Guide

To

Restrictive Clauses

in Employment Agreements in India

July 2017 Edition
(Second Edition)

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Notes:

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This Guide is an academic exercise. It does not offer any advice or suggestion to any individual or firm or company.

Preface

Whether a company has one employee or more than a thousand employees, the company needs some form of employment agreement or contract. Besides the post, the salary and such other essential details, almost every employer wishes to include some restrictive clauses in employment agreements.

Given the unemployment scenario in India, employees are rarely in a position to negotiate terms of employment agreements. More often than not, a new employee merely signs on the dotted line. He / she does not even read the long fine print that is put up before him / her in the form of a standard printed agreement.

Months or years later questions are raised about his / her behavior vis-à-vis the restrictive clauses contained in the employment agreement. It is in the interest of the employer to ensure that the restrictive clauses contained in the employment agreement are able to withstand scrutiny by courts.

This Guide is intended for the benefit of employers in India. There seems to be a view among human resources personnel of employers that any standard employment agreement downloaded from the internet may well be used. Not much time and attention is devoted to drafting of employment agreements especially the parts related to restrictive clauses. On the part of employees also, while great deal of negotiations take place about salary, perquisites and job description, there are hardly any discussions about restrictive clauses which are assumed to be some form of words of God that can never be questioned.

The purpose of this Guide is to put forth the complexities involved in restrictive clauses. We seek to stress that “one-size-fits-all” approach is not suitable for employment agreements. Every organization has different needs and the employment agreement of the organization ought to be tailored accordingly. HR professionals need to restrain themselves in trying to be more loyal than the King. Clauses that have the potential of being declared void by courts must be avoided.

We, Anil Chawla Law Associates LLP, are committed to serving businesses. This Guide is a part of our ongoing commitment and passion. We hope that Indian businesses find this Guide useful.

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1. Introduction

Most employers in India have some form or the other of a standard employment contract. Often the employer gives a detailed offer to the prospective employee. In some cases, the offer as and when it is accepted by the employee becomes an "Employment Agreement" or Employment Contract". In some cases, the offer is a small cover note with an Annexure giving a draft of a formal Employment Agreement. As and when the employee accepts the offer, the draft formal Employment Agreement is printed on a stamp paper and duly signed by both the employer and the employee. From a legal standpoint, in both cases a contractual relationship is created between the employer and the employee. The relationship is evidenced by the document which can be in any form and which states the terms and conditions agreed to between the two.

Employers face problems of attrition, lack of loyalty, leakage of key confidential information, weaning of clients by existing and past employees, etc. Employers try to protect themselves by inserting restrictive clauses in Employment Agreements.

As is to be expected, every employer wants to have restrictive clauses that are cast in stone and allow no leeway to any present or past employee. The obstacle in such restrictive clauses comes from constitution of India, laws of India and courts. The chains that lawyers create for employers are often broken by courts. It is hence important for employers to understand what is permissible under the law and what is clearly forbidden.

This Guide is to enable employers to get an understanding of various types of restrictive clauses and also the applicable laws. In Chapter 5, we look at some key judgments of Honourable Supreme Court and High Courts. Samples of restrictive clauses are given in the three Annexures.

2. Types of Restrictive Clauses

Restrictive Clauses can be classified into the following categories:

a) **Non-Disclosure Clauses** – A business has to often handle confidential information, whether related to the employer or related to the employer's clients / suppliers / associates. It is essential for the business to ensure that the confidential information is not disclosed to persons who are not supposed to receive the information. Non-disclosure clauses often have two components – (1) commitment to not disclose the confidential information to any person who is not supposed to receive it and (2) commitment to not use the confidential information for any purpose other than the business's interest. So, non-use is often a part of non-disclosure clauses. Examples of Non-Disclosure Clauses are given in **Annexure A**.

b) **Non-Compete Clauses** – No employer wants any of its employees to do anything that will help competition in any way. Achieving this objective by appropriate clauses in employment agreements is the target of every employer. Helping competition includes a range of possible activities like providing critical information (confidential and non-confidential), giving advice to a potential competitor, planning to become a competitor in due course, working part-time for a potential competitor, etc. A well-drafted non-compete clause intends to cover every such possibility. Examples of Non-Compete Clauses are given in **Annexure B**.

c) **Non-Solicitation Clauses** – Non-Solicitation is usually broken down in to two distinct categories. The first prevents an employee from attempting to solicit or entice other employees of the employer to move away from their current jobs with that employer. The second area non-solicitation clauses cover is protection over the current clients or customers of the employer that the employee has had dealing with. Examples of Non-Solicitation Clauses are given in **Annexure C**.

d) **Garden Leave Clause** – This is a new category of clauses in Indian scenario. According to one opinion, Garden Leave Clause is not a restrictive clause. Garden Leave Clause gives an option to the employer to stop the employee from working or coming to the premises of the employer. An employer resorts to sending an employee on Garden Leave if the

employer is apprehensive that the employee may use his presence at the premises to gather confidential information or to entice other employees away from employment of the employer or to indulge in some other activity detrimental to the interests of the employer. A Garden Leave Clause operates along with other restrictive clauses mentioned above. It enables the employer to stop the employee from joining a new employer while keeping him / her away from work and work related information. Considering the novel nature of the clause, we devote an entire chapter to the clause.

3. Garden Leave Clause

The term "Garden Leave" or "Gardening Leave" originated in British Civil Service. In Britain, the term was often used as euphemism for "suspended". An employee under investigation would request for permission (or be asked) to not attend office and to take care of the garden at home. In due course, the term has expanded to include all situations where an employee is restrained from coming to office even though he / she continues to be in employment.

Employers often resort to sending an employee on garden leave as soon as he / she submits resignation. Say, the employee has submitted resignation with notice period of three months. During this period, the employee may use his / her position in the organization to remove confidential information and sensitive records for use in the organization that he / she intends to join. Restricting the employee from entering office premises during the notice period prevents access to sensitive and confidential information. If the organization was to instead relieve the employee immediately on submission of resignation letter, the employee would be moving directly to a competitor with confidential information fresh in head. It is assumed that as time passes, most sensitive and confidential information loses value for the competitor and hence, a cooling period for the employee protects the employer.

Garden Leave, essentially, refers to the right of an employer to keep an employee on its rolls without giving the employee any work and also restricting his / her access to offices and computer systems of the employer. In the Information Technology and related sectors the term "Benching" is used which is largely the same as Garden Leave.

Garden Leave Clause in employment agreements authorizes the employer to retain an employee on its rolls without giving him / her any work and while simultaneously preventing the employee from taking up employment with any competitor.

Garden Leave Clauses are not yet popular in India. The law on the subject is still nascent in India.

The only case known to us related to Garden Leave Clause in India is VFS Global Services Private Limited vs. Mr. Suprit Roy, Bombay High Court (Decided on 10th

December 2007; MANU/MH/1043/2007) (hereinafter referred to as "**the VFS case**").

In the VFS case, VFS Global Services Private Limited had executed an agreement which had a Garden Leave Clause as under:

> The Company reserves the right to require you to remain away from work/employment for a period of 3 (three) months after termination or resignation of your services with the company. You shall agree to comply with all conditions that may be laid down by the Company at the time of such resignation or termination. The Garden Leave period shall commence after you have served the notice period and have ceased to be on the rolls on the Company.
>
> You shall be bound and undertake that you will not directly or indirectly, whether through partnership or as a shareholder, joint venture partner, collaborator, employee, consultant or agent or in any other manner whatsoever, whether for profit or otherwise carry on any business, which competes directly or indirectly with the whole or any part of the business of visa processing services or having/conducting business similar to the business conducted by the company for a period of 3(three) months after serving the notice period and ceasing to be an employee of the Company.
>
> You shall also be bound to comply with the conditions of Non Compete and Non Solicitation as set out in the terms and conditions. The Company shall pay you compensation which shall be equal to 3 (three) month's remuneration last drawn by you at the time of your termination or resignation. Please note that the company shall apply this clause at its sole discretion and you shall not claim it as a right.

Essential feature of the Garden Leave Clause in the VFS Employment Contract was that the clause imposed restrictions on the employee for three months after he ceased to be an employee of the company. This was a fatal mistake in drafting of the clause. It violated the essential condition for enforceability of such a clause under Contracts Act and also was against the commonly understood concept of Garden Leave Clause. Honourable High Court declared the clause to be void under section 27 of the Contract Act. Relevant extracts of the judgment read as follows:

> **8.** Since the Judgment of the Supreme Court in Niranjan Shankar Golikari v. Century Spinning & Mfg. Co. Ltd. MANU/SC/0364/1967 : (1967)ILLJ740SC , a distinction has been drawn in Indian law between a restrictive condition in a contract of employment which is operative during the period of employment and one which is to operate after the termination of the employment. A restriction during the term of employment is regarded as valid and not in restraint of trade. A condition which operates after the term of employment ceases is in restraint of trade. This distinction was adverted into in

> **10.** In the present case, the Garden Leave Clause is intended to operate after the contract of employment stands terminated, either as a result of resignation or upon the employee ceasing to remain in service upon termination. The submission of Counsel appearing on behalf of the Plaintiff that the payment of three months compensation by the employer would amount to an extension of the contract is contrary to the plain terms of the clause. The clause defines the period of three months to commence after the employee has served the period of notice and upon his having ceased to be on the rolls of the Company. The measure of compensation is three months of last drawn wages. The payment of this compensation however, does not renew the contract of employment which has come to an end. The Garden Leave Clause is therefore, prima facie in restraint of trade and is hit by Section 27 of the Contract Act. The effect of the

This was clearly a case of bad drafting of the Garden Leave Clause that led to the clause being struck down by the Honourable High Court.

Declaring the Garden Leave Clause as void in the VFS case acted as a damper for wider acceptance of the clause in Employment Agreements in India. However, we are of the opinion that a properly drafted Garden Leave Clause will not be void under Indian law and can be extremely useful protection for employers in addition to other restrictive clauses.

Key points to be kept in mind while drafting Garden Leave Clause in an employment agreement are as follows:

a) Garden Leave must operate while the employee is in employment and not after cessation of employment.

b) Compensation given to employee during Garden Leave should be reasonable. Typically, fixed portion of salary is paid while discretionary or performance-based portion of remuneration is not paid.

c) Garden Leave should not be excessively long. For example, it is likely to be extremely difficult to get a court to agree that an employee will not be given any work and will be restrained for taking up any other employment for a period of five years.

d) While reasonableness is not a condition under section 27 of the Indian Contract Act, it is suggested that the Garden Leave Clause be reasonable.

e) Garden Leave Clause should be a part of the employment agreement which the employee has executed without any duress.

Keeping the above principles in mind, a suggested redrafting of the Garden Leave Clause in VFS Employment Agreement is as follows:

> The Company, at its sole discretion, reserves the right to require the Employee to remain away from work for a period (hereinafter called as "**Garden Leave Period**"), which may extend to a maximum of 3 (three) months after submission of resignation by the Employee to the Company or after the date of Letter of Intention to Terminate issued by the Company to the Employee. During the Garden Leave Period, the Employee shall continue to be bound by all conditions of employment but will not be given any work and will not be allowed to enter the premises of the Employer except with special permission. The Garden Leave period shall run parallel with the notice period for resignation / termination. The Employee will continue to be in the employment roll of the Company during the Garden Leave Period.
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> During Garden Leave Period, the Employee shall be bound by all restrictions related to confidentiality, non-disclosure, non-compete, non-solicitation etc. as applicable to an employee of the Company.
>
> During the Garden Leave Period, the Employee shall continue to be entitled to receive salary and other non-discretionary components of his / her remuneration package but will not be entitled to receive or avail perquisites which are related to working such as use of company bus, lunch in office premises etc. and will also not be entitled to receive any discretionary components of his / her compensation package.
>
> The Employee will have no right to demand or claim Garden Leave. In case of resignation, the Company will inform the Employee within fifteen (15) days of receipt of resignation letter whether it wants to avail the Garden Leave Period. In case of intention to terminate, the requirement of Garden Leave Period will be a part of the Intention to Terminate Letter issued by the company.
>
> During the Garden Leave Period, neither the Employee nor the Company will have the right to terminate the employment agreement.

Given below is an example of a general Garden Leave Clause which will enable the employer to send employee on garden leave at any time during the employment without disclosing the reasons for the same (reasons may include, non-availability of projects with the employer suiting the skill-set of employee,

pending investigation against the employee, resignation by employee or intended termination of the employee):

> The Company, at its sole discretion, will have at all times the right to require the Employee to remain away from work, from offices of the Employer and from all computer systems of the Employer except to the extent specifically permitted by the Employer for a period (hereinafter called as "**Garden Leave Period**"), which may extend to a maximum of 6 (six) months at a time. The Company will not be required to disclose any reason(s) for sending the Employee on Garden Leave.
>
> In case the Employee submits his / her resignation, the Employer may within fifteen (15) days from the date of receipt of resignation letter inform the Employee about its decision to send the Employee on Garden Leave. In any such case, the Employee will continue to be on employment rolls of the Company during the complete duration of Garden Leave Period.
>
> In case the Company wishes to terminate the Employee and wishes to send the Employee on Garden Leave prior to cessation of his / her employment, the Company shall issue a Intention to Terminate Letter to the Employee wherein the Employee will be informed about the intention of the Company to terminate him / her and also about the Garden Leave Period.
>
> The Employee will continue to be in the employment roll of the Company during the Garden Leave Period. During Garden Leave Period, the Employee shall be bound by all restrictions related to confidentiality, non-disclosure, non-compete, non-solicitation etc. as applicable to an employee of the Company. In particular, during the Garden Leave Period the Employee will be strictly prohibited from any contact by either email or by any other form of communication or by personal meeting with any of the Company's suppliers, associates, competitors, clients, potential clients, contractors, vendors and any officer(s) / employee(s) or other such person(s).
>
> During the Garden Leave Period, the Employee shall continue to be entitled to receive salary and other non-discretionary components of his / her remuneration package but will not be entitled to receive or avail perquisites which are related to working such as use of

company bus, lunch in office premises, use of Company sports facilities, etc. and will also not be entitled to receive any discretionary components of his / her compensation package.

The Employee will have no right to demand or claim Garden Leave.

If the Garden Leave is after submission of resignation or after issue of Intention to Terminate Letter, neither the Employee nor the Company will have the right to terminate the employment agreement during the Garden Leave Period.

The above suggested Garden Leave Clause will need to be integrated with the standard Employment Agreement of the company.

We are hopeful that adoption of Garden Leave Clause in employment agreements will help Indian employers.

4. Applicable Laws

There is no specific law in India related to employment agreements. If an employee is covered under labour laws (Employees State Insurance Act, Employees Provident Fund Act, Minimum Wages Act etc.), he / she enjoys the protections and benefits under the relevant act. Most of the labour laws have a definition of employee which typically includes employees receiving below the specified monthly salary level. For example, the salary limit for Employees State Insurance is Rs. 21,000 per month. Government is in the process of increasing the limit for Provident Fund from Rs. 15,000 p.m. to Rs. 25,000 p.m.

Generally speaking, employers do not have employment contracts for employees covered by labour laws. The practice is to have a formal employment agreement (or an offer for employment duly accepted by the employee) for employees who receive monthly salary above the threshold limit. Service conditions for such employees are not subject to any labour laws and are only subject to the employment agreement, which is treated as a contract and is hence subject to the law related to contracts in India.

Indian Contract Act 1872

Indian Contract Act, 1872 is the general contract law in India. It is not specific to employer-employee relationship. However, it is the most important law in relation to employment agreements. Some key concepts under Indian Contract Act relevant to employment contracts can be summed up as follows:

Proposal-Acceptance – A valid contract must have a proposal by one to the other and an acceptance of the proposal by the other.

Let us consider, A makes a proposal for employment to B asking B to accept the proposal by signing and returning a duplicate copy of the proposal. B does not return the signed duplicate copy but starts working as an employee. A few months later, A accuses B of violating non-disclosure and non-compete clauses of the Employment Proposal. B can plead that in the absence of a contract the clauses have no force. A will be at difficulty to prove that starting employment and receiving salary from A binds B to conditions of a Proposal which B has not accepted. Practically speaking, B may even deny receiving the Proposal. Such a denial will further weaken the case of A against B.

In view of the above, it is recommended that a valid contract is duly made between the employer and the employee. It may be mentioned here that acceptance of the employee must be "absolute and unqualified". If an employee receives an employment offer by signing on the duplicate copy an acknowledgment of receipt by inscribing words like "Received with thanks", the employee will be able to argue later that he / she had only acknowledged the proposal and not accepted it. Such situations should be avoided by ensuring that there is no doubt or confusion that the employee has accepted the employment offer without any conditions.

Voidable Contracts – Under section 19 of Indian Contract Act, any contract based on coercion, fraud or misrepresentation is voidable at the option of the party who consented to the agreement based on either of coercion, fraud or misrepresentation. Viewed in the context of employment agreements, employers have the option of terminating the employment agreement if the employee has committed any coercion, fraud or misrepresentation.

This is most relevant with regard to rampant fraud and misrepresentation committed by employees at all levels in India when applying for employment. Window dressing of CV / Resume is common. However, there is a point when innocent brushing up of one's qualification and experience crosses the line and becomes either fraud or misrepresentation. The following three examples will illustrate the concept:

Example 1 - A person named A presents his resume or CV to a potential employer, say B. The resume provides that A had obtained his Masters degree in business administration from a recognized university specializing in marketing. On the basis of the resume, B employs A. Sometime later, B realizes that A had not passed the final semester of his Masters degree. A has committed fraud as defined under section 17 of Indian Contract Act. B has the option to void the contract. B need not serve any notice as may be required under the Employment Agreement since the employee is not being terminated under the Employment Agreement.

Example 2 - A candidate, say P, approaches an employer (Say Q) for a vacancy of an Insurance Sales Officer. The selection of P for the post was based largely on Q's impression that P had past experience in sale of insurance policies. P in the past had served an insurance company on a post of clerical staff for ten years. He was never involved in selling insurance policies. He did not claim in his resume that he was ever involved in sale of insurance policies. Officers of Q interviewed P and asked him various questions about the insurance company for which P used

to work. P answered all questions related to his past employer correctly. Officers of Q did not ask P whether he was working in his past job as a clerk or as a sales person. P was offered the job as Insurance Sales Officer. P joined the new job. Subsequently, Q discovered that P had no sales experience. This is a case of misrepresentation and not fraud. It was the duty of Q to exercise due diligence and ask P about the nature of his job at past employer. Since Q had the means of discovering the truth with ordinary diligence, the contract is not voidable. Q cannot make the employment contract with P void on the basis of the misrepresentation.

Example 3 – A person named X was working with an employer named U where he committed financial misappropriation and cheating. U terminated him and filed a criminal case against him before the court of first class judicial magistrate. While the case was under progress, X applied to Y for employment. Y had a standard application form where there was a question asking if the candidate had any court cases pending against him. In the application form, X replied in the negative. X committed fraud, making the contract between X and Y voidable at the option of Y. Subsequently X applied for a job to Z. There was no standard application form at Z. X did not disclose the criminal case against him in his application. During the interview Z did not ask him whether any criminal case was pending against him. Z employed X. Subsequently Z came to know of the criminal case against X filed by U. Z had not exercised ordinary diligence which could have helped it discover the truth. So, Z cannot annul the contract claiming voidability under Indian Contract Act.

Essential conditions for an employment contract to be voidable under section 19 of Indian Contract Act can be summed up as follows:

a) There should be either coercion or fraud or misrepresentation

b) Coercion or fraud or misrepresentation should have been caused before the execution of the contract.

c) Coercion or fraud or misrepresentation should be of such nature that the employer can claim that he was "induced to enter into the contract". A fraud or misrepresentation that did not induce the employer to enter into the contract cannot be a valid ground for claiming the contract to be voidable. An example – a boy was asked during interview by his potential employer whether he had any tattoos on his body; he replied in the negative. He joined the job. A few months later at an office party around the pool everyone noticed the big prominent tattoo on his arm. The officer who had interviewed him was aghast. However, the officer could not claim that his

negative reply on the question of tattoo had induced him to select him and hence, the employment contract was not voidable.

d) It is the duty of the employer to exercise due diligence as regards misrepresentation. A potential employee is under no obligation to disclose the facts which may be detrimental to him / her. It is the duty of the employer to ask relevant questions and get the potential employee to either state the truth or face the risk of committing fraud. An employer is not expected to guard against fraud but must protect against misrepresentation.

Void contracts – A void contract is one which cannot be enforced under laws of India. While voidable contracts can be annulled at the option of one of the parties to the contract, a void is ab initio without any legal feet. Neither party can claim any benefit under a void contract.

Indian Contract Act specifically provides conditions that make a contract void. Generally speaking, void contracts can be classified into four categories –

(a) Contracts with unlawful objects or consideration (Section 23 and 24)

(b) Contracts without consideration (Section 25)

(c) Contracts in restraint of marriage (Section 26)

(d) Contracts in restraint of trade (Section 27).

Of the above four, section 26 and section 27 are most relevant to the present discussions related to restrictive clauses in employment agreements. Let us discuss the two.

Restraint of Marriage – Any employment contracts that restrict the employee from marrying are void. While it is not common for employers to try to restrict their employees from marrying, in some industries such restrictions are not unheard of. For example, a film producer may want leading heroine of his film to not marry till the film is released. Enforceability of such contracts is doubtful. Relevant section of Indian Contract Act reads as follows:

Section 26 - Agreement in restraint of marriage void

Every agreement in restraint of the marriage of any person, other than a minor, is void.

Restraint of Trade – Section 27 of Indian Contract Act restricts any agreement from restraining one from "exercising a lawful profession, trade and business of any kind". The only exception allowed is in case of sale of goodwill of a business. Needless to say, the exception is not relevant for our discussions here. However, Honourable Supreme Court has ruled that restrictions imposed on an employee during the period of employment are valid, while restrictions imposed after termination of employment are void. We shall discuss this in the next chapter.

Section 27 reads as follows:

Section 27 - Agreement in restraint of trade void

(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.

Constitution of India

Article 19 (1)(g) of the Constitution of India guarantees all citizens the right to practice any profession or occupation or trade or business of their choice. The relevant portion of the Article is as under:

Article 19 - Protection of certain rights regarding freedom of speech, etc.

(1) All citizens shall have the right-

(g) to practise any profession, or to carry on any occupation, trade or business.

However, the right to carry on a profession, trade or business is not unqualified. It can be restricted and regulated by the authority of law. The restrictions have to be reasonable and in public interest.

Moreover, it is important to understand that fundamental rights are available only against the State or in other words government or government undertakings. Fundamental rights have almost no scope when the relationship is between a private employer and an individual employee.

Competition Act 2002

Common sense dictates that restrictive clauses in employment agreements restrict competition and hence ought to be within the purview of Competition Act, 2002. However, in legal matters case-law scores over common sense.

Mr. Larry Lee Mccallister, an American citizen, moved against Pangea3 Legal Database Systems (P.) Ltd. under section 19(1)(a) of the Competition Act, 2002 (Larry Lee Mccallister Vs. Pangea3 Legal Database Systems (P.) Ltd.; The Competition Commission of India, Decided on 6th November 2013, MANU/CO/0083/2013). In the case, the Competition Commission of India decided that an employment contract raises no competition issue. Relevant extract from the judgment reads as follows:

> The contract of providing service by an 'expert' to an employer is a contract of an individual with an enterprise or a firm. No relevant service market is involved in this. The issue of dominance in the relevant market thus would not arise. The issue of relevant service market arises only where there is a service provider who provides service to one and all who pay for the service. A person who seeks employment with an enterprise tends to seek maximum salary in lieu of his service to be provided to the enterprise. Once he enters into contract of employment with the enterprise, he is not a service provider to one and all, nor can his service be purchased by other competitors of the enterprise, so long as he is in employment of that enterprise. All consultants/experts who seek employment negotiate the terms of employment in the very beginning. If an expert is unique kind of expert and is much sought after, he is able to dictate his terms at the time of employment and reverse is also possible where the kind of employee the company is seeking is easily available and there are lot many people seeking job, than the company is able to dictate its terms. In such contracts, no issue of competition arises. A clause in service contract restricting an employee from taking employment with the competitors, after he leaves the employment, for a particular period, raises no competition issue. The employee who enters into such contract negotiates his salary/pay package accordingly and takes into calculations even the period for which he would not be able to provide his expertise to competitors.

We are most humbly of the opinion that Mr. Larry Lee Mccallister failed to argue his case well before the Commission and he further did not take his case before the Honourable Supreme Court. It is not appropriate to say that the law in the matter is settled. Nevertheless, for the moment till the Honourable Supreme Court rules otherwise, we must consider that Competition Act 2002 has no relevance to restrictive clauses in employment agreements.

5. Relevant Case Laws

As mentioned in the previous chapter, Honourable Supreme Court has ruled that restrictions imposed on an employee during the period of employment are valid, while restrictions imposed after termination of employment are void. Some cases on the subject are discussed below.

A. Superintendence Company of India (P) Limited Vs. Sh. Krishan Murgai [1]

Appointment letter of an employee contained some conditions under which the employee agreed that during the course of employment, he would not be permitted to engage himself in any part time job. The appointment letter further provided that the employee would not be permitted to join any firm of competitors or run a business of his own on similar lines, for a period of two years at the place of his last posting after he leaves the company. And lastly, he was prevented from revealing secrets of the company to other parties. Relevant restrictive clause read as follows:

> 10. That you will not be permitted to join any firm of our competitors or run a business of your own in similar lines directly and/or indirectly, for a period of two years at the place of your last posting after you leave the company.

The employee accepted these terms. In due course, the employee was terminated by his employer. After termination, he started carrying on business of similar nature. He also solicited the business and customers of the company and even used the trade secrets of the company.

The company brought a suit for a permanent injunction to restrain the employee from his post-termination activities. Two issues before the court were – (a) whether the restrictive clause which was supposed to operate on "*after you leave the company*" will operate on employee's termination and (b) whether post-termination restrictions were valid under law.

[1] Supreme Court, Decided on 21 March 1980 / 9 May 1980, MANU/SC/0457/1980

On the first issue, Honourable Supreme Court held that termination does not amount to leaving the company. The clause which was supposed to operate on the employee leaving the company will not operate if he is terminated. Relevant extract from the judgment of Justice Tulzapurkar reads as follows:

> 9. In our view, the word "leave" has various shades of meaning depending upon the context or intent with which it is used. According to the plain grammatical meaning that word in relation to an employee, would normally be construed as meaning voluntary leaving of the service by him and would not include a case where he is discharged or dismissed or his services are terminated by his employer. Ordinarily the word "leave" appears to connote voluntary action. In Words & Phrases Permanent Edition 24 pag 499 the following statement of law based on an American decision occurs:
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> > An application for the employment of a street car conductor provided that in the event of his leaving the services for any reasons whatever within six months, the money paid to him for work under instruction while on trial should be deducted from such moneys as should be due from the company on the date of his, "leaving". Held, that the word "leaving" meant to quit or depart, implying volition on the part of the person leaving, and limited the forfeiture of the instruction wages to a case where plaintiff left defendant's employ of his own volition, nor was such instruction effected by the words, "for any reason whatsoever." Muesling v. International Ry. Co., 147 N.Y.S. 177178, 85 Misc. 309
>
> In our view having regard to the context in which the expression "leave" occurs in Clause (10) of the service agreement and reading it alongwith all the other terms of employment it seems to us clear that in the instant case the word "leave" was intended by the parties to refer only to a case where the employee has voluntarily left the services of the appellant company of his own, and since here the respondent's services were terminated by the appellant company the restrictive covenant contained in Clause (10) would be inapplicable and, therefore, not enforceable against the respondent at the instance of the appellant company. Counsel for the appellant company urged that our construction would lead to putting a premium upon an dishonest employee who by his own misdemeanour and misbehavior may invite termination of his services. All that we can say is that the appellant company should have taken care td use appropriate language while incorporating such restrictive covenant so as to include every case of cessation of employment arising from any reason whatsoever and not used the expression "leave," which normally is synonymous to the expression "quit" and indicates voluntary act on the part of the employee.

On the same point, Justice Sen took the view a narrower construction of the expression “leave” ought to be adopted. Relevant extract from his judgment reads as follows:

> 62. The true rule of construction is that when a covenant or agreement is impeached on the ground that it is in restraint of trade, the duty of the Court is, first to interpret the covenant or agreement itself, and to ascertain according to the ordinary rules of construction what is the fair meaning of the parties. If there is an ambiguity it must receive a narrower construction than the wider. In Mills v. Dunham, L.R. [1891] 1 Cha 576 Kay, LJ. observed :
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> > If there is any ambiguity in a stipulation between employer and employee imposing a restriction on the latter, it ought to receive the narrower construction rather than the wider-the employed ought to have the benefit of the doubt. It would hot be following out that principle correctly to give the stipulation a wide construction so as to make it illegal and thus set the employed free from all restraint. It is also a settled canon of construction that where a clause is ambiguous a construction which will make it valid is to be preferred to one which will make it void.

> 63. The restraint may not be greater than necessary to protect the employer, nor unduly harsh and oppressive to the employee. I would, therefore, for my part, even if the word 'leave' contained in Clause 10 of the agreement is susceptible of another construction as being operative on termination, however, accomplished of the service e.g. by dismissal without notice, would, having regard to the provisions of Section 27 of the Contract Act, 1872, try to preserve the covenant in Clause 10 by giving to it a restrictive meaning, as implying volition i.e. where the employee resigns or voluntarily leaves the services. The restriction being too wide, and violative of Section 27 of the Contract Act, must be subjected to a narrower construction.

On the issue of restrictive clauses operating after the termination of employment, Justice Sen observed as follows:

> 52. Under Section 27 of the Contract Act, a service covenant extended beyond the termination of the service is void. Not a single Indian Decision has been brought to our notice where an injunction has been granted against an employee after the termination of his employment.

It is clear that the Honourable Supreme Court has unequivocally stated that "**a service covenant extended beyond the termination of the service is void**".

B. Desiccant Rotors International Pvt. Ltd. Vs. Bappaditya Sarkar and Anr.[2]

In the present case (which came up before the Honourable Delhi High Court) the employee signed an Obligation Agreement under which he agreed that for two years after termination of employment – (a) he would not compete directly or indirectly against the company and its group companies; (b) he would not interfere with the relationship of the company with its customers, suppliers and employees; (c) he would not disclose the confidential information to which he was privy as employee of company to any third party; (d) he would deliver back all properties of the company which were in his possession; and (e) he would not retain copies of any of the properties of the company.

In addition to the Obligation Agreement, employee signed two declarations declaring that if he failed to comply with the declarations it would amount to breach of trust and that he would take full liability and responsibility of the same. Within three months of leaving employment the employee joined a competitor of the company.

The Honourable High Court opined as follows:

[2] Delhi High Court, Decided on 14 July 2009, MANU/DE/1215/2009

> 14. The stance of Indian courts on the question of restraint on trade is unmistakably clear. There are no two ways about the fact that the approach towards a negative covenant subsisting during the course of employment is completely different from the approach which would be taken towards the applicability of a negative covenant post-employment duration. The

The final judgment of the Honourable High Court in the above matter is summed up in the following words:

> 15. I have no doubt that such was the intention of the plaintiff, but with equal conviction I believe that such is the intention of all employers who rely on like negative covenants in employment contracts with their employees. It is this attempt to protect themselves from competition which clashes with the right of the employees to seek employment where so ever they choose and in a clash like this, it is clear that the right of livelihood of the latter must prevail. Clearly, in part at least, the Obligation Agreement sought to restrain Defendant No. 1 from seeking employment with an employer dealing in competitive business with the plaintiff after he had ceased to be an employee of the plaintiff, and that too for a period of two years. Such an act cannot be allowed in view of the crystal clear law laid on this issue. However, in the impugned order dated February 20, 2008 the injunction restraining Defendant No. 1 is limited in scope, in the sense that it does not restrain the Defendant No. 1 from working with Defendant No. 2 or any other person/company, thereby steering clear of impinging the formers freedom to choose his own work place. The injunction only restrains Defendant No. 1 from approaching the plaintiffs suppliers and customers for soliciting business which is in direct competition with the business of the plaintiff. Hence, the injunction which has already been granted by order dated February 20, 2008 is made absolute. The interim application is disposed of accordingly.

The Honourable High Court took the view that an employee's right of livelihood must prevail over employer's right to restrict employee from joining competitive business. In other words, the employee had a right to work with the competitor. However, the court opined that the employer had a right to refrain employee from approaching its suppliers and customers for soliciting business for a period of two years after cessation as an employee. In other words, post-employment restriction on joining a competitor was rejected but the restriction of non-solicitation for two years after termination was protected.

C. Percept D' Mark (India) Pvt. Ltd. Vs. Zaheer Khan and Anr.[3]

The case does not relate directly to an employment situation. The company had entered into an agreement with a cricketer of national repute on 1st October 2000 for a period of three years commencing on 30th October 2000 and expiring on 29th October 2003.

The agreement included a condition that the player could not accept any offer for endorsements, promotions, advertising or other affiliation with regard to any

[3] Supreme Court, Decided on 22 March 2006, MANU/SC/1412/2006

product or services and that prior to accepting any such offer, he was under an obligation to provide the company in writing all the terms and conditions of such third party and offer the company the right to match such third party offer.

The cricketer informed the company on 10th September 2003 that he was not interested in renewing and/or extending the terms of the said agreement and the same would, therefore, end as of 20th October 2003. In November 2003, the cricketer entered into an agreement with a third party. The company protested against this and pulled the cricketer to court.

The Supreme Court in deciding the matter quoted approvingly Niranjan Shankar Golikari[4], Superintendence Company of India[5] and Gujarat Bottling[6] Opinion of the Court on the issue of post-contractual commitments is summed up as follows:

> 38. The legal position with regard to post-contractual covenants or restrictions has been consistent, unchanging and completely settled in our country. The legal position clearly crystallised in our country is that while construing the provisions of Section 27 of the Contract Act, neither the test of reasonableness nor the principle of restraint being partial is applicable, unless it falls within express exception engrafted in Section 27.

It is important to note that the Honourable Court affirmed that even if a restraint is reasonable it would be null and void under section 27 of the Contract Act. Moreover, partial restraints are also disallowed.

D. Central Inland Water Transport Corporation Limited and Anr. Vs. Brojo Nath Ganguly and Anr.[7]

In the present case, two issues came up before the Honourable Supreme Court.

i) Is a government company "the State" under Article 12 of the Constitution of India?

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[4] Niranjan Shankar Golikar vs. The Century Spinning and Mfg. Co. Ltd., Supreme Court, Decided on 17 January 1967, MANU/SC/0364/1967

[5] Supra

[6] Gujarat Bottling Co. Ltd. and others vs. Coca Cola Company and others, Supreme Court, Decided on 4 August 1995, MANU/SC/0472/1995

[7] Supreme Court, Decided on 6 April 1986, MANU/SC/0439/1986

ii) Does an unconscionable term in a contract of employment makes the contract void under Section 23 of the Indian Contract Act, 1872?

The first issue is not relevant to our discussion here. As regards the second issue, Honourable Supreme Court examined the issue with reference to government companies but the comments of the Court are of general nature and are extremely relevant for all employment agreements.

The case relates to quick and immediate termination of two employees of Central Inland Water Transport Corporation Limited (hereinafter referred to as "**the Corporation**") without any enquiry by merely giving three months' salary.

The employees were covered by "Central Inland Water Transport Corporation Ltd. Service Discipline and Appeal Rules" of 1979 framed by the Corporation (herein after referred to as '**the Rules**'). Rule 9 of the Rules provided as under.

> **9.** TERMINATION OF EMPLOYMENT FOR ACTS OTHER THAN MISDEMEANOUR. -
>
> (i) The employment of a permanent employee shall be subject to termination on three months' notice on either side. The notice shall be in writing on either side. The Company may pay the equivalent of three months' basic pay and dearness allowance, if any, in lieu of notice or may deduct a like amount when the employee has failed to give due notice.
>
> (ii) The services of a permanent employee can be terminated on the grounds of "Services no longer required in the interest of the Company" without assigning any reason. A permanent employee whose services are terminated under this clause shall be paid 15 days' basic pay and dearness allowance for each completed year of continuous service in the Company as compensation. In addition he will be entitled to encashment of leave at his credit.

Employees were terminated under Rule 9(i). Employees had filed a suit challenging their termination and validity of Rule 9 before the Calcutta High Court. The Honourable High Court had awarded in favor of the employees and declared Rule 9 as ultra vires Article 14 of the Constitution of India and quashed the order of termination. The Corporation had appealed to the Supreme Court for quashing the order of the High Court.

While examining the legality of the Rule 9(i), the Honourable Supreme Court devoted significant attention to the issue of "unconscionable" parts of a contract under Indian Contract Act.

> **76.** The said Rule constitute a part of the contract of employment between the Corporation and its employees to whom the said Rules apply, and they thus form a part of the contract of employment between the Corporation and each of the two contesting Respondents. The validity of Rule 9(i) would, therefore, first fall to be tested by the principles of the law of contracts.
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> **78.** Under which head would an unconscionable bargain fall? If it falls under the head of undue influence, it would be voidable but if it falls under the head of being opposed to public policy, it would be void. No case of the type before us appears to have fallen for decision under the law of contracts before any court in India nor has any case on all fours of a court in any other country been pointed out to us. The word "unconscionable" is defined in the Shorter Oxford English Dictionary, Third Edition, Volume II, page 2288, when used with reference to actions etc. as "showing no regard for conscience; irreconcilable with what is right or reasonable". An unconscionable bargain would, therefore, be one which is irreconcilable with what is right or reasonable.

It is important to note the definition of "unconscionable" as put forth by the Honourable Supreme Court is something that is not right or reasonable. This definition is not derived from any law but is based on essential moral sense of a good human being. We need to keep the same in mind in all our discussions on restrictive clauses in employment agreements.

Notably, while the test of reasonableness is not a part of tests for a valid contract under Indian contract law, this judgment introduced the concept of conscionable, which may in fact be a step ahead of plain reasonableness. Conscionable includes in its purview the concept of moral right while reasonable does not necessarily include moral right.

In expanding the horizons of Indian contract law, Honourable judges took recourse to common law, present legislative thinking and modern ideas that say that freedom of contract is not a fundamental freedom. The following extracts from the judgment are interesting and seem to lay down principles that have application far beyond the case that was before the Honourable Court.

79. Although certain types of contracts were illegal or void, as the case may be, at Common Law, for instance, those contrary to public policy or to commit a legal wrong such as a crime or a tort, the general rule was of freedom of contract. This rule was given full play in the nineteenth century on the ground that the parties were the best judges of their own interests, and if they freely and voluntarily entered into a contract the only function of the court was to enforce it. It was considered immaterial that one party was economically in a stronger bargaining position than the other; and if such a party introduced qualifications and exceptions to his liability in clauses which are today known as "exemption clauses" and the other party accepted them, then full effect would be given to what the parties agreed. Equity, however, interfered in many cases of harsh or unconscionable bargains, such as, in the law relating to penalties, forfeitures and mortgages. It also interfered to asset aside harsh or unconscionable contracts for salvage services rendered to a vessel in distress, or unconscionable contracts with expectant heirs in which a person, usually a money-lender, gave ready cash to the heir in return for the property which he expects to inherit and thus to get such property at a gross undervalue. It also interfered with harsh or unconscionable contracts entered into with poor and ignorant persons who had not received independent advice (See Chitty on Contracts, Twenty-fifth Edition, Volume I, paragraphs 4 and 516).

The position has been thus summed up by John R. Pedan in "The Law of Unjust Contracts" published by Butterworths in 1982, at pages 28-29 :

> ...Unconscionability represents the end of a cycle commencing with the Aristotelian concept of justice and the Roman law laesio enormis, which in turn formed the basis for the medieval church's concept of a just price and condemnation of usury. These philosophies permeated the exercise, during the seventeenth and eighteenth centuries, of the Chancery court's discretionary powers under which it upset all kinds of unfair transactions. Subsequently the movement towards economic individualism in the nineteenth century hardened the exercise of these powers by emphasizing the freedom of the parties to make their own contract. While the principle of pacta sunt servanda held dominance, the consensual theory still recognized exceptions where one party was overborne by a fiduciary, or entered a contract under duress or as the result of fraud. However, these exceptions were limited and had to be strictly proved.
>
> It is suggested that the judicial and legislative trend during the last 30 years in both civil and common law jurisdictions has almost brought the wheel full circle. Both courts and parliaments have provided greater protection for weaker parties from harsh contracts. In several jurisdictions this included a general power to grant relief from unconscionable contracts, thereby providing a launching point from which the courts have the opportunity to develop a modern doctrine of unconscionability. American decisions on Article 2. 302 of the UCC have already gone some distance into this new arena....

92. Should then our courts not advance with the times? Should they still continue to cling to outmoded concepts and outworn ideologies? Should we not adjust our thinking caps to match the fashion of the day? Should all jurisprudential development pass us by, leaving us floundering in the sloughs of nineteenth-century theories? Should the strong be permitted to push the weak to the wall? Should they be allowed to ride roughshod over the weak? Should the courts sit back and watch supinely while the strong trample under foot the rights of the weak? We have a Constitution for our country. Our judges are bound by their oath to "uphold the Constitution and the laws". The Constitution was enacted to secure to all the citizens of this country social and economic justice. Article 14 of the Constitution guarantees to all persons equality before the law and the equal protection of the laws. The principle deducible from the above discussions on this part of the case is in consonance with right and reason, intended to secure social and economic justice and conforms to the mandate of the great equality clause in Article 14. This principle is that the courts will not enforce and will, when called upon to do so, strike down an unfair and unreasonable contract, or an unfair and unreasonable clause in a contract, entered into between parties who are not equal in bargaining power. It is difficult to give an exhaustive list of all bargains of this type. No court can visualize the different situations which can arise in the affairs of men. One can only attempt to give some illustrations. For instance, the above principle will apply where the inequality of bargaining power is the result of the great disparity in the economic strength of the contracting parties. It will apply where the inequality is the result of circumstances, whether of the creation of the parties or not. It will apply to situations in which the weaker party is in a position in which he can obtain goods or services or means of livelihood only upon the terms imposed by the stronger party or go without them. It will also apply where a man has no choice, or rather no meaningful choice, but to give his assent to a contract or to sign on the dotted line in a prescribed or standard form or to accept a set of rules as part of the contract, however unfair, unreasonable and unconscionable a clause in that contract or form or rules may be.

This principle, however, will not apply where the bargaining power of the contracting parties is equal or almost equal. This principle may not apply where both parties are businessmen and the contract is a commercial transaction. In today's complex world of giant corporations with their vast infra-structural organizations and with the State through its instrumentalities and agencies entering into almost every branch of industry and commerce, there can be myriad situations which result in unfair and unreasonable bargains between parties possessing wholly disproportionate and unequal bargaining power. These cases can neither be enumerated nor fully illustrated. The court must judge each case on its own facts and circumstances.

Having introduced the concept of “unconscionable” in Indian contract law, the Honourable Court decided that it is the duty of courts to intervene and strike down all contracts that are unconscionable.

The next issue before the Honourable Court was whether an unconscionable term in a contract was void or voidable. The Honourable Court decided that all such contracts were void and not voidable. Relevant extract from the judgment reads as follows:

94. Is a contract of the type mentioned above to be adjudged voidable or void? If it was induced by undue influence, then under Section 19A of the Indian Contract Act, it would be voidable. It is, however, rarely that contracts of the types to which the principle formulated by us above applies are induced by undue influence as defined by Section 16(1) of the Indian Contract Act, even though at times they are between parties one of whom holds a real or apparent authority over the other. In the vast majority of cases, however, such contracts are entered into by the weaker party under pressure of circumstances, generally economic, which results in inequality of bargaining power. Such contracts will not fall within the four corners of the definition of "undue influence" given in Section 16(1). Further, the majority of such contracts are in a standard or prescribed form or consist of a set of rules. They are not contracts between individuals containing terms meant for those individuals alone, Contracts in prescribed or standard forms or which embody a set of rules as part of the contract are entered into by the party with superior bargaining power with a large number of persons who have far less bargaining power or no bargaining power at all. Such contracts which affect a large number of persons or a group or groups of persons, if they are unconscionable, unfair and unreasonable, are injurious to the public interest. To say that such a contract is only voidable would be to compel each person with whom the party with superior bargaining power had contracted to go to court to have the contract adjudged voidable. This would only result in multiplicity of litigation which no court should encourage and would also not be in the public interest. Such a contract or such a clause in a contract ought, therefore, to be adjudged void. While the law of contracts in England is mostly judge-made, the law of contracts in India is enacted in a statute, namely, the Indian Contract Act, 1872. In order that such a contract should be void, it must fall under one of the relevant sections of the Indian Contract Act. The only relevant provision in the Indian Contract Act which can apply is Section 23 when it states that "The consideration or object of an agreement is lawful, unless . . . the court regards it as . . . opposed to public policy."

The types of contracts to which the principle formulated by us above applies are not contracts which are tainted with illegality but are contracts which contain terms which are so unfair and unreasonable that they shock the conscience of the court. They are opposed to public policy and require to be adjudged void.

Having decided that “unconscionable” clauses of a contract are void, the next issue before the Honourable Court was to decide whether Rule 9(i) was “unconscionable”.

101. No chapter description of Rule 9(i) can be given than to call it "the Henry VIII Clause". It confers absolute and arbitrary power upon the Corporation. It does not even state who on behalf of the Corporation is to exercise that power. It was submitted on behalf of the Appellants that it would be the Board of Directors. The impugned letters of termination, however, do not refer to any resolution or decision of the Board and even if they did, it would be irrelevant to the validity of Rule 9(i). There are no guidelines whatever laid down to indicate in what circumstances the power given by Rule 9(i) is to be exercised by the Corporation. No opportunity whatever of a hearing is at all to be afforded to the permanent employee whose service is being terminated in the exercise of this power. It was urged that the Board of Directors would not exercise this power arbitrarily or capriciously as it consists of responsible and highly placed persons. This submission ignores the fact that however highly placed a person may be, he must necessarily possess human frailties. It also overlooks the well-known saying of Lord Acton, which has now almost become a maxim, in the Appendix to his "Historical Essays and Studies", that "Power tends to corrupt, and absolute power corrupts absolutely." As we have pointed out earlier, the said Rules provide for four different

> **103.** The Corporation is a large organization. It has offices in various parts of West Bengal, Bihar and Assam, as shown by the said Rules, and possibly in other States also. The said Rules form part of the contract of employment between the Corporation and its employees who are not workmen. These employees had no powerful workmen's Union to support them. They had no voice in the framing of the said rules they had no choice but to accept the said Rules as part of their contract of employment. There is gross disparity between the Corporation and its employees, whether they be workmen or officers. The Corporation can afford to dispense with the services of an officer. It will find hundreds of others to take his place but an officer cannot afford to lose his job because if he does so, there are not hundreds of jobs waiting for him. A clause such as Clause (i) of Rule 9 is against right and reason. It is wholly unconscionable. It has been entered into between parties between whom there is gross inequality of bargaining power. Rule 9(i) is term of the contract between the Corporation and all its officers. It affects a large number of persons and it squarely falls within the principle formulated by us above. Several statutory authorities have a clause similar to Rule 9(1) in their
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> the country. A clause such as Rule 9(i) in a contract of employment affecting large sections of the public is harmful and injurious to the public interest for it tends to create a sense of insecurity in the minds of those to whom it applies and consequently it is against public good. Such a clause, therefore, is opposed to public policy and being
>
> opposed to public policy, it is void under Section 23 of the Indian Contract act.

The Honourable Court decided that Rule 9(i) was unconscionable and was opposed to public policy. The Rule was held to be void.

The general rule formulated by this case is that in an employment agreement **any restrictive clause which the court considers to be "unconscionable" will be considered as opposed to public policy and will be void**.

The above case has been discussed in various cases before Honourable Supreme Court as well as before different High Courts in India. The concept of "conscionable" has been subject to much legal scrutiny. It is interesting to quote from the judgment in the case of Ajit Kumar Nag vs. Indian Oil Corporation Ltd.[8]

> *University of Cambridge*, (1723) 1 Str 557]. But we are also aware that principles of natural justice are not rigid or immutable and hence they cannot be imprisoned in a straight-jacket. They must yield to and change with exigencies of situations. They must be confined within their limits and cannot be allowed to run wild. It has been stated ; "To do a great right after all, it is permissible sometimes to do a little wrong". [Per Mukharji, C.J. in *Charan Lal Sahu v. Union of India MANU/SC/0285/1990 :* , (Bhopal Gas Disaster); AIR1990SC1480] While interpreting legal provisions, a court of law cannot be unmindful of hard realities of life. In our opinion, the approach of the Court in dealing with such cases should be pragmatic rather than pedantic, realistic rather than doctrinaire, functional rather than formal and practical rather than 'precedential'.

Two cases below take the discussion on "conscionable" further ahead.

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[8] Supreme Court, Decided on 19 September 2005, MANU/SC/0584/2005

E. Prashant B. Narnaware vs. Vijaya Bank [9]

In the present case, Honourable High Court of Karnataka used the principle laid down by the Honourable Supreme Court in the above-mentioned case of Central Inland Water Transport Corporation Limited vs. Brojnath and held the clause providing for payment of Rs. 200,000- by employee to employer as unconscionable.

Mr. Prashant B. Narnaware (hereinafter referred to as '**the Petitioner**') was appointed as Assistant Manager of Vijaya Bank ('**Respondent Bank**') on 15th November 1999. The employment contract between the Petitioner and the Respondent Bank provided for the following condition.

> (w) selected candidates are required to execute an indemnity bond of Rs. 2.00 lakh (Rs. Two Lakh only) indemnifying that they will pay an amount of Rs. 2.00 lakh to the Bank if they leave the service before completion of 3 years.

Subsequently the petitioner on 7th August 2007 was promoted to the position of Senior Manager and similar condition as above was imposed on the Petitioner by the Respondent Bank.

On 17th July 2009, the Petitioner submitted his resignation. Respondent Bank asked him to deposit a sum of Rs.2,00,000/- (Rupees Two Lakhs Only) as per the employment contract to get his resignation accepted. The Petitioner requested the Bank officials to waive the payment of Rs.2,00,000 and release him from the job. However, the Bank declined the request of the Petitioner. He deposited the amount and left the job.

Thereafter, the Petitioner approached the Honourable High Court to get the said condition of employment quashed and claim a refund of Rs.2,00,000/- deposited by him against his resignation.

The Honourable High Court relied on the decision of Honourable Supreme Court in Central Inland Water Transport Corporation Limited vs. Brojnath and declared the said condition of employment as unconscionable. The petition was allowed and the Respondent Bank was ordered to refund the amount along with an interest of 9% to the Petitioner.

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[9] Karnataka High Court, Decided on 8 August 2012, MANU/KA/1209/2012

F. Dr. S. Gobu vs. The State of Tamil Nadu[10]

In this case, Honourable Madras High Court looked at amounts claimed from a doctor by a hospital on account of leave and other facilities granted to him for post-graduate studies. Honourable High Court held that the doctor could not on one hand take the benefits and on the other hand refuse to abide by his commitments. The doctor was ordered to pay up as per the contract.

Dr. Gobu (**Petitioner**) was serving as an Associate Professor in General Surgery department of a Medical College. The issues before the court are summed up by the court as follows:

> **1.** The two questions arise for consideration in these two writ petitions are (1) whether the petitioner, an Associate Professor in General Surgery working in the third respondent College is entitled to wriggle out of an agreement reached between him and the management on 2.9.2006 and (2) whether the petitioner is entitled to leave his service as a matter of right without fulfilling his obligations?

The Petitioner had applied for a super-specialty post-graduate as a service candidate. His position is summed up in the following paragraph by the Honourable High Court:

> **5.** The petitioner applied for PG course (Super Speciality) course in M.Ch Gastroenterology by an application, dated 18.5.2006. His application was forwarded by the institution to the selection committee to treat him as a service candidate on 26.5.2006. At the time of forwarding his application for the course, he was informed that during the study period, he will not be paid any salary or stipend as well as course fee and the period will be treated as leave on loss of pay. Even when the application was forwarded, there is no guarantee that his leave on loss of pay will be sanctioned and it will be done on the basis of administrative exigency prevailing at that time. He was also informed that for doing PG Super Speciality course, he should execute an undertaking cum indemnity bond that he will serve in the third respondent college for a minimum of twice the period of study leave after completion of course (i.e. for six years). In case, he discontinues the course before completion or leave the college after completion but before the bond period, he had to pay penalty as per the bond condition. He was also informed that the selection committed has declared the third respondent as an unaided non-minority institution. The petitioner did not object to these conditions at the time of forwarding his application.

The Petitioner had executed a bond with his employer which is summed up as follows:

[10] Madras High Court, Decided on 8 July 2010, MANU/TN/0675/2010

7. The conditions of bond executed by the petitioner and impugned in the writ petitions as found in Clauses 1 and 5 are as follows:

> **1.** The Employee agrees and undertakes to serve the employer for a minimum period of six years after completion of the course for which the employee was sponsored.
>
> ...
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> **5.** That the employer reserves the right to terminate the appointment at its absolute discretion after giving three months notice or on payment of three months salary in lieu of notice.

8. But Clause No. 2 of the agreement which is not under challenge is as follows:

> 2. That in the event of the employee leaving the Employer or any of the Offices that come under the control of the Director of the Employer on his own accord within the minimum period of six years specified in the earlier paragraph from the date of his joining with the employer, after completion of the course for which he was sponsored, the employee shall reimburse to the employer an amount equal to pay and allowance for this bond period and the expenditure on the study by the institution if any.

The Petitioner pleaded as follows:

9. The ground of challenge of the petitioner was that the contractual obligation between the petitioner and the second respondent was only to give three months notice either way or three months pay in lieu of notice. Once the petitioner has sent a valid resignation, there is no master and servant relationship between the petitioner and the second and third respondents. The agreement executed between the petitioner and the second respondent has no legal validity.

Honourable High Court held that the contractual commitments must be adhered to by the Petitioner. It is not open for the Petitioner to have on one hand benefit of getting admission as a service candidate along with leave and on the other hand not pay the quantified damages provided in the contract. Relevant part of the decision of the Honorable High Court in the matter is as follows:

28. In the light of the above and the factual matrix brought on record, this Court is of the opinion that though Clause No. 1 obliges a candidate to serve for six years, but the second clause makes that rigour disappear with the quantified damages to be paid. In the present case, the petitioner is the beneficiary of three years leave period together with salary paid and he was treated as service candidate and not as a direct candidate. Therefore, he cannot have best of both Worlds. The contract agreed to by him stipulates that he should serve for six years in the institution after the completion of the course. The petitioner is bound to serve the institution for six years as agreed to by him. But in case he wants to waive the said condition, then Clause No. 2 provides for a way out by paying the quantified damages. Since the petitioner had left the service abruptly by sending his resignation, he was bound by the terms of the agreement, dated 2.9.2006 and cannot escape from the liability to pay damages.

Noticeably, the Honourable High Court refused to let the Petitioner have the benefit of section 27 of Contract Act. Allegations of arbitrariness as well as of unequal bargaining power were also turned down by the Honourable Court. The following extract from the judgment explains the logic followed by the Honourable High Court:

> **29.** It must be held that Clause No. 1 of the agreement executed by him does not suffer from any arbitrariness or it was not done due to any unequal bargaining power. On the contrary, the petitioner is a trained medical doctor and has been in service for several years. Therefore, it cannot be said that he signed it with an unequal bargaining power. This is especially so when there are thousands of candidates standing for direct selection to Super Speciality PG courses, the petitioner had the advantage of being selected as a service candidate under the 50% quota. He was also paid for the entire period salary by the IRT management. Without standing on any prestige, they had waived the earlier bond condition so as to enable him to undergo the Super Speciality course. The petitioner having had the fruits of all the benevolence showered on him ought to have served the institution by the knowledge gained in the higher studies. If had to resile from the terms of the agreement, there is no other option except to pay the quantified damages as agreed to by him in Clause 2 of the agreement which is also not under challenge in these writ petitions.

6. Summary of Legal Position

The law is fairly clear with respect to restrictive clauses. The legal position can be summed up as under:

i. Restrictions imposed on an employee during the employment are legally enforceable.

ii. Restrictions imposed on an employee after termination of employment are void. This applies even when restrictions are reasonable. In other words, even reasonable restraint on employee after termination of employment is not enforceable.

iii. As far as post-employment restraints on freedom of employee to join a new employer or to pursue a trade of his / her liking are concerned, partial restraint and complete restraint stand on equal footing. Even if partial restriction is imposed on an employee after termination of his / her employment, such restriction shall lack legal enforceability.

iv. Unconscionable term in a contract of employment is void even during the period of employment. A contract clause is unconscionable if it is neither right nor reasonable. Whether an employment condition is unconscionable is to be decided by the court depending upon the facts and circumstances of the case. However, a common sense approach is advised while drafting employment agreements.

v. An employee has the right to engage in any gainful activity after his employment ceases but this cannot be a license to take away confidential intellectual property of the employer or approach employer's suppliers and customers for soliciting business. Similarly, after cessation of employment the employee cannot claim freedom to entice other employees of his former employer.

vi. Protection under Article 19 (1) (g) of Constitution of India is available only against the state i.e. only when the employer is either the government or a government undertaking.

vii. As per Competition Commission of India, Competition Act has no relevance with restrictive clauses in employment agreements.

Law aims for fair play. While on one hand, employers are prevented from imposing unreasonable and unfair terms; on the other hand an employee is prevented from flouting reasonable terms and conditions stated in employment agreement.

Annexure A

A. Examples of Non-Disclosure Clauses

The following are some typical examples of Non-Disclosure clauses which prevent employees from disclosing confidential information during and after employment.

> "In the course of the employment, you will or may have access to confidential information belonging to the Company. It is mutually agreed that your relationship with the Company is one of confidence with respect to such information.
>
> The components of your remuneration package are strictly confidential and are not to be discussed with anyone other than the directors of the Company. Breach of confidentiality can result in instant dismissal or disciplinary proceedings. These components are salary, superannuation, salary sacrifice arrangements, overtime (if applicable), bonus (if applicable) and professional or other memberships (if applicable).
>
> You shall at all times (including after your employment ends for any reason):
>
> a. Hold all confidential information in confidence and not discuss, communicate or transmit to others or make any unauthorized copy of or use the trade secrets in any capacity, position or business unrelated to the Company and unauthorized by the Company;
>
> b. Use the confidential information in confidence only in furtherance of proper Company-related reasons for which such information is disclosed or discovered;
>
> c. Take all reasonable action, that the Company deems necessary or appropriate, to prevent unauthorized use or disclosure of, or to protect the Company's interests in, the confidential information except as required by law to do so."

In the above example the employee is restricted from sharing or discussing or using the confidential information or the trade secrets of the company except for business purpose. The employee is also asked to take reasonable steps to protect such confidential information or trade secrets from others.

In the following example the employee commits to keep all the confidential information in confidence except and to the extent when disclosure is mandatory under any law in force. The employee further agrees that he / she shall not discuss or disclose the confidential information of company to any person or business unrelated to company:

> The Employee hereby commits to hold all Confidential Information in confidence except and to the extent when disclosure is mandatory under any law in force. The Employee shall not discuss, disclose, communicate or transmit to others (including any other employee / consultant / associate of the Company) or make any unauthorized copy of or use the Confidential Information in any capacity, position or business unrelated to the Company and unauthorized by the Company. Any discussion or disclosure or communication or transmitting or use of confidential information shall be strictly for furtherance of the proper interests of the Company and for the reasons the confidential information was made available to the Employee in the first place.

In the preceding examples, the focus was on preventing company information from going out. Let us look at an example where the employee promises to keep Third Party Information confidential.

> I understand, in addition, that the Company has received and in the future may receive from third parties confidential or proprietary information, including but not limited to non-public and extremely confidential data of (a) the Company's clients (b) the vendors, customers, personnel, business partners and other stakeholders of the Company's clients; and (c) third party providers of data ("Third Party Information") subject to a duty on the Company's part to maintain the confidentiality of such Third Party Information and to use it only for certain limited purposes. During the term of my employment and thereafter, I shall hold Third Party Information in the strictest confidence in trust for the Company and the third party owner of such Information and shall not disclose any Third Party Information to anyone (other than Company personnel who need to

know such information in connection with their work for the Company) or use, except in connection with my work for the Company, unless expressly authorized in writing by an officer of the Company. I recognize that all Third Party Information shall be the sole property of the respective third party and its assigns.

Following is an example of an elaborate non-disclosure clause.

Any information certified or declared or stamped as confidential by an officer or director of the Employer will be considered as Confidential Information. Such information may be oral or verbal or written or may be contained in the form of drawing(s) or document(s) or electronic record(s) or electro-magnetic record(s) or any other form of information storage.

The Employee promises and agrees to receive and hold the Confidential Information, as defined above, strictly in confidence. Without limiting the generality of the foregoing, the Employee hereby promises and agrees:

A. to protect and safeguard the Confidential Information against unauthorized use, publication or disclosure;

B. not to use any of the Confidential Information except for Business Purposes related to the work of the Employer;

C. not to, directly or indirectly, in any way, reveal, report, publish, disclose, transfer or otherwise use any of the Confidential Information except as specifically authorized in writing by the Employer;

D. not to use any Confidential Information to unfairly compete or obtain unfair advantage in relation to Employer in any commercial activity which may be comparable to the commercial activity / activities currently carried out by the Employer or proposed to be carried out by the Employer in future;

E. to strictly restrict access to the Confidential Information to those of the Employer's officer(s), director(s), and employee(s) who clearly need such access to carry out the business of the Company;

F. to advise each of the persons to whom the Employee provides access to the Confidential Information, that such persons are strictly prohibited from making any use, publishing or otherwise disclosing to others, or permitting others to use for their benefit or to the detriment of the Employer, any of the Confidential Information;

G. to comply with any other reasonable security measure(s) imposed by the Employer;

H. to refrain from directly contacting or communicating by whatsoever means to the source(s) of the Confidential Information without written consent of the Employer.

The Employee agrees that restrictions imposed by this clause will continue even after his / her employment with the Employer ceases.

Annexure B

B. Examples of Non-Compete Clauses

Few examples of typical Non-compete clauses during employment are listed below:

> The Employee agrees that during the course of his / her employment with the Company he / she will not, without prior written consent of the Company, work or consult for or otherwise affiliate himself / herself with any business or proposed business likely to be in competition with or in any way similar to the Company's business. Without affecting the generality of the foregoing, the Employee hereby specifically asserts that he / she will not be directly or indirectly associated with such business or proposed business either as a partner or owner employee or consultant or officer or director or manager or agent or associate or investor or adviser or any other such capacity. The Employee hereby further asserts that he / she will not build or design or assist or advise or finance or acquire or lease or operate or manage or own or purchase or organize or take preparatory steps in relation to a business or proposed business likely to be in competition with or in any way similar to the Company's business.

In the above example, the employee agrees that during the course of his employment, he will not involve himself with any kind of business which is similar to the company business. In contrast with the above where all sorts of competing is prohibited, in some cases restriction is only limited. For example, in the following clause the restriction is only for 75 km radius.

> The Employee shall not, during his employment, without the prior written consent of the Company, carry on, or be engaged in, or be concerned with, or interested in, or employed by, any person engaged in or concerned with or interested in a business which is the same as, or substantially similar to, or in competition with, the Company's business within a radius of seventy-five (75) kilometers from any office of the Company where the Employee is employed.

Geographic restrictions are not very common. However, most employers are keen to prevent their staff from soliciting business from the company's clients. The following clause achieves that.

> The Employee promises that, during his / her employment with the Company, he / she shall not, directly or indirectly, whether alone or in association with others, in any capacity whatsoever, and whether for his / her benefit or the benefit of a third party do any or all of the following: (a) solicit the business of any Client (other than on behalf of the Company); (b) engage in, participate in, invest in, provide, or attempt to provide any services to any business which seeks to service the Client(s) of the Company either directly or indirectly. Without prejudice to the foregoing, during his / her employment with the Company the Employee shall not receive any favors or benefits or remuneration or gifts either in cash or kind from any of the clients or suppliers or associates or competitors or potential competitors or potential clients or potential suppliers of the Company.

It may be pointed out that in all examples above restrictions are for the period of employment. While employers will like to ensure that employees do not compete even after termination of employment, such post-employment restrictions are not legally valid. Hence, we give no examples of any non-compete clauses that operate even after ceasing of employment.

Annexure C

C. Examples of Non-Solicitation clauses

Two examples of Non-solicitation clauses are given below:

> In order to protect the Company's legitimate business interests, including (without limitation) its interests in the Proprietary Information, its substantial and near permanent relationships with Clients, and its Client goodwill, I agree that during my employment with the Company, and continuing for two (02) years after the date my employment with the Company ends for any reason (including but not limited to voluntary termination by me or involuntary termination by the Company), I shall not, as an officer, director, employee, consultant, owner, partner, or in any other capacity, either directly or through others, and either for my benefit or for the benefit of a third party: (a) solicit, induce, encourage, or participate in soliciting, inducing, or encouraging any employee, independent contractor or consultant of the Company to terminate his or her relationship with the Company or to work in any capacity for any person or entity other than the Company; (b) solicit the business of any Client (other than on behalf of the Company). I agree that should I violate this covenant of non-solicitation, the Company shall be entitled to claim damages including cost of litigation and legal consultations from me.

Another example of non-solicitation clause is as follows.

> During his / her employment with the Company and for a two year period following the termination of his / her employment for any reason or without reason, the Employee shall not solicit or induce any employee(s) of the Company or any of its subsidiaries to leave their employment with the Company.

We are of the opinion that a non-solicitation clause may operate for some period after termination of employment. A post-employment non-solicitation will not be rendered void under section 27 of Indian Contract Act. However, ours is not the last word on the subject. We look forward to some court judgment on the subject.

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