

Enforceability of Lock-in Period in Employment Contracts

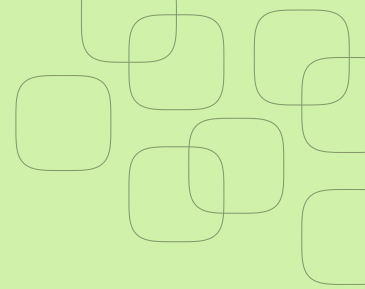
Introduction

The lock-in period is a widely recognized and frequently included clause in various types of agreements, particularly in business and legal contracts. This clause serves as a mechanism to ensure stability and commitment by preventing either party from prematurely terminating the agreement for a specified duration. Regardless of the termination clause that may be present in the agreement, the lock-in period creates a binding obligation for the parties to fulfill their respective responsibilities and honor the terms of the agreement throughout the specified period. This ensures continuity and fosters mutual trust, as both parties are assured of the other's commitment to upholding their obligations during this time. By reducing the risk of abrupt withdrawal or non-compliance, the lock-in period provides a structured framework for stability and predictability in the contractual relationship. Even though the lock-in period has its own benefits, is it legally enforceable to include a lock-in period clause in employment contracts that restricts employees from leaving the organization or joining another organization?

The enforceability of such clauses in employment contracts was notably addressed in the Lily Packers Private Limited case, where the Delhi High Court upheld the validity of a three-year lock-in period in an employment agreement, emphasizing that reasonable restrictions during the tenure of employment do not violate fundamental rights.

Understanding Covenants in Employment Contracts

In the realm of employment contracts, two types of covenants often play a crucial role: positive and negative covenants. Negative covenants are contractual provisions that restrict certain actions of the employees. These covenants can operate either during the term of employment or after the contract has been terminated. A nuanced legal approach differentiates the implications and enforceability of these two scenarios.



Negative Covenants During Employment

The Supreme Court of India addressed this issue in *Niranjan Shankar Golikari v. Century Spinning And Manufacturing Co.*¹, the Court distinguished between negative covenants during employment and those applicable after termination. It held that covenants restricting employees to serve exclusively during their employment period are generally lawful. Such covenants do not constitute restraint of trade as defined under Section 27 of the Indian Contract Act, unless they are excessively harsh, unreasonable, or unconscionable.

For example, a negative covenant requiring an employee not to work for another employer or not to engage in similar business during their employment period is deemed reasonable and enforceable. The Supreme Court emphasized that restrictive considerations differ significantly between covenants active during employment and those post-termination.

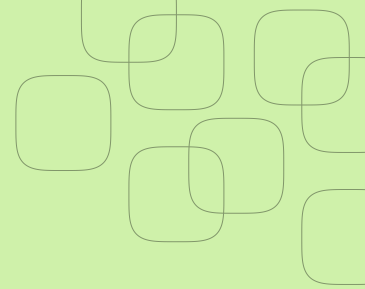
Negative Covenants After Employment

Negative covenants restricting employees post-termination are evaluated under stricter scrutiny, as these may infringe upon the individual's right to pursue a livelihood. Courts carefully examine whether such provisions amount to an unreasonable restraint of trade and are against public policy.

In the case of *Lily Packers Private Limited v. Vaishnavi Vijay Umak*², the Delhi High Court upheld a negative covenant applicable during the employment period. The covenant restricted the employee from engaging in work similar to or substantially similar to that carried out during their employment. The Court found this restriction reasonable and necessary to protect the employer's interests, reinforcing that such covenants during the employment period do not amount to restraint of trade.

¹ MANU/SC/0364/1967.

² MANU/DE/4537/2024.



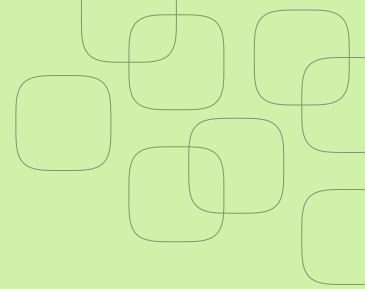
Post-termination, certain clauses in employment contracts remain enforceable, such as confidentiality clauses, data protection clauses, and intellectual property rights clauses. These provisions are critical for safeguarding an employer's sensitive information and proprietary assets even after the employment relationship ends. In the landmark case of *Niranjan Shankar Golikari*, the Supreme Court granted an injunction restraining the employee from disclosing or divulging any confidential information acquired during their tenure.

Lock-In Periods in Employment Contracts

Another significant aspect of employment contracts is the inclusion of lock-in periods. Lock-in periods ensure that employees serve their employers for a defined duration, providing stability and continuity to the organization. The question of whether such provisions violate fundamental rights under the Constitution of India has been widely debated. However, courts have consistently upheld that lock-in periods, when mutually agreed upon by the parties, do not infringe upon constitutional rights.

In the *Lily Packers* case, the court held that the clause which states the lock-in period for the employees does not violate the fundamental rights of the employees as enshrined in the Constitution of India. The High Court was of the opinion that the such clauses in an agreement are usually decided upon voluntarily, as also such employment contracts are entered into by the parties by their own individual consent and volition. It is also noted that such clauses in employment contracts may in fact be necessary for the health of the employer institution as it provides the required stability and strength to the employer institution and its framework.

Lock-in periods are usually negotiated voluntarily, with terms like pay fixation and emolument benefits included in the agreement. These provisions are particularly prevalent at executive levels, where organizational stability is critical. By minimizing employee attrition, lock-in periods contribute to the employer's long-term strength and operational health.



Courts have consistently maintained that any reasonable covenant within the term of an employment agreement is both valid and lawful. Consequently, the inclusion of a lock-in period in employment contracts cannot be interpreted as a violation of Fundamental Rights guaranteed by the Constitution of India. Employment contracts are generally viewed as matters of contractual disputes rather than cases involving the infringement of fundamental rights. While certain employment conditions may occasionally be deemed an unreasonable restriction on an employee's right to seek employment, a lock-in period of three years does not fall into such a category and is considered permissible.

When an employee breaches the lock-in period specified in their employment contract, the employer may have the right to claim compensation for the resulting loss. This begins with referring to the contractual terms, which often include a clause outlining the consequences of breaking the lock-in period, such as repayment of training costs, signing bonuses, or other incurred expenses. The loss must be quantifiable and directly attributable to the breach. Employers can invoke provisions under the Indian Contract Act, 1872, such as Section 73, which allows for compensation due to contract breaches. However, the employer must demonstrate the incurred loss and make reasonable efforts to mitigate it.

Conclusion

In summary, negative covenants during employment are generally lawful, provided they are reasonable and protect the employer's interests. Post-termination covenants, however, require careful examination to ensure compliance with public policy and fundamental rights. Similarly, lock-in periods in employment contracts, when agreed upon voluntarily, are considered essential for the stability and growth of organizations.

This framework helps balance the rights of employees with the legitimate interests of employers, ensuring fairness and legal integrity in employment agreements.

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