

UNDERSTANDING ‘EXCLUSIVE ZONING’ IN INDIA | VALIDITY AND ENFORCEABILITY OF RESTRICTIVE COVENANTS UNDER INDIAN LAWS

1. INTRODUCTION

The much-awaited opening of the first official retail store by Apple Inc. (“**Apple**”), in India in April 2023¹ occurred in the presence of Apple CEO Tim Cook, tech enthusiasts and thousands of Apple fans at the Reliance Jio World Drive mall. What was noticeably missing at Reliance Jio World Drive mall was the presence of any of the competitors of Apple, including the major players in the Indian consumer electronics market including HP, HTC, Lenovo, Dell, Microsoft, LG, Amazon, Facebook, Sony and Google. As per media reports, this tech vacuum was due to the lease agreement executed by Apple for leasing the premises of its retail store at Reliance Jio World Drive mall, which includes a restrictive covenant providing that 22 specified competing brands are not allowed to occupy any space for setting up of any retail stores for retailing, advertising, selling, offering, displaying and merchandising their products and services within Apple’s ‘exclusive zone’ in the mall.²

While it is not atypical for certain privileges and benefits to be provided to the anchor tenants in a mall or shopping complex, a covenant restricting the lessor from leasing other spaces in the shopping mall to a competitor of such anchor tenants may have several implications beyond just generating revenue for the anchor tenant, including restraining the freedom of profession, trade or business of the lessor as well as unsuspecting third parties. In this article, we attempt to analyse the jurisprudence behind the permissibility of such restrictive covenants across several jurisdictions and to assess the validity and enforceability of such restrictive covenants in modern commercial contracts under the Indian Contract Act, 1872 (“ICA”).

2. JURISPRUDENCE IN SELECT FOREIGN JURISDICTIONS

While the entry of Apple in the Indian retail market has generated much interest and scrutiny of its lease arrangement, tenants across the world have been executing lease agreements providing for restrictions on competitors from utilising the same premises, especially in shopping complexes and malls, and the validity of such agreements is subject to applicable legalisations and principles of law in each jurisdiction.

For instance, the English doctrine of restraint of trade (from which Section 27 of the ICA has been derived) states that an agreement in restraint of trade is void, unless it is designed to protect legitimate business interests, such as protection of trade secrets, customer/client relationships or goodwill, the scope of the restriction is limited to what is ‘reasonably necessary’ and the restraint is not contrary to public interest.³ To ascertain if the restriction is ‘reasonably necessary’ factors such as the term of the restriction, geographical limit of restriction or the scope of activities covered in the restriction and their co-relation to the legitimate

¹ Please refer to <https://www.apple.com/in/newsroom/2023/04/apple-bkc-now-open-in-mumbai/#:~:text=Apple%20BKC's%20more%20than%20100,first%20retail%20location%20in%20India.&text=Apple%20BKC%20opened%20today%20in,%2C%20arts%2C%20and%20entertainment%20district.>

² Please refer to <https://www.thetechoutlook.com/news/business/apples-exclusive-zone-at-reliance-jio-world-drive-in-mumbai-wont-allow-22-competitive-brands-to-advertise-and-sell/> <https://9to5mac.com/2023/04/12/apple-banned-22-competing/>.

³ Please refer to <https://enlaw.co.uk/restraint-trade-commercial-contracts/>; <https://www.debevoise.com/insights/publications/2021/03/restraint-of-trade-in-commercial-contracts.>

interest to be protected are considered. In addition to the abovementioned criterion, the courts also look to balance the protection of the freedom of trade with the enforceability of contracts which have become generally 'accepted' and 'normal' as part of a trading society.⁴

However, unlike England, where the doctrine of restraint of trade has developed as a common law principle, in the United States and the European Union the concept of restraint of trade has been codified as part of legislations primarily for protection against the restraint of competition. In the United States, Section 1 of the Sherman Act, 1890 provides that “*every contract, combination in form of trust or otherwise, or conspiracy, in restraint of trade or commerce.... is declared to be illegal*”.⁵ The aforesaid section has been interpreted over a period of time to prohibit only those contracts which ‘unreasonably’ restrain trade, where courts weigh the purported anti-competitive effects of the restraint against any pro-competitive justifications.⁶ Similar to the United Kingdom, the courts can consider factors such as tenure, territorial boundaries and scope of the restriction to determine reasonableness of the restrictive covenant and its impact on the competition in the market.⁷ Similarly, in the European Union, the principle of restraint of trade is governed by Article 101 of the Treaty on the Functioning of the European Union which provides that all agreements between undertakings which have ‘*as their object or effect*’ the prevention, restriction or distortion of competition within the internal market including those relating to directly or indirectly fixing prices or trading conditions or limiting or controlling markets, are void.⁸ Accordingly, to determine if any contract is in restraint of trade, the first and foremost test is to check if such contract is by its very nature or object harmful to the competition in the market. In case a contract is not by its object anti-competitive, the duration of the restrictive covenant, the amount and size of the local competition and barriers to entry for new participants will be assessed to ascertain if the restrictive covenant is preventing, restricting or distorting competition ‘in effect’.⁹

Interestingly, in each of the ‘abovementioned jurisdictions, there are judicial precedents which have held, a covenant restraining a landlord from leasing his extended premises to a competitor of the lessee, to be valid, pursuant to an analysis of the ‘reasonability’ of the restriction based on the factors mentioned above.

3. RESTRICTIVE COVENANTS UNDER SECTION 27 OF THE ICA

As per Section 27 of the ICA, *every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void*. From a bare reading of Section 27 of the ICA, it appears that the prohibition against restraint of trade is an absolute restriction and any contract even if restraining trade for anyone (including a third party) for a limited time or in a limited geographical area is void to that extent. Only a limited exception has been included under Section 27 itself which provides that in case goodwill of the business is sold, the purchaser and seller may agree that the seller shall be refrained from carrying on a similar business within specified local limits, provided that the buyer continues to carry on the purchased business in such local limit and such limits appear reasonable to the court. Accordingly, a contract which restrains certain

⁴ Please refer to <https://www.debevoise.com/insights/publications/2021/03/restraint-of-trade-in-commercial-contracts>; <https://www.shlegal.com/news/no-quantum-leap-in-the-doctrine-of-restraint-of-trade>.

⁵ Please refer to <https://www.ftc.gov/advice-guidance/competition-guidance/guide-antitrust-laws/antitrust-laws>.

⁶ Please refer to [https://uk.practicallaw.thomsonreuters.com/6-567-9285?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/6-567-9285?transitionType=Default&contextData=(sc.Default)&firstPage=true).

⁷ *Fab’Rik Boutique, Inc. v Shops Around Lenox*, 2014 Ga. App. LEXIS 612 (Ga. Ct. App. Sept. 8, 2014).

⁸ Please refer to <https://www.eucomplaw.com/object-and-effect/>; [https://uk.practicallaw.thomsonreuters.com/0-578-3505?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/0-578-3505?transitionType=Default&contextData=(sc.Default)&firstPage=true).

⁹ *SIA ‘Maxima Latoija’ v Konkurences padome*, Case C-345/14; Please refer to <https://www.klclawfirm.com/wp-content/uploads/CRR-Commentaries-No-3.pdf>.

third-party competitors from undertaking lawful profession, trade or business in the premises of a shopping complex appears *prima facie* void since it does not fall within the limited ambit of the statutory exception.

This strict interpretation is also supported by early judicial precedents. When the doctrine of restraint of trade under Section 27 of the ICA was first analysed by the Calcutta High Court, the court took a strict interpretation and opined that Section 27 of the ICA not only prohibits an absolute restraint, but also any partial restraint.¹⁰ However, it is key to understand that the early jurisprudence on the doctrine of restraint of trade under Section 27 of the ICA developed in context of employment related restraints where the parties to the contracts may not have equivalent negotiating power, unlike modern commercial contracts where parties are on an equal footing. Considering that such a strict interpretation would render most modern commercial contracts void, the courts in India started adopting a more lenient approach when faced with partial restraints and the doctrine of restraint of trade has evolved significantly in India. Indian courts have opined on the applicability of the doctrine of restraint of trade in the context of modern commercial contracts, such as franchise agreements,¹¹ non-compete arrangements¹² and share purchase agreements,¹³ keeping pace with the developments in commerce and the complexity of commercial arrangements.

After more than a century of evolving jurisprudence, it is now a well-established position in law that where a contract is for the advancement of trade, as may be ‘reasonably’ determined, the contract shall not attract the doctrine of restraint of trade under Section 27 of the ICA. In *Gujarat Bottling Co Ltd & Ors v. Coca Cola Company and Ors*,¹⁴ a landmark judgement of the Hon’ble Supreme Court of India (“**Supreme Court**”) in this regard, the court held that the covenant which restricts Gujarat Bottling Company to manufacture, sell, bottle, deal or otherwise be concerned with the products of any brands or trade names other than Coca Cola in a franchise agreement, was for facilitating the supply and distribution of goods of the franchiser and the intent of the restrictive covenants was not *per se* restraint of trade. Further, the Supreme Court also held that the restrictive covenant in the franchise agreement was limited in its application during the period of subsistence of the agreement and accordingly, cannot be termed as a restraint of trade under Section 27 of the ICA. The view has been reinforced by the Supreme Court and Delhi High Court in subsequent judgements, which allow us to identify certain common factors which the courts in India analyse to assess the reasonableness of a restrictive covenant in commercial contracts which may lead to the conclusion that the covenant is not in the restraint of trade:

- (a) *Object of the Agreement*: An agreement, the very object of which is to restrain trade is *prima facie* void.¹⁵ However, a restrictive covenant, where the restriction is ancillary to the main agreement and reasonably necessary to give effect to such transaction and protect the interest of parties may be considered not to be in restraint of trade.¹⁶ For instance, restrictive covenants where the object is facilitating the supply and

¹⁰ *Madhub Chunder v Rajcoomer Doss*, (1874) 14 Beng LR 76.

¹¹ *Gujarat Bottling Co Ltd & Ors v Coca Cola Company and Ors* AIR 1995 SC 2372.

¹² *Percept D’Mark (India) (P) Ltd. v Zaheer Khan*, (2006) 4 SCC 227.

¹³ *Affle Holdings Pte Limited v. Saurabh Singh*, MANU/DE/0152/2015.

¹⁴ *Gujarat Bottling Co Ltd & Ors v Coca Cola Company and Ors* AIR 1995 SC 2372.

¹⁵ *Hurry Krishna v. Authilechmy*, 33 IC 238: 8 LBR 389, (FB).

¹⁶ *Gujarat Bottling Co Ltd & Ors v Coca Cola Company and Ors* AIR 1995 SC 2372.

distribution of goods,¹⁷ preventing solicitation of employees,¹⁸ protection of trade secrets and confidential information¹⁹ may not be considered to be in restraint of trade.

- (b) Time Limit of the Restraint: An agreement may be held void in the event the restrictive covenant extends beyond the term of the agreement.²⁰ However, the Supreme Court, while analysing validity of restrictive covenant in a promotion agreement, held that the doctrine of restraint of trade may not be applicable during the continuance of the contract and applies only once the contract is terminated.²¹
- (c) Geographical or Territorial limit of the Restraint: An agreement may be held void in the event the restrictive covenant has an undefined or unreasonable geographical limit. However, a restrictive covenant in commercial contracts restraining the right to establish, run or set up any competing business within a limited area may be considered not to be in restraint of trade.²²
- (d) Protection of Goodwill: Restrictive covenants for the protection of goodwill in case of a sale of business, including non-compete covenants under a share purchase agreement,²³ are considered to fall within the statutory exception under section 27 of the ICA. While the ICA does not define the term 'goodwill', courts have interpreted it to mean, *inter alia*, the benefits arising from connections and reputation of a business²⁴ or the 'business reputation' which is a composite of personal reputation, local reputation and objective reputation of the products of the business²⁵.

4. CONCLUSION

While the validity of a restrictive covenant establishing an 'exclusive zone' prohibiting competition in a shopping centre has perhaps not *per se* been analysed by Indian courts, there is well established jurisprudence to indicate the judicial principles to be analysed for enforcement of any restrictive covenant. Applying the principles discussed earlier, it appears that the restrictive covenant provided in the lease agreement executed by Apple may be permitted under Indian laws considering that the objective of the lease agreement is not to merely restrain trade but to facilitate the retail trade of the goods of Apple, the geographical area of the restraint is limited to the premises of the shopping centre and the time period of the restriction appears to be co-terminus with the tenure of the lease. Further, a court may give importance to the fact that a commercial lease agreement requires a long-term lease commitment from the tenant as well as substantial investment in improvements or modifications in the premises.

Having said that, as commercial arrangements grow increasingly complex, the scope of restrictive covenants often depend on negotiations between the parties keeping in mind their commercial intent and considerations, and the validity of such covenants needs to be assessed on a case-to-case basis. Thus, while the lease agreement executed by Apple may appear reasonable to the average person, any similar agreements with aggressive

¹⁷ *Gujarat Bottling Co Ltd & Ors v Coca Cola Company and Ors* AIR 1995 SC 2372.

¹⁸ *Wipro Limited vs. Beckman Coulter International S.A.* MANU/DE/2671/2006.

¹⁹ *Hi Tech Systems and Services Limited v Suprabhat Ray*, 2015 SCC OnLine Cal 1192.

²⁰ *Percept D'Mark (India) (P) Ltd. v Zaheer Khan*, (2006) 4 SCC 227; *Aakash Educational Services Ltd v Sahib Sital Singh Bajwa*, 2020 SCC OnLine Del 1719.

²¹ *Percept D'Mark (India) (P) Ltd. v Zaheer Khan*, (2006) 4 SCC 227.

²² *Ozone Spa Pvt. Ltd. v Pure Fitness & Ors*, 222 (2015) DLT 372.

²³ *Affle Holdings Pte Limited v. Saurabh Singh*, MANU/DE/0152/2015.

²⁴ *Samsung India Electronics Pvt. Ltd. v Addl. CIT, Range-7*.

²⁵ *Dulaldas Mullick and Ors. v Ganesh Das Damani and Ors.* AIR 1957 Cal 280.

terms, for instance increasing the geographical limits or expanding the list of competitors restrained from trading may require a fresh analysis of the 'reasonability' of such restrictive covenants. Further, such restrictive covenants also need analysis from the lens of being 'anti-competitive' or an abuse of dominant position under Sections 3 and 4 of the Competition Act, 2002 and it may be interesting to see if a proliferation of such clauses draws regulatory scrutiny.

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