suggest that India sought to depart from common law, it was not the idea of 'reasonableness' that was to be avoided, primarily because the idea was not in the common law mainstream at the time the Indian Contract Act was drafted. Finally, the mere exclusion of the word 'reasonable' from section 27 is also not conclusive, since a closer look at the evolution of the doctrine in common law clearly shows that the very concept of 'restraint' includes in it the idea of 'reasonableness', making them inseparable. Thus, reading in reasonableness into the very idea of restraint under section 27 is far from unsound, in fact, it is mandated by the very nature of inquiry involved.

The Law Commission of India in its 13th Report, way back in 1958, strongly recommended that section 27 be amended, since the constraints that it imposes on Indian business and contracts is commercially undesirable. More than five decades after that Report, and in the face of a legislative reluctance to accept the Law Commission's recommendation, it appears that an amendment is not the only means to make the Indian position on restraint of trade commercially appropriate, and that the law as it stands, also permits and mandates a 'reasonableness' inquiry.