Advanced Contracts, Tendering and Public Procurement
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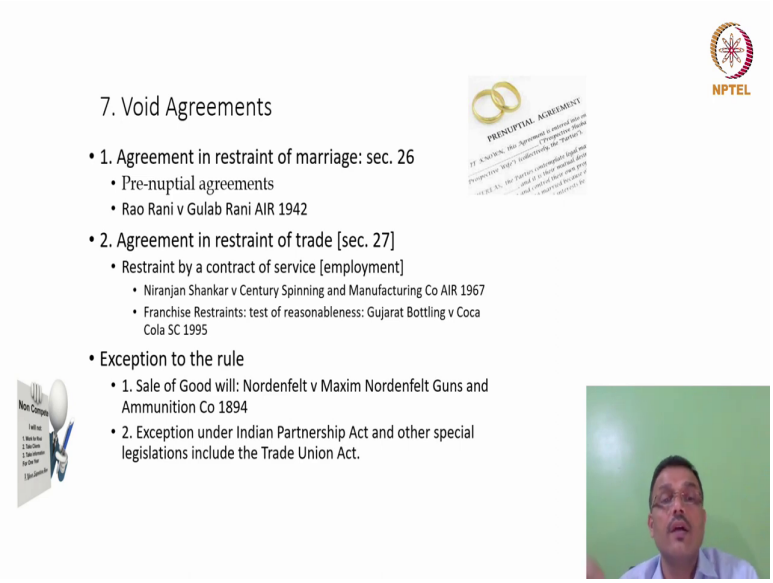
Void Agreements – Part 02



Section 27 has provided for certain exceptions which state that certain kinds of restraints on trade is permissible. The right to freedom of trade under the Constitution of India is not absolute and reasonable restrictions can be imposed on the ground of public order, morality so on and so forth.

If you have sold your business, you can be imposed with a reasonable restraint of trade not to carry out a similar trade or establishing a competing trade because you have not only sold the business but also the goodwill of the business. This is necessary to protect the interest of the new buyer and in those circumstances a non-compete clause can be held to be valid.

In the 1894 case of Nordenfelt versus Maxim Nordenfelt Guns and Ammunitions Company, a gun manufacturer decided to sell his business. He named the business after him. It was acquired by another entity. In this case, the courts said that the non-compete clauses ought to be reasonable. The time-space-locality rule would be a critical element to test the reasonability of a non-compete clause.

There are also statutes that agree that resident of trade is necessary. One of the statutes is the Trade Union Act, where a member of a trade union cannot associate themselves with any other trade union society or movement. So, an agreement in which a trade union member is restrained from joining some other trade union is considered to be reasonable and permissible as per the Trade Union Act and would not be considered as restraint of trade because it is

necessary to protect collective bargaining. If there is a clause that restricts members from taking membership in other unions such kind of restraint restriction is reasonable and will not attract Section 27.

Similarly, under the Partnership Act, restraint can be imposed on an outgoing partner from carrying on a similar business to that of the partnership firm. This seems obvious considering the fact that if an outgoing partner decides to establish a competitive business to the existing one, then the original partnership business will go down. Hence, to protect the interest of the partnership any outgoing partner can be imposed with restrictions which are considered necessary and reasonable.

These instances would not attract Section 27 to hold the contract void. The law on restraint of marriage or restraint of trade is not an absolute kind of rule and exceptions are necessary. In terms of subjectivity, Courts can, on a case-to-case basis, judge whether a restraint is necessary or unreasonable.

In most of these cases, especially in the Nordenfelt case, the courts relied on the Blue Pencil rule. The Blue Pencil rule is the rule of an editor who tries to strike out whatever is unreasonable. An agreement can be allowed to be valid provided some of the objectionable terms, years, conditions is removed by using a Blue Pencil rule. Just like an editor's judgment, the judges can exercise discretion and rule that severing the terms that are in restraint of trade, the remainder of the agreement or the contract can be held to be enforceable.

Section 28 says that agreements in restraint of legal proceedings are void. Section 28 has a lot of significance as it underlies that invoking legal proceeding is the fundamental legal right of every citizen.

Contracts and agreements cannot restrain or restrict such a right of access to legal proceedings as legal proceedings are a matter of public law. If there is any such clause which stops the rights of employees or any other contracting party from approaching the court, from exercising their legal rights and legal proceedings including the remedies that are there for breach of contract, then those kinds of clauses or agreements can be held to be contravening Section 28 and hence can be declared void.

One of the clauses that has been so evaluated is called the Ouster clause. In the United States the Ouster Clause is inserted to state that neither of the parties shall have the right to approach to the courts of law. The jurisdiction of the courts is ousted. In the United States, freedom of contract is kind of absolutely respected if the parties are not in an unequal bargaining position. Courts have held that ouster clause is acceptable if the parties intend the contract to be binding. Therefore, the intention of the parties is very relevant for the contract to be made enforceable. Similarly, if it is expressed that the courts must not exercise any jurisdiction, then the courts will not exercise that jurisdiction because that is what the intention of the parties is. Private parties can determine whether to subject it to the court's jurisdiction or whether they would want to seek other forms of remedies. So, the courts are not going to exercise forceful jurisdiction and in some of the states such a clause has been held to be valid.

Any kind of an ouster clause will be considered as a restraint of legal proceedings in India as section 28 does not allow parties to oust the jurisdiction of the courts. The courts have been bestowed with the inherent jurisdiction to try matters relating to contracts possibly due to the kind of legal system that we have adopted. Freedom of contract in India is definitely not absolute it is not something supreme that shall be respected always. The courts will exercise jurisdiction and hold such Ouster clauses as directly contravening section 28 and this would definitely amount to making an agreement or attempting to restrain the exercise of legal proceedings by the court of law.

In modern day contracts, parties generally decide which law will apply to their contract by exercising freedom of choice and freedom of contract. When the Indian Contract Act 1872 states that it extends throughout the territory of India, it refers to the fact that when a contract is made in the Indian territory, the applicable law would not have to be chosen as Indian Contract Act would e automatically applicable. In this backdrop, it is pertinent to understand what a choice of law clause is. It may come into place when one of the parties to the contract is not in India or the subject matter of the contract is to be executed beyond the territories of India. When international contracts are made, there are three choices: either Indian law can be chosen because one of the parties is India or the law of the country to which other [arty belongs to can be chosen or the law of a third country can be chosen. These are three different possibilities that can exist and hence in such kinds of international contracts the parties have the freedom to choose the law applicable to the contract.

Would choice of law clause amount to restraint of legal proceeding? Indian courts or the Indian legal proceedings will only apply Indian law and would not apply or interpret foreign law or foreign contract. The choice of law will depend upon where the contract will be finally adjudicated in terms of legal proceedings. So, choice of law directly does not attract Section 28. The parties have the freedom to do so and in certain cases this is exercised inevitably in international contracts which is a valid act.

The term restraint under section 28 can take two forms: if the restraint is absolute, giving no choice whatsoever then it will attract section 28 and it will be held to be void. If the restraint is partial, depending upon its necessity and reasonability such kinds of restraints are permissible.

In modern-day contracts, be it government or private, choosing the forum for adjudication of disputes which is referred to in contract management programs as the choice of forum clubs,

can be for the convenience of the parties. For instance, the Life Insurance Corporation of India, makes a contract they may wanted to choose one city court as the forum for adjudication of disputes. They might have a clause which says that the city civil court of Mumbai shall have jurisdiction to try all disputes arising from this contract and this will be uniform across all Life Insurance Corporation of India contracts.

What are the advantages of choosing a forum? Here, what is being said is not that the courts will not have jurisdiction but that the Mumbai court alone should have the jurisdiction to decide disputes. Such an exercise of choice by selecting one city and its court to decide disputes arising from the contract is permissible. However, there are some challenges arising from the Civil Procedure Code and various other legislations by which default jurisdiction over certain disputes is given to the courts within whose jurisdiction those disputes arise. For example, let us take immobile property disputes, the courts in that territory can only exercise jurisdiction over those kinds of disputes because the property is situated there.

If an Indian is entering into a contract with a French company or a French national or with some entity in France, the parties would have three kind of forums to choose from. No French national would accept the jurisdiction of the Indian courts due to inconvenience. Similarly, it is definitely not comfortable for an Indian to accept the French courts as France is still a civil law country and India is a common law country. The courts can either exercise jurisdiction based on the nationality of the parties or it can exercise jurisdiction based on where the cause of action has arisen or where the breaches have occurred.

Thus, the choice of forum is available but only in certain kind of contracts. If there are two Indian parties and the subject matter of the dispute is in India, it could be against public policy for the parties to choose law and forum outside India. This is because it would amount to an ouster of the Indian courts' jurisdiction. In the TDM Infrastructure Limited case, the Supreme Court has observed that choosing law and forum outside India will not be considered in favor of public policy.

Choosing the forum can be a tricky affair if the two parties, say India and France, choose to go to a third country which is a neutral party. However, courts of every jurisdiction are bound to apply the law of that land alone. So, Switzerland cannot be approached to decide the matter in accordance with the Indian contract law or French national contract law. Choice of forum has to be made after considering the nature of the contract and the parties, the legal system to which the forum belongs to and whether there can be a vesting of jurisdiction.

Arbitration is an exception to Section 28. Arbitration is accepted as an alternate dispute forum and is akin to a legal proceeding. It is a process of dispute resolution which is outside the court, by a panel of arbitrators. The number of arbitrators could be 1, 3, 5 or any other odd number.

In modern day contracts an arbitration clause is there as taking a proper legal recourse is quite time consuming. The average time in the Indian court for any commercial disputes ranges between 2 years to 4 years in the trial stage itself. This is a long time for businesses and they cannot afford to lose the opportunity of business, and the opportunity to make profits and money. The courts are already burdened with the number of cases and commercial disputes can actually add to the burden of pending cases before the judiciary. Hence, arbitration is a viable alternate option. Arbitration has already existed in this country right from 1940. Now, there is the Arbitration and Conciliation Act, 1996 which has been amended from time to time.

In an arbitration, the arbitration panel is likely to devote more time which would lead to faster resolution of disputes as it has been constituted exclusively for the contract and the dispute arising therefrom. A specialized arbitrator can also be appointed as commercial or contractual disputes friends need not necessarily be legal disputes and could be related to matters like construction, engineering, design, financial etc. There are many kinds of challenges that arise in contracts and every kind of dispute cannot be decided by a lawyer. Therefore, arbitration provides an option of having a specialized person as the arbitrator. For example, in a dispute that arose between Government of India and Reliance regarding pricing of natural gas, an expert arbitrator who has actually worked in natural gas sector is desirable for ascertaining the price at which it can be sold. considering the extraction-exploration costs and the percentage of profit that needs to be reserved for the company. Even though arbitration does not require advocates, most of the arbitrations are conducted by advocates as the procedures resemble that of a court system.

Because of the recent amendments, arbitration has to be completed within 12 months. The cost of arbitration has also been increasing because of the number of sittings and the time taken. While the law says that the cost of arbitration should be borne by both the parties, there are instances of change of arbitrators whenever they charge an unreasonable fee. Today, arbitration is done mostly through institutional arbitrations, and is not adhoc. The Indian Council of Arbitration is one such institution. The institution constitutes the arbitration panel

and notifies a fixed fee. Hence the cost of arbitration can be reduced if institutional arbitrations are resorted to. If the parties cannot agree on the arbitrator, the courts can help them and appoint the arbitrator as well.

An arbitration clause is a valid exception and will not be considered as a restraint of trade. If there is an arbitration clause in an agreement, the courts cannot intervene and it would be the duty of the court to refer to the matter back to arbitration. Courts have to show restraint and this makes it a viable approach to resolve disputes in an alternate forum in a more efficient manner. Hence, the law helps resolution of disputes in a faster and more meaningful manner.

Amendments have been introduced in the Indian Contract Act which has brought about the challenge of prescriptive clauses. These are clauses that look at the time to exercise the legal proceeding. The right to go to the court has to be invoked within 3 years of the cause of action or within 3 years from when the breach has arisen. Though this is the normal limitation period for general contracts, it can vary for special contracts. For example, in government contracts, the limitation time is 30 years.

This is how the Limitation Act of 1963 applies to what is call as the doctrine of laches or the doctrine of delay. If anyone delays in exercising their right, then courts would not entertain the suit as there ought to be some reasonable time that has to be fixed for parties to exercise their right to go to the court and file cases and suits. It cannot be an unlimited time as it would result in a public legal system disorder. Therefore, the limitation law has to be adhered to. Even in the Consumer Protection Act, the consumer has to approach the concerned forum within two years from the time he comes to know of a defect or deficiency in service. One of the exceptions is that delay in approaching the courts can be condoned according to the discretion of the court. It is usually permitted if the petitioner has suffered some physical or mental injury.

How does prescriptive clause work? In a prescriptive clause, the time within which courts have to be approached is reduced contractually. But this would clearly violate section 28 because it restrains your right to legal proceeding by reducing the time within which you can exercise your right of legal proceeding. A contract cannot reduce a higher time prescription laid down by law, failing which it would be considered as violative of public policy.

However, prescriptive clauses can be resorted to in an alternative scenario. It can be contractually stipulated that any claim should be notified to the other party within a fixed time. This is a common clause in insurance contracts, where, say for instance, it can be laid

down that claim regarding a motor vehicle accident should be submitted within 2-3 months from cause of action. If this claim is not made within the stipulated time period, the insurance company will not be able to verify the claim and the corresponding records.

To bring about efficiency in the contract prescriptive clauses can be used. Clauses which provide that if an employee has any claim over the employer, say, due to some injury at a workplace he must make this claim within three months, failing which claim will be extinguished, are permissible and would not considered in the restraint of legal proceeding. However, the time that is fixed, say, in the insurance case is unilaterally or one-sidedly imposed by the insurance company. This can be tested on the ground of public policy saying is whether it is reasonable or not. This could be something that the IRDA can determine the same and might not warrant court intervention.