

## Research Paper

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### **Employment contracts in India.**



**Business Laws**

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## RESEARCH PAPER

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### 1. INTRODUCTION

The employer-employee relationship is, and has always been, in a constant state of evolution. As the nature of this relationship evolves and changes, so does the nature of disputes that arise as a result of diverging interests which the employer and employees seek to protect in their interaction with each other and the society in general. Several laws and legislations have been drafted to create an appropriate framework to address these concerns with an objective to reasonably balance the interests of employers and employees. Such employment laws have a broad ambit and include within their scope all areas of the employer-employee relationship and are not merely restricted to contractual issues and/or workplace discrimination. This research publication focuses on the analysis of the legal framework existing in India to address emerging concerns in the relationship between employers and employees along with developments through case laws. The legislations governing several aspects of the employer-employee relationship are so numerous, complex and ambiguous, existing both at the national and state level, that they tend to promote litigation rather than providing easy solutions to potential problems. However, concerns of employers and employees relating to protection of confidential information, non-disclosure and non-solicitation have not yet been addressed through legislation in India, thus warranting recourse to judicial interpretation and common law. This paper seeks to provide an overview of the scenarios where disputes may arise between employers and employees, and highlights the need for formulation of a coherent legal framework within which to address such concerns. Further, this paper also assesses the validity of various restrictive covenants which are increasingly being incorporated in employment contracts.

### 2. STAGES OF EMPLOYMENT DISPUTES

#### 2.1 Before employment

It is possible that disputes may arise even before a person is employed as an employee of a company. Cases where a new recruit has joined employment without duly terminating his agreement with the previous employer may pose risk of potential disputes. Such situations are

also possible when a prospective or a newly hired employee has a post-termination obligation (which include non-disclosure of confidential information, non-solicitation, non-compete etc.) with an erstwhile employer which he or she may have breached. Typically, such disputes would arise between the erstwhile employer and employee. However, there have been instances where the prospective employer has also been dragged into litigation, by taking the position that the new employer is encouraging and assisting the employee to breach his obligations towards the previous employer. Further, many companies have a pre-employment screening policy, with an objective to provide a degree of certainty that the potential employee does not have a criminal record involving dishonesty, or breach of trust involving his/her fiduciary or official capacity, or has not misused his/her official or fiduciary position to engage in a wrongful act including money laundering, etc. Such a screening policy may raise concerns of violation of the right to privacy of the persons being subjected to such screening as the mode and manner of collecting such information may violate rights of individuals guaranteed under Article 21 of the Indian Constitution. The following scenarios may also give rise to pre hire employment disputes; i) when the employer withdraws offer prior to employee's joining; and ii) when the employee's background check results are unsatisfactory or the employee provides incorrect disclosures or misrepresents to the prospective employer. To reduce litigation risk, it is also helpful to obtain a representation from the new employee (whether under the employment contract or otherwise) that the employee has not and will not breach any obligations towards his previous employer, as a result of joining the employment of the new employer.

## **2.2 During employment**

During the course of employment, several disputes may arise between the employer and the employee. These can be broadly summed up in 2 categories, namely employment related disputes and disputes relating to restrictive covenants during employment. While employment related disputes include misconduct or indiscipline of an employee, indulging in criminal activities, under-performance, breach of the terms of the employment contract or HR policies/code of conduct etc., are few of the contentious issues which may ultimately lead to a dispute; disputes relating to restrictive covenants include, non-compete and non-disclosure of confidential information. If the employee is in breach of a non-compete restriction, prohibiting the employee from engaging in any kind of business or activity which is similar to the company's business, or a mandate to not disclose or misuse confidential information or

trade secrets passed on to the employee, during the course of his employment, such breaches would inevitably lead to a potential dispute.

### **2.3 Termination**

In cases where the employee voluntarily resigns or retires from employment, it is unlikely that there will be a dispute (unless there are elements of a breach being committed by the employee). In contrast, termination of employment by the employer often leads to a stand-off between an employee and employer which has all the ingredients for baking a potential dispute. Termination of employment due to misconduct, breach of the employment agreement including violation of restrictive covenants therein, is often escalated and settled through resort to courts. An important factor to be considered in a dispute relating to termination of employment by the employer is whether the employee being so terminated enjoys statutory protection of employment such as a “workman” as defined in the Industrial Disputes Act, 1947 (“IDA”) and/or protection under the state-specific labour laws such as the Shops and Establishments Act. The IDA also contains unfair labour practices on the part of the employer. If the employee does enjoy such protection, then before terminating the employment of such an employee for any of the above reasons, the employer would have to serve the employee with at least a 30 days’ notice or pay salary in lieu thereof. The procedure to be followed for termination due to ‘misconduct’ would involve framing of charges and issuance of a charge sheet, conducting an internal (domestic) enquiry by an unbiased inquiry officer, followed by issuance of a show cause notice. The process needs to be followed as per the principles of natural justice and the employee should be given an opportunity to submit his defense and call upon witnesses. Decision to terminate employment should be taken depending on the gravity of the misconduct on the part of the employee.

Post termination

### **2.3 Post termination**

Covenants restraining employees from joining competitors even after the cessation of employment are often found in modern day employment contracts. Restrictions in this category may also prevent a former employee from starting a competing business or even advising a family member or relative who is in a similar line of business. A breach of post termination clauses often forces the employer to seek advice on the legal recourse available to it. Indian courts however prioritize the protection of rights of an employee seeking employment over protecting the interests of the employer seeking to protect itself from

competition. In view of the Constitution of India and the provisions of the Indian Contract Act, 1872, (“**Contract Act**”) courts have generally held that the right to livelihood of the employees must prevail in spite of an existing agreement between the employer and the employee. Further, courts frown upon any form of post-employment restraint as restraint is considered to reduce the economic mobility of the employees, thereby limiting their personal freedom of choice of work/livelihood. The underlying reasoning behind invalidating post-employment restraints is that if such restraints were permitted, the employee would be unfairly restrained from using the skills and knowledge gained, to advance further in the industry precisely because of such increased expertise. The validity of such restrictive covenants is tested on the standards of reasonability - involving considerations of duration and space of the restriction in question.

### **3. RESTRICTIVE COVENANTS IN INDIA**

Incorporation and subsequent enforcement of ‘restrictive covenants’ such as confidentiality, non-disclosure and non-solicitation in employment contracts, intended to restrict the employees from disseminating confidential and other important information exclusively available with an employer, are often contentious issues in India because such provisions seemingly conflict with Section 27 of the Contract Act.

#### **3.1 Non-competition restriction**

An agreement in restraint of trade has been defined as “one in which a party agrees with any other party to restrict his liberty in the future to carry on trade with other persons who are not parties to the contract in such a manner as he chooses”. As an exception to this general rule, agreements under which one party sells his goodwill to another, while agreeing not to carry on a similar business within specified local limits, are valid, provided such agreements appear to the court to be reasonable. Article 19 (g) of the Constitution of India clearly provides every citizen the right to practice any profession, trade or business. This is not an absolute right and reasonable restrictions can be placed on this right in the interest of the public, the courts have always been weary of upholding such restrictions and have kept the interpretation of this provision flexible so as to ensure that principles of justice, morality and fairness are aptly applied, depending upon the facts and circumstances of each case. Employers often tend to incorporate restrictive covenants in the agreement to protect their confidential information and trade secrets as well as their growing business. For any restrictive

covenant to fall within the ambit of Section 27 of the Contract Act, the agreement has to be in restraint of trade. Unlike the law in the United Kingdom, the Contract Act does not distinguish between partial and total restraint of trade, if the clause amounts to restraint post termination of the agreement, then the same is void. Section 27 itself is succinct and doesn't offer insight as to what kinds of restraints are valid; the qualification of 'reasonable' restraints being valid and enforceable has been read into Section 27 by the courts. To determine whether a restrictive covenant in employment contract would be reasonable and valid or not, the courts have paid due regard to bargaining power of each party, reasonableness of restrictions set out in the covenant, time, place and manner of restriction etc. In India, due to the heavy bargaining power of the employers, the trend is for the courts to protect the rights of the employee and adopt an interpretation favourable to the employee. Section 27 of the Contract Act has been applied in the context of (1) employer - employee contracts, (2) contracts with partners, (3) dealer contracts and (4) miscellaneous cases. While it is a settled position of law that restrictive agreements bind current employees in lawful employment of the employer throughout the duration of the contract, the position of law regarding validity of such restraints on employees after termination of contract is more contentious and adjudicated before courts.

### **3.2 Non-Solicitation of Employees and Customers**

A non-solicitation clause prevents an employee or a former employee from indulging in business with the company's employees or customers against the interest of the company. For example, an employee agrees not to solicit the employees or clients of the company for his own benefit during or after his employment. Non-solicitation obligations have been enforced in some circumstances, albeit on a case by case basis. For instance, in *Desiccant Rotors International Pvt. Ltd vs Bappaditya Sarkar & Anr*, the Delhi High Court allowed an injunction against the manager prohibiting him from soliciting Desiccant's customers and suppliers to stand in effect. It is pertinent to note, however, that the Delhi High Court held that a marketing manager could not be deemed to possess confidential information and that his written declaration to that effect in his employment agreement was meaningless and thus rejected Desiccant's claim to enforce the confidentiality obligations on the manager. Such clauses may be valid if reasonable restrictions such as distance, time limit (reasonable time frame), protection and non-usage of trade secrets and goodwill are imposed on former employees.

### **3.3 Non- Disclosure of Confidential Information and Trade Secrets**

The employee is mandated to take reasonable steps 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 shall not discuss or disclose the confidential information of the company to any person or business unrelated to the company. In *Diljeet Titus v. Mr. Alfred A. Adebare and Others*, the defendant, an advocate, was working at the plaintiff's law firm. On termination of employment, the defendant took away important confidential business data, such as client lists and proprietary drafts, belonging to the plaintiff. The defendants contended that, they were the owners of the copyright work as it was done by them during their employment since the relation between parties was not that of an employer and employee. The Delhi High Court rejected this contention and ruled that the plaintiff had a clear right in the material taken away by the defendant. Accordingly, the Delhi High Court restrained the defendant from using the information taken away illegally. It should be noted that the Delhi High Court did not prohibit the defendants from carrying on a similar service. The defendants were only restrained from using the information they took, as this was necessary to protect the interests of the plaintiff." The relationship between the parties was in the nature of a contract of service.

### **3.4 Training Bond**

The employer to protect and safeguard its interest often executes a training bond with its employees for training imparted and/or provided during the course of their employment or specifically provided prior to joining, to ensure that they work for a particular duration. These bonds specify the minimum period for which the employee shall serve the employer though such clauses may not be enforceable in the Indian context. If the employee acts in breach of such an agreement, the employer can seek compensation, at times limited to the expenses incurred for training the employee. However, the compensation awarded should be reasonable and not imposed by way of a penalty. The employer is entitled only to reasonable compensation based on facts and circumstances of the case. The sole purpose of such contracts is to ensure that the resources and time of employers are not rendered meaningless in training with no benefits derived whatsoever due to early resignation. In *Satyam Computer Services Limited vs Ladella Ravichander*, the Defendant was an employee who had abruptly left the company and as per terms of employment bond, was to pay liquidated damages of Rs. 2,00,000 along with stipend charges and additional expenses incurred by the company for the



Defendant. However, the Andhra Pradesh High Court held that such action by the Defendant did not cause any damage or loss to the company and it would be unreasonable to acquire such amount from the Defendant. An amount of Rs 1,00,000 was fixed by the court as reasonable damages taking into consideration the period of work and the fact that no actual loss was caused to the Company. The employer is required to establish that the employee was the beneficiary of special favour or concession or training at the cost and expense wholly or in part of the employer and there had been a breach of the undertaking by the beneficiary of the same. In such cases, the breach would per se constitute the required legal injury resulting for the employer due to breach of the contract.

### **3.5 Non-Poaching Agreements**

Whilst non-compete, non-solicitation and non-disclosure agreements deal with the employer-employee relationship, a fourth class of restrictive agreement which are often signed by the parties is the non-poaching agreement which is executed between two employers. In an age of constantly evolving specialized industries and niche talent pools, employers often tend to invest a very large amount of human capital into their employees. If these employees subsequently join direct competitors, it can result in substantial economic loss for the employer. A non-poaching agreement therefore enforces guidelines to be followed in cases of lateral hiring. This type of agreement essentially considers the case wherein two organizations/companies agree not to solicit or 'poach' the employees of their direct competitors -non-poaching agreement per se does not contravene section 27 of the Contract Act as it does not restraint an employee from seeking and/or applying for any job/employment. What this class of agreement does instead is it simply mandates that one competitor should seek the consent of the other before hiring that other competitors' employee/s. However, non-poaching agreements have been thought to enhance non-competitive behaviour in the market place. In India, the law regarding section 27 of the Contract Act is well settled as has been previously discussed. However, the issue of non-poaching agreements now also comes within the ambit of the Competition Act, 2002. Whilst no cases have been considered exclusively in connection with non-poaching agreements under the Competition Act so far, Section 3 expressly states that agreements which are anti-competitive in nature are banned. However, so long as non-poaching agreements prescribe guidelines for lateral hiring and do not outright ban this practice, they are not thought to be in contravention of section 3.

#### 4. CONCLUSION

The relevance of inserting restrictive covenants in all kinds of contracts has evolved over a period and gained significant importance specifically due to growing trend of employer-employee disputes. The Law Commission of India in its 13th Report in 1958 had recommended that Section 27 under the Contract Act be amended to include only agreements in restraint of trade that are unreasonable or in the interests of public to be void, however till date no such amendment has taken place. Restrictive covenants need to be analysed on a case-to-case basis. While broad principles emerge from the rulings, whether a condition is violative or not is a question of fact which only a court of law can examine and arrive at an appropriate conclusion based on facts and circumstances.

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#### **About the author:**

The author is a corporate lawyer empaneled with Evaluator. Views expressed are personal.

