Advanced Contracts, Tendering and Public Procurement
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Void Agreements – Part 01

Section 23 and Section 27 assumes great significance in understanding contract law in modern times.

Section 27 of the Indian Contract Act clearly states that an agreement in restraint of trade is void. Freedom of trade, be it of an individual or companies, cannot be restricted through any kind of agreement or clauses. If one tries to look at the justification it clearly means that even in 1872 and also after the Constitution of India was adopted, freedom of trade was very paramount as a right both under common law as an equitable right and then as a constitutional right.

Section 27 clearly states that any contract, be it of service or goods, should not restrain the right of individuals to trade with others. Therefore, when two parties come together and make an agreement it should not say that the other party cannot trade with a third person.

In modern times the best clause to understand, appreciate and evaluate Section 27 would be clauses such as non-compete clause. A non-complete clause clearly states that an employee must not work for a competitor or should not establish a competing interest to that of the employer.

These clauses are generally there in most modern-day contracts. It is there in a B2E contract which is called business to employment contract and also exists largely in B2B contracts which are called business to business contracts. We will talk about non-compete clause in a little while. However, you will appreciate that there are other clauses that can be contentious and may attract Section 27 and those clauses could be say a confidentiality clause.

Confidentiality clauses expect that the employee or the other party maintain absolute confidentiality of trade information. So, restraint of trade or restraint of trade information can also be extended. Trade information is also considered as the intellectual property of an industry protected through Patent Act, Copyright Act or Trademark Act or even Industrial Design as the case may be. When contracts are made generally these are trade secrets that could be shared with an employee and he is expected to maintain that information confidentially and not misuse that information either personally or by sharing it with a third party, especially a competitor.

One of the earliest cases in which the Supreme Court of India had to evaluate the actions of an employee in violation of a no-compete clause was Niranjan Shankar Golikari versus Century Spinning and Manufacturing Company. In this case, Niranjan Shankar Golikari was an employee in a textile mill. Textile mills often have to develop a lot of technology either developed in-house or bought from outside so that they can actually deal with market conditions. Niranjan Shankar Golikari was a shift supervisor who was poached by a rival company. The rival company Two Century Spinning Mills was keen to develop business and compete with Century and hence the only way they could do that was to poach some very talented existing employees of Century Spinning and Manufacturing Company.

Poaching in employment is a normal practice. Every new competitor wants to compete but not probably fairly, or by following ethical and legal norms, but by probably entering into some kind of agreement in which they poach talented employees to come and join them by giving them some additional incentive and additional salary. However Niranjan Shankar's contract had a non-compete clause. This clause very clearly expected Niranjan Shankar to be 100 percent loyal to his employer. Because he was a full-time employee, he was supposed to only work for his employer and during this kind of employment not actually serve any other employer or compete with the existing employer. However, Niranjan Shankar decided to apply for leave and he did not mention his reasons for leave. He extended the leave but did not inform his company. His company found out that Niranjan Shankar was actually

negotiating and working for a competitor. In the guise of leave of absence, Niranjan Shankar was working against the interest of his current employer and was establishing competing interest to his current employer.

Century Milling and Manufacturing Company wanted to enforce the non-compete clause. When non-compete clause is aligned with the confidentiality clause, it would clearly mean that Niranjan Shankar had a duty and an obligation not to disclose confidential information with the competitor. If he did so, the economic value that is attached to confidential information can be the damages that Century Spinning and Manufacturing Company could claim from Niranjan Shankar. However, this is difficult to prove and hence, the first kind of remedy that Century Spinning and Manufacturing Company wanted in this case was an injunction. When you read the Specific Relief Act of 1963, injunction is also a remedy for breach of contract. There are three kinds of injunctions that are mentioned under the Specific Relief Act, one of which is a temporary injunction which is granted at a very preliminary stage in the dispute. It is to save salvage, abate any further loss that can be caused to the petitioners. A temporary injunction in this case could refrain Niranjan Shankar from working with the rival which will adversely affect his employer's interest. Century company can also convince the Court that Niranjan Shankar has breached the contract and hence a permanent injunction should be granted against him which means he can never go and join anyone else. The Specific Relief Act also talks about mandatory injunction. Mandatory injunctions are injunctions in which whatever a positive obligation in a contract has to be done. Mandatory injunction is an order of the court to actually perform certain obligations that are due that the Court has recognized as a potential final remedy.

In this case, Niranjan Shankar was found violating his employment terms and conditions. However, Niranjan Shankar unsuccessfully argued that a non-compete clause is not restraint of trade. The court did not admit his argument for the simple reason is that when you are in service as a full-time employee you must show loyalty and fidelity to your own employer. You cannot compete with your existing employer when he's actually compensating you. So, non-compete clauses are enforceable during the term of the contract and it can be enforced against employees who are in service. They are supposed to be loyal to their employers and such kinds of clauses will not be considered as restraint of trade.

At some point of time teachers were also asked not to take extra tuitions because they were full-time employees of the government and hence this extra tuitions were in direct conflict of

interest with their services so you will find such non-compete and confidentiality clauses as a common agreement in most service and employment contract.

In understanding Section 27 another case of significance is Gujarat Bottling Company versus Coca Cola, a Supreme Court judgment of 1995. While we see Niranjan Shankar Golikari as a case of a B2E kind of a contract, the Gujarat Bottling Case is a B2B contract.

The courts have always taken a very strict view of any kind of restraint of trade on an employee. Every employee, individual and citizen has to have the right for gainful employment and the freedom of trade because he cannot show loyalty continuously to an employer. Once he leaves employment it becomes viewed as 'post termination of employment.' During the tenure, any kind of employment restraints have been considered to be reasonable and enforceable. However, can any of these clauses, especially the non-compete clause, operate post the termination of employment?

Post the termination of a contract, the courts have taken a very sympathetic view and a liberal approach in saying that employees have the right to occupation, business and trade which clearly means that he has to earn his own livelihood, if not with the current employer who has already terminated the service the employee should have the freedom to join any competitor, any other person because that is his right to livelihood. Hence, the courts have said that if any clauses operate post the termination of a contract such clauses will be considered as in restraint of trade. If the restraint is unreasonable, then the courts will actually read down that clause and hold the agreement to be void or the clause to be unenforceable. If the restraint is found to be reasonable and unnecessary, then the courts will actually uphold the clause and make it operational.

How much of the restraint is necessary post termination of a contract? The rule that common law developed was called the 'time-space-locality' rule. Can it be said that an employee should refrain from work for 10 years or that he should not work in India or that he should not work in the aviation sector? Here, time is the kind of restriction in the first case, locality in the second and space in the third.

This time-space-locality rule can probably apply in a B2B contract. So, take the Gujarat Bottling versus Coca-cola case which involved a franchisee contract. In India, we do not have any kind of a law on franchisee and hence the Indian contract law applies to such kinds of contracts. Franchisee contracts are common and upcoming in India where there are two parties, a franchiser and a franchisee. What happens in a franchise contract is that an agent or

someone who can actually make goods or represent is appointed. Most of the food chain stores like McDonald's or Nilgiris stores may adopt a franchisee kind of a trade agreement. This is a trade trade licensee agreement where they have a particular model of business where they partner with the franchisee in local areas as they cannot open their own factory outlet or own store everywhere else. The franchisee will represent the trademark. For instance, the franchisee will be the person making KFC in that local area who would get the contract, trademark license agreement and he represents the brand KFC. His employees will be trained to probably make KFC products. KFC will probably have a standard design for that restaurant. Every kind of machinery and raw material would be provided by KFC. Franchisee agreements are seen even in the education sector especially with children's education especially in coaching centers.

This model creates a win-win situation for two parties. However, franchisee agreements can run into rough weather where there can be disputes, disagreements and challenges. Every franchiser has a concern regarding the trade secrets and the operational business and marketing strategies that would be shared with the franchisee. If the franchisee terminates the contract or the contract comes to a conclusion, the franchisee may approach another rival which may adversely affect the franchisers right. Hence, it is quite obvious for the franchisers to have clauses like the non-complete clause or non-solicitation clauses.

Non-solicitation clause means that an exiting partner to a contract will not solicit the other partner's clients, customers, trade, contacts and networks. While non-solicitation clause is reasonable, the challenge lies in operationalizing it post the termination of a contract. Suppose a partner exiting from a food processing business establishes his own business in the food processing industry. Inevitably the customers are likely to be the same even if they have not been solicited.

In Gujarat Bottling versus Coca-cola case, Coca-cola gave a franchise agreement with Gujarat bottling company for three years. Coca-cola shared trade secrets, the recipe of making these drinks, trained those employees, supervised the marketing strategy etc. They were not happy with the quality of Gujarat bottling. Coca-cola served a notice of termination post which Gujarat bottling started negotiating with Pepsi to transfer some of their shares to Pepsi. They did so after the notice of termination was served but not after termination of the contract which is an interim phase.

In this case, the Supreme Court agreed that restraint of trade post-termination can attract Section 27. What happened in this case was a clear breach of trust and that of contractual duties and obligations. An unwarranted hurry was shown by Gujarat bottling where it tried to talk and negotiate to an immediate rival during the term of the contract. Notice of termination means the contract still is going on and one cannot establish competing business during the term of the contract including the notice period of termination.

So, franchisee contracts being B2B contracts, have a lot of valuation, business strengths and strategies and hence in a B2B contract some of these clauses may have validity. Confidentiality clauses, especially in franchise agreements, have been held to be survival clauses. They can survive post the termination of the contract imposing an obligation not to disclose this information to any third party or misuse that information. So, the agreement in restraint of trade is valid and hence, the courts will evaluate the kind of restraint through these clauses. They will decide whether the restraint is necessary and reasonable and if it is not, then the clause or the contract can be held to be void. Section 27 has been invoked in many cases both before the High Courts and the Supreme Court in trying to understand how can contracts be made and what is the rule of acceptability of restraint and what is the voidness that can come when restraint is imposed.