TERMINATING AN EMPLOYEE – LEGAL STANDPOINT

The relationship between an employer and employee begins with the signing of a contract of employment. Since in general contracts, the parties are bound by the terms of contract and are liable for breach thereof, so also in a contract of employment, the employer and the employee are governed by the terms of employment, and thus assumes great significance in determining the rights and obligations of both parties. It is thus necessary to construct the terms of employment and conditions of service in the contract of employment with great diligence and prudence. Omissions may cost the employer dearly in pecuniary terms at a later stage. In order to understand the legal standpoint of termination, one must first understand the difference between a workman and employee, since an employee shall be governed by the terms of his 'contract of employment' and termination thereof is per the contract, a workman on the other hand cannot be 'hired and fired' at will, despite anything contrary in the contract or service rules.

Indian laws classify employees in 'workmen' and 'employee' categories. The classification of an employee as a workman or not, assumes significance. A workman is provided various protective remedies under law and is entitled to certain statutory benefits which an employee may not be entitled to (depending on the terms of his contract of employment). Accordingly, an employee can usually be terminated on the basis of the terms of his employment contract (also known as a hire and fire rule). However, termination of a workman requires more compliance, adherence to processes and payment of retrenchment compensation to the terminated employee. For an employee to be categorized as a 'workman', the person employed in an industry should be doing a manual, unskilled, skilled, technical, operational, clerical or supervisory work for hire or reward. However, a person who is employed mainly in a managerial or administrative capacity, or who being employed in a supervisory capacity draws salary exceeding Rs 10,000 (ten thousand) per month or exercises, either by the nature of the duties attached to the office or by reason of the powers vested in him, functions mainly of a managerial nature, is excluded from the definition of a workman, and therefore governed solely by the terms and conditions of 'contract of employment'. However, if the person in employment is a workman, then any dispute or difference between the employer and workman arising out of or connected with the discharge, dismissal, retrenchment or termination of the services of a workman is categorized as an 'industrial dispute', and the concerned retrenched employee can approach the appropriate labour authorities for adjudication. However, if the person is an employee, he will be governed by terms and conditions of the 'contract of employment', and the employer may terminate his services as per the terms construed in the contact.

2.1 RESTRAINT UPON EMPLOYEES

An employment agreement under which an employee agrees that he will serve a particular employer for certain duration, and that he will not serve anybody else during that period, is a valid agreement. During

the period of employment, the employer has an exclusive right to avail the services of his employee, and therefore a restraint on the employee to serve somebody else at the same is reasonable. Such an agreement is not hit by doctrine of restraint of trade. However, an agreement to restrain an employee from competing with his employer after termination of employment is not allowed in the eyes of law.

2.2 AGREEMENT RESTRAINING LEGAL PROCEEDINGS, VOID

Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract, by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to the extent. In other words, if an agreement restricts a party thereto absolutely from enforcing his contractual rights by bringing usual legal proceedings, the same is void. Additionally, according to the Indian Limitation Act, 1963 (the "**Limitation Act**") there is a time limit for various actions. If an agreement between the parties stipulates a smaller time limit than prescribed under the Limitation Act, the agreement is void. Thus if an agreement prohibits an action if brought after one year of the breach of contract, the same is void, because it takes away the right to bring an action after one year. Thought the period of limitation for such an action prescribed in the Limitation Act is three years.

2.3 AGREEMENT IN RESTRAINT OF TRADE

According to section 27 of the Contract Act, 1872 (the "**Contract Act**"), "Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void." An agreement which unnecessarily curtails the freedom of a person to trade is against public policy. Restraining a person from carrying on a trade generally aims at avoiding competition and has monopolistic tendency and this is both against individual's interest as well as the interest of the society and on that ground such restraint is discouraged by law. The aforesaid section which declares an agreement in restraint of trade as void, does not allow any distinction between a total restraint or a partial restraint. Thus, whether an agreement imposes a total restraint example it stipulates that A shall not carry on a trade anywhere in the country during his lifetime, or it imposes only a partial restraint, requiring A not to trade within a certain area, or for a certain duration, the agreement is void.

2.3.1 EXCEPTIONS TO AN AGREEMENT IN RESTRAINT OF TRADE

i. SALE OF GOODWILL

When there is sale of business by a person along with its goodwill, the seller of the business may make an arrangement with the buyer not to carry out business in competition with the buyer. Such an arrangement, if imposes a reasonable restriction on the seller's right to carry on the business, is valid. When a person purchases goodwill of the business, he pays for the right to carry on a certain type of business, in exchange for an express or an implied promise by the seller not to carry on that type of business. it will be contrary to the spirit of the contract of sale of goodwill, if the seller of goodwill, who has received money for the same, starts that business in competition with the buyer again. If the object of the agreement is to protect the rights of the buyer of the goodwill, the restraint is valid. If however, the agreement in essence is a covenant against competition rather than that of sale of goodwill, it would be void. The only exception to the above rule, lies in the Indian Partnership Act, 1932 (the "**Partnership Act**") under the following four situations:

a. Section 11 (2) of the Partnership Act, permits the partners of a partnership firm to make a contract which provides that a partner shall not carry on any business other than that of the partnership firm while he is a partner.

b. Another exemption is contained in section 36 (2) of the Partnership Act, which states that a partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within a specified period or within specified local limits; and, notwithstanding anything contained in section 27 of the Contract Act such agreement shall be valid if the restrictions imposed are reasonable. Generally an outgoing partner is paid his share of the goodwill of the firm, and it is reasonable that he agrees that he will not carry on a business similar to that of the firm.

c. Section 54 of the Partnership act contains another exception to the rule and permits such an agreement to be made upon or in anticipation of the dissolution of the firm. Partners may, upon or in anticipation of the dissolution of the firm, make an agreement that some or all of them will not carry on a business similar to that of the firm within a specified period or within specified local limits and notwithstanding anything contained in section 27, of the Contract Act such agreement shall be valid if the restrictions imposed are reasonable.

d. Section 55 (3) of the Partnership Act contains yet another exception to the above rule, and reads as follows: "Any partner may upon the sale of the goodwill of a firm, may make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits, and, notwithstanding anything contained in section 27 of the Contract Act such agreement shall be valid if the restrictions are reasonable. In other words, when on dissolution of the partnership firm, the firm's goodwill has been sold, there may be an agreement by any partner, who has received consideration on the sale of goodwill of the

firm, in favor of the buyer of the goodwill, that such partner shall not carry on a similar business for a certain duration of time or within specified local limits, such an agreement is valid, if the restrictions imposed are reasonable.

2.4 EMPLOYMENT BOND

The present era is experiencing phenomenal changes in the economy and industrial processes, which has resulted in greater business competition. To cope up with competition, the employers incur huge expenditure in imparting training to their employees for improving the quality of goods and services of the company. However, sometimes the employees leave their employment after honing the skills and improving the knowledge of the industry for better salary and incentives. The increasing rate of attrition subjects the employers not only to financial losses but also delays in completing the ongoing projects thereby directly impacting their goodwill and reputation in the market. Therefore, in order to safeguard their interest, employers have of late started to obtain an employment bond from their employees who are found suitable for training or skill development. Such employment bonds are agreements between the employer and employee wherein among other terms & conditions of the employment, an additional clause is incorporated which requires the employee to serve the employer compulsorily for a specific time period else refund the amount specified as bond value. The question that arises here is whether such a method to retain employees is effective, acceptable and enforceable under the law.

2.4.1 EMPLOYMENT BOND: NEED AND ENFORCEABILITY

Generally before selecting employees for providing training or skill enhancement program, employers take necessary safeguard of conducting interviews, take assurances that employee will stick to complete the projects for which he is being trained and shall also train the other co-employees so that an effective and efficient work environment is created. However, employees still tend to leave for greener pastures and, therefore, it is increasingly becoming necessary for the employers to enter into an employment bond to safeguard their interests. If employee leaves the employment without serving the company for agreed time period, the employer is expected to suffer due to the undue delay in completing the work undertaken, which can ultimately affect its reputation and creditability in the market. To prevent such situations, the employer can compensate the loss incurred if a valid employment bond has been executed. Such bonds also deter the employees from committing any breach of the agreed terms and conditions. Now, the most pertinent question that arises here is whether the employment agreement with negative covenant is enforceable under Indian laws? The simple answer is yes. Such employment agreements with the negative covenant is valid and legally enforceable if the parties agree with their free consent i.e.

without force, coercion, undue influence, misrepresentation and mistake. The courts in India have held in its various judgments that in the event of breach of contract by the employee, the employer shall be entitled to recover damages only if a considerable amount of money was spent on providing training or incurred other expenses for the employee. Further, the courts have been reluctant to restrain the employee from joining a competitor employer. The employment bond will not be enforceable if it is either one sided, unconscionable or unreasonable. Therefore, it is pertinent to be cautious while drafting the employment bond because it is mandatory that the conditions mentioned in the employment bond, including the compulsory employment period and amount of penalty are reasonable in order to be valid under the Indian law. The term "reasonable" is not defined under the legislation and, therefore, the meaning has to be determined on a case by case basis depending upon the issues involved and circumstances of the case. In general, the conditions stipulated in the contract should justify that it is necessary to safeguard the interest of the employer and to compensate the loss in the event of breach of contract. Further, the penalty or compulsory employment period stipulated in the contract should not be exorbitant to be considered as valid and to be regarded as reasonable.

2.4.2 CHALLENGING THE ENFORCEABILITY OF EMPLOYMENT BOND

The validity and enforceability of the employment bond can be challenged on the ground that it restrains the lawful exercise of trade profession or trade or business. As per section 27 of the Contract Act, 1872 (the "**Contract Act**") any agreement in restraint of trade or profession is void. Therefore, any terms and conditions of the agreement which directly or indirectly either compels the employee to serve the employer or restrict them from joining competitor or other employer is not valid under the law. The employee, by signing a contract of employment, does not sign a bond of slavery and, therefore, the employee always has the right to resign from the employment even if he has agreed to serve the employer for specific time period.[1] However, the restraints or negative covenants in the agreement or contract may be valid if they are reasonable. For a restraint clause in an agreement to be valid under law, it has to be proved that it is necessary for the purpose of freedom of trade. For instance, if the employer is able to prove that the employee is joining the competitor to divulge its trade secrets then the court may issue an injunction order restricting the employment of the employee to protect the interests of the employer. Whenever an agreement is challenged on the ground of it being in restraint of trade, the onus is upon the party supporting the contract to show that the restraint is reasonably necessary to protect his interests.[2]

In order to execute a valid employment bond, the parties have to ensure that the following requisites have been complied: i) the contract of employment has to be signed by the parties with free consent; ii) the

[1]Central Inland Water Transport Corporation vs. Brojonath Ganguly, (1986)IILLJ171SC
[2] Niranjan Shankar Golikari vs. The Century Spinning and Manufacturing Company Ltd, AIR 1967 SC 1098

conditions stipulated must be reasonable; and iii) the conditions imposed on the employee must be proved to be necessary to safeguard the interests of the employer. Further, the employment bond stipulating conditions such as to serve the employer compulsorily for a specific time period or penalty for incurring the expenses is in the nature of the indemnity bond and, therefore, such kind of employment bond has to be executed on a stamp paper of appropriate value in order to be valid and enforceable.[3]

2.4.3 REMEDIES AVAILABLE TO EMPLOYER AND EMPLOYEE

In the event of breach of employment bond, the employer might incur a loss and, therefore, may be entitled for compensation. However, the compensation awarded should be reasonable to compensate the loss incurred and should not exceed the penalty, if any, stipulated in the contract.[5] Usually, the court determines the reasonable compensation amount by computing the actual loss incurred by the employer having regard to all circumstances of the case. Even if the bond stipulates payment of any penalty amount in the event of breach, it does not mean that the employer shall be entitled to receive the stipulated amount in full as compensation on the occurrence of such default; rather the employer shall be entitled only for reasonable compensation as determined by the court.

As mentioned, the conditions stipulated in the employment bond should be reasonable in order to be valid and, therefore, even if unreasonable condition/clauses are stipulated in the contract such as imposing exorbitant duration of compulsory employment period or huge penalty upon the employee, the court shall award compensation only if it determines that the employer has incurred loss by such breach of contract. The court normally considers the actual expenses incurred by the employer, the period of service by the employee, conditions stipulated in the contract to determine the loss incurred by the employer to arrive at the reasonable compensation amount. For instance, in the case of *Sicpa India Limited v Shri Manas Pratim Deb*[4], the plaintiff had incurred expenses of Rs 67,595 (sixty seven thousand five hundred ninety five) towards imparting training to the defendant for which an employment bond was executed under which the defendant had agreed to serve the plaintiff company for a period of three years or to make a payment of Rs 2,00,000 (two lakh). The employee left the employment within a period of two years. To enforce the agreement the employer went to the court, which awarded a sum of Rs 22,532 (twenty two thousand five hundred thirty two) as compensation for breach of contract by the employee. It is crucial to note that though the bond stipulates a payment of Rs 2,00,000 (two lakh) as compensation for breach of contract, the court had considered the total expenses incurred by the employer and the

[3] IBS Software Services Group vs. Leo Thomas, 2009 (4)KLT 797
[4] MANU/DE/6554/2011

employee's period of service while deciding the compensation amount. Since the defendant had already completed two years of service out of the agreed three year period, the court divided the total expenses of Rs 67,595 (sixty seven thousand five hundred ninety five) incurred by the plaintiff into three equal parts for three years period and awarded a sum of Rs 22,532 (twenty two thousand five hundred thirty two) as reasonable compensation for leaving the employment a year before the agreed time period. Similarly, the High Court of Andhra Pradesh in the case of *Satyam Computers v Leela Ravichander*[5], had also reduced the compensation amount considering the period of service of the employee. In view of the aforesaid discussions and various court decisions, the employment bond is considered to be reasonable as it is necessary to protect the interests of the employer. However, the restrains stipulated upon the employee in the said contract should be "reasonable" and "necessary" to safeguard the interests of the employer or else the validity of the bond may be questioned. The employees are always free to decide their employment and they cannot be compelled to work for any employer by enforcing the employment bond. The court can; however, issue order restricting the employment of the employee only if the said action is deemed necessary to safeguard the trade secrets, proprietary interest of the employer. In the event of breach of contract by the employee, the only remedy available to the employer is to obtain a reasonable compensation amount. The compensation amount awarded shall be based upon the actual loss incurred by the employer by such breach.

2.5 CLASSIFICATION OF EMPLOYEES

Employees are broadly classified into the following eight categories:

i. *Temporary employee*: means an employee who has been appointed for a limited period for work which is of essentially temporary nature and who is employed temporarily as an additional employee in connection with temporary increase in work of permanent nature.

ii. *On contract*: a workman employed on contractual basis means someone whose tenure of employment is for a specified period of time and the workman is entitled to only the benefits specified in the contract of employment. Such contract employee shall not have any right to claim permanency or regularization of his employment in the organization after the expiry of specified period. Unless terminated earlier by one month's notice or pay in lieu thereof, such appointment will automatically come to an end at the expiry of the specified period and no notice or any compensation will be payable.

iii. *Probationer*: means an employee who is previously employed to fill a permanent vacancy or post and who has not completed six months or 240 (two hundred forty) days of service in the aggregate in that post and has not been confirmed in writing.

[5] MANU/AP/0416/2011

iv. *Trainee*: a trainee is an apprentice (not under the Apprentices Act, 1961) or learner who is selected for training in any job or trade on a stipend or allowance for such period not exceeding three years in all and on such terms and conditions as may be determined by the management from time to time.

v. *Part-time employee*: means an employee who is employed for less than the normal period of working hours.

vi. *Intern:* a student who works, sometimes without pay, in order to gain work experience or satisfy requirements for a qualification.

vii. *Permanent employee*: means an employee who has been employed on a permanent basis, or who, having been employed as a substitute or a temporary employee has subsequently been made permanent by an order in writing by the management. A permanent employee also means an employee who has been engaged on a permanent basis against a permanent post and includes any person who has satisfactorily completed a probationary period.

viii. *Casual employee*: is someone who is employed to fulfill unexpected requirement due to unusual or seasonal pressure of work which is of an occasional or casual nature. The person's wages are fixed on hourly or daily basis and he is not entitled to leave or other benefits of any kind as available to permanent employees.