



**LEARNING THE LAW-
UNDERSTANDING LAW
OF CONTRACTS**

AGREEMENTS AGAINST PUBLIC POLICY- VOID

PART 2: AGREEMENT IN RESTRAINT OF TRADE- S. 27

ABOUT MYSELF

- ▶ Advocate by Profession.
- ▶ Alumnus of National Law School of India University Bangalore.
- ▶ Former experience as an educator with Career Launcher Pvt. Ltd. and Mahatma Gandhi State Institute of Public Administration, Chandigarh.
- ▶ Hobbies: Hiking, Painting and Teaching.



THIS COURSE WOULD HELP

- ▶ Law students- perusing courses in graduation or post graduation.
- ▶ Any one who wishes to learn/ know about the law.
- ▶ Students preparing for competitive exams such as: UPSC-CSE, STATE-CSE, JUDICIAL SERVICES EXAMINATIONS, CLAT, CA, CS, UGC-NET, LLM Entrance, Bar Council exam, etc.



SOURCES

- ▶ Law of Contract by Dr. Avtar Singh
- ▶ Indian Contract Act by Dr. RK Bangia
- ▶ Case Laws.

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AGREEMENTS VOID ON GROUNDS OF BEING EXPRESSLY AGAINST PUBLIC POLICY

Section 26

- Agreement in restraint of marriage, void

Section 27

- Agreement in restraint of trade, void

Section 28

- Agreement in restraint of legal proceedings void.

Section 29

- Agreements void for uncertainty.

Section 30

- Agreement by way of wager, void.

SECTION 27 OF INDIAN CONTRACT ACT

► **Agreement in Restraint of Trade, Void:**

Every agreement by which anyone 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 goodwill is sold-** One 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 person deriving title to the goodwill 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.



S.27 Agreement in restraint of trade: void



Landmark Case: *Nordenfelt v. Nordenfelt* (1894) A.C. 535

- ▶ **FACTS:** An inventor and a manufacturer of guns and ammunition, sold the goodwill and agreed with the buyer that he will:
 1. Not practice the same trade for **25 years**.
 2. Not engage **in any business** competing or likely to compete **in any way** for the time being carried on by the company

Landmark Case: *Nordenfelt v. Nordenfelt* (1894) A.C. 535

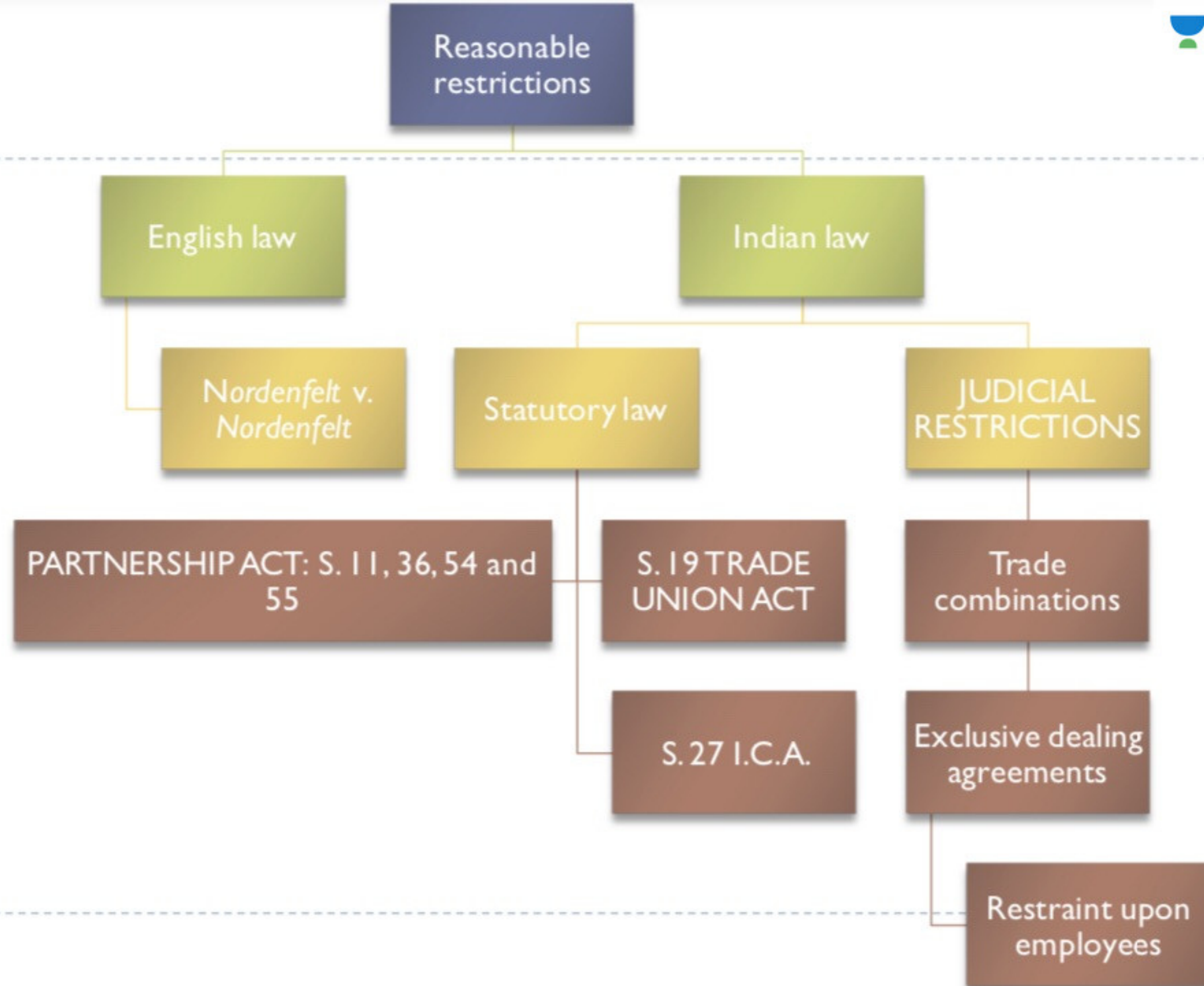
▶ COURT HELD:

- The first part of the agreement was **valid** being **reasonably necessary** for the **protection of purchaser's interest**.
- But the rest of the covenant by which he was prohibited from competing with the company **in any business** that the company might carry on was **unreasonable** and **therefore void**.
- *Lord Macnaughten*: “ The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading and all restraints of trade of themselves, if there is nothing more, are contrary to public policy and, therefore, void. That is the general rule. But there are exceptions. Restraint of trade may be justified by the special circumstances of a particular case. The only justification is that the restriction should be reasonable – reasonable in reference to the interest of the parties and reasonable in reference to the public interest.

Landmark Case: *Nordenfelt v. Nordenfelt* (1894) A.C. 535

TO SUM UP:

- I. If a contract is classifiable as in restraint of trade it is prima facie void and cannot become binding unless the test of reasonableness is satisfied.
- II. The restraint must be reasonable in the interest of both parties and also in the public interest.
- III. Whether a restraint is reasonable or not is a question for the court to decide.



STATUTORY RESTRICTIONS: INDIAN

PARTNERSHIP ACT

- **Section 11(2):** A contract may provide that none of the partners shall carry on any business other than that of the firm.
 - **Section 36(2)** enables the partners to contract restraining an outgoing partner from carrying on business similar to that of the firm within a specified period or within specified local limits. Such agreement, notwithstanding anything contained in Section 27 of the Indian Contract Act, shall be valid if the restriction imposed is reasonable.
 - **Section 54:** The partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits. Such agreement, notwithstanding anything contained in Section 27 of Indian Contract Act, shall be valid if the restrictions imposed are reasonable.
 - **Section 55(3):** Any partner may, upon the sale of goodwill of a firm after the dissolution, makes an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limit. Such agreement should be valid if the restrictions imposed are reasonable.
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STATUTORY RESTRICTION: TRADE UNION ACT

- ▶ Section 19 of the Trade Union Act, 1926: An agreement between the members of a registered trade union in restraint of trade shall not be void or voidable.
 - ▶ *Thus an agreement- between the members of a registered trade union not to accept employment unless certain conditions as to wages, hours of work etc are fulfilled, will not be void as per section 27 of the Indian Contract Act.*
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JUDICIAL RESTRICTIONS

I. TRADE COMBINATIONS:

Haribhai v. Sharaf Ali, (1897) 22 ILR Bom 861:

An agreement between two companies that one would not employ the former employee of the other has been held to be void in both companies were engaged in manufacturing similar products involving technical processes in which employees were likely to get knowledge of trade secrets and confidential information.

The companies agreed that neither would employ without the consent of the other, any person who has been the employee of the other for any time during the previous five years. The agreement was held to be void.



JUDICIAL RESTRICTIONS

2. EXCLUSIVE DEALING AGREEMENTS:

Where a manufacturer or supplier, after meeting all the requirements of a buyer has surplus to sell to others, he cannot be restrained from doing so. → ***SK Kalu v. Ram Saran Bhagat, (1908) 8 CWN 388.***



JUDICIAL RESTRICTIONS

3. Restraints upon Employees:

Charlesworth v. Mc. Donald, ILR (1998) 23 Bom. 103:

Facts: A agreed to become assistant for three years to B who was a physician practising at Zanzibar. The appointment was subject to the clause against practising. A left the service within an year and began to practice there on his own account.

But he was restrained from doing so during the period of 3 years.

COURT HELD: An agreement of this class does not fall within Section 27. if it did, all contracts of personal service of a fixed period would be void. An agreement to serve exclusively for a week, a day, or even for an hour necessarily prevents the person so agreeing to serve from exercising his calling during that period for anyone else than the person with whom he so agrees.

JUDICIAL RESTRICTIONS

▶ 3. Restraints upon Employees:

in the case of ***Superintendence Company of India v. Krishna Murgal (1981) 2 SCC 246***: it was held that restriction beyond the term of service is prima facie void and the only ground on which it could be justified is by bringing it within the scope of exceptions i.e. By showing that it is necessary for protection of trade secret or for employers goodwill.

→ In the case of ***Bhramaputra Tea Co. V. E. Scarth, ILR (1885) 11 Cal 545***: a clause restraining employee who was in service for 5 years to seek further employment was held invalid and unreasonable but in the case of ***Niranjan Shanker Golikari v. Century Weaving and Spinning Mills Case***: the court held that the clause stating that 'where there was appointment for 5 years the employee will not serve anywhere else even if he has left the service earlier', was held to be valid, as it was for the protection of trade secrets.



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