

ENFORCEABILITY OF MINIMUM LOCK IN PERIOD CLAUSES IN EMPLOYMENT CONTRACTS: ANALYSIS OF RECENT SUPREME COURT JUDGMENT IN VIJAYA BANK

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1. INTRODUCTION

The debate surrounding the contours and scope of restraint of trade under Section 27 of the Indian Contract Act, 1872 (“**Contract Act**”) is an old and evolving one. One of the issues that keep arising time and again is whether a restrictive covenant during the subsistence of an employment agreement in the form of requirement of a minimum tenure is enforceable or not. The Supreme Court in *Vijaya Bank v Prashant B Narnaware*,¹ was dealing with the aspect of whether a minimum lock in period bond clause of a public sector bank would amount to restraint of trade under Section 27 of the Contract Act or can be said to be opposed to the public policy and thereby be contrary to Section 23 of the Contract Act. This article focuses on analyzing the judgment and its implications for employment agreements.

2. BACKGROUND

The Supreme Court in the classic decision of *Niranjan Shankar Golikari v Century Spg and Mfg Co Ltd*² had observed the following in the context of restraint of trade and the scope and ambit of the restriction under Section 27 of the Contract Act:

“The result of the above discussion is that considerations against restrictive covenants are different in cases where the restriction is to apply during the period after the termination of the contract than those in cases where it is to operate during the period of the contract. Negative covenants operative during the period of the

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1. 2025 SCC OnLine SC 1107 : 2025 INSC 691.
2. 1967 SCC OnLine SC 72 : AIR 1967 SC 1098.

contract of employment when the employee is bound to serve his employer exclusively are generally not regarded as restraint of trade and therefore do not fall under section 27 of the Contract Act. A negative covenant that the employee would not engage himself in a trade or business or would not get himself employed by any other master for whom he would perform similar or substantially similar duties is not therefore a restraint of trade unless the contract as aforesaid is unconscionable or excessively harsh or unreasonable or one sided (...).”

Subsequently, the Supreme Court in *Superintendence Co of India (P) Ltd v Krishan Murgai*³ speaking through Sen J held as follows:

“Agreements of service, containing a negative covenant preventing the employee from working elsewhere during the term covered by the agreement, are not void under Section 27 of the Contract Act, on the ground that they are in restraint of trade. Such agreements are enforceable. The reason is obvious. The doctrine of restraint of trade never applies during the continuance of a contract of employment; it applies only when the contract comes to an end.”

3. IMPUGNED CLAUSES

3.1 Recruitment Notification Clause- Clause 9 (w)

“Selected candidates are required to execute an indemnity bond of Rs.2.00 Lakh (Rupees 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”.

3.2 Appointment Letter Clause - Clause 11 (k)

“You are required to serve the Bank for a minimum period of 3 years from the date of joining the bank and should execute an indemnity bond for Rs. 2.00 lakhs. The said amount has to be paid by you in case you resign from the services of the bank before completion of stipulated minimum period of 3 years. For this purpose, you have to bring a blank non-judicial stamp paper of Rs. 100/- procured in the State of your posting.”

3. (1981) 2 SCC 246.

4. RELEVANT PROVISIONS UNDER THE CONTRACT ACT

Section 27: Agreement in restraint of trade, void

“Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.”

Section 23. What considerations and objects are lawful, and what not

“The consideration or object of an agreement is lawful, unless—
 it is forbidden by law; or
 is of such a nature that, if permitted, it would defeat the provisions of any law; or
 is fraudulent; or
 involves or implies, injury to the person or property of another; or
 the Court regards it as immoral, or opposed to public policy.
 In each of these cases, the consideration or object of an agreement is said to be unlawful. Every agreement of which the object or consideration is unlawful is void.”

5. ISSUE FRAMED BY COURT

Whether clause 11(k) of the appointment letter amounts to restraint of trade under Section 27 of the Contract Act and/or opposed to public policy and thereby being contrary to Section 23 of the Contract Act and violative of Articles 14 and 19 of the Constitution of India, 1950?

6. JUDICIAL REASONING OF THE SUPREME COURT IN *VIJAYA BANK CASE*

6.1 The Contract Act is not a code but for matters provided therein, it is to be considered as exhaustive and accordingly, for restraint of trade, the provision contained in Section 27 of the Contract Act is to be viewed as the parameter in which a restriction being valid or not is to be permitted.

6.2 Given that Section 27 provides that only every agreement by which anyone is restrained from exercising a lawful profession, trade or business is void, it can be concluded that a restrictive covenant operating during the subsistence of an employment contract would be valid as it does not impose does not restraint in the sense it is used in Section 27 to trade or employment.

6.3 The Supreme Court speaking through Bagchi J observed that the relevant clause in the appointment letter only seeks to impose a restriction on the respondent's option to resign by specifying a specified term. Since, the clause was not meant to restrain future employment, it cannot be considered to be violative of Section 27 of the Contract Act.

6.4 Incorporation of a minimum service tenure for experienced employees to reduce attrition and improve efficiency cannot be said to be in contravention of public policy⁴ or unconscionable.⁵

6.5 A senior managerial grade pay employee to be asked 2 Lakhs as liquidated damages cannot be deemed to be very high to make the concept of resignation itself difficult. The Supreme Court also observed the resignation by the employee by paying the said amount itself demonstrates this though it was paid under protest.

6.6 Accordingly, the Supreme Court held that the restrictive covenant as specified in the restrictive covenant of the appointment letter of the

4. See *Central Inland Water Transport Corpn Ltd v Brojo Nath Ganguly* (1986) 3 SCC 156, 216-217. Observations of the Supreme Court quoted as follows:

91. ... 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 s 23 when it states that "The consideration or object of an agreement is lawful, unless ... the court regards it as ... opposed to public policy"...

5. See *Superintendence Co of India (P) Ltd v Krishan Murgai* (1981) 2 SCC 246, 265. Observations quoted as follows:

59. It is well-settled that employee covenants should be carefully scrutinised because there is inequality of bargaining power between the parties; indeed no bargaining power may occur because the employee is presented with a standard form of contract to accept or reject. At the time of the agreement, the employee may have given little thought to the restriction because of his eagerness for a job; such contracts "tempt improvident persons, for the sake of present gain, to deprive themselves of the power to make future acquisitions, and expose them to imposition and oppression".

employee neither amounted to a restraint of trade nor can it be construed to be opposed to public policy.

7. ANALYSIS OF THE JUDGMENT AND ITS IMPLICATIONS

Keeping in mind the scope and ambit of Section 27 of the Contract Act and its interpretation as laid down by the Supreme Court including the classic decision in *Niranjan Shankar Golikari*⁶ the interpretation that reasonable restrictions during the subsistence of the employment cannot be set aside unless they are onerous is in line with the statutory framework.

This judgment though may not necessarily be a precedent automatically for similar clauses in private sector as it is fact specific and the Supreme Court has specifically upheld it by observing the peculiar circumstances of a public sector bank as Vijaya Bank as follows:

“Public sector undertakings like the appellant-bank needed to compete with efficient private players operating in the same field. To survive in an atmosphere of deregulated free-market, public sector undertakings were required to review and reset policies which increased efficiency and rationalized administrative overheads”⁷

Furthermore, even for the public sector and also for the private sector, the validity of an employment bond clause will be seen on a case-to-case basis and may not be automatically applicable for junior level employees where attrition is anticipated.

The other issue that arises is that given that the employee had served approximately around 18 months out of the designated 36 months prescribed as the minimum tenure, should the entire liquidated damages prescribed of Rs 2 Lakhs would have been deemed payable. On this, the Supreme Court has gone by the perspective of the quantum of liquidated damages high as the employee was on a lucrative pay package.

6. (n 3).

7. See *Vijaya Bank case* 2025 SCC OnLine SC 1107 : 2025 INSC 691, paras 26 and 27. Relevant observations quoted below:

26. ... Ensuring retention of an efficient and experienced staff contributing to managerial skills was one of the tools inalienable to the interest of such undertakings including the appellant-bank.

27. This prompted the appellant-bank to incorporate a minimum service tenure for employees, to reduce attrition and improve efficiency. Viewed from this perspective, the restrictive covenant prescribing a minimum term cannot be said to be unconscionable, unfair or unreasonable and thereby in contravention of public policy.

The Supreme Court in *Kailash Nath Associates v DDA*⁸ speaking through Nariman J has held that,

“Where a sum is named in a contract as a liquidated amount payable by way of damages, the party complaining of a breach can receive as reasonable compensation such liquidated amount only if it is a genuine pre-estimate of damages fixed by both parties and found to be such by the Court. In other cases, where a sum is named in a contract as a liquidated amount payable by way of damages, only reasonable compensation can be awarded not exceeding the amount so stated.” Likewise, in *Kailash Nath*, it was clarified that, “Reasonable compensation will be fixed on well-known principles that are applicable to the law of contract, which are to be found inter alia in Section 73 of the Contract Act”.⁹

Accordingly, for categories of employees where the pay package is not considered to be lucrative, the entire liquidated damages may not be payable but a proportionate reduction may be undertaken basis the tenure already served and the tenure left.

8. (2015) 4 SCC 136.

9. *ibid.*