



Somanna Kalappa
Principal Associate

VALIDITY OF RESTRICTIVE COVENANT & LIQUIDATED DAMAGES IN EMPLOYMENT CONTRACT

Supreme Court of India ("SC"), in *Vijaya Bank and another case*¹ held, on May 14, 2025, that a restrictive covenant in an appointment letter requiring an employee to serve for a minimum period and to pay liquidated damages ("LD") upon premature resignation is not in restraint of trade² nor is it opposed to public policy³ or violative of Articles 14⁴ and 19⁵ of the Constitution.

Brief Facts.

- The respondent-employee *viz.* Prashant B Narnaware ("Prashant") joined the appellant-bank ("Vijaya Bank") in 1999 as Probationary Assistant Manager and was later promoted.
- In 2006, Vijaya Bank issued a recruitment notification for officers post, which included a condition requiring selected candidates to execute an indemnity bond of Rs. 2 lakh promising to pay this amount to the bank if they leave service before completing three years.
- Prashant, aware of this condition, applied for and was selected for the post of Senior Manager. The appointment letter of 2007 also included the same condition.
- Accepting this condition, Prashant resigned from his previous post and joined the new position and executed an indemnity bond.
- Prashant tendered his resignation to join another bank before completing three years. His resignation was accepted and he paid Rs. 2 lakhs to Vijaya Bank 'under protest'.
- Thereafter, Prashant filed a writ petition before the Karnataka High Court ("HC") challenging the recruitment notification⁶ and the appointment letter⁷, arguing *inter alia* they violated Articles 14 and 19 of the Constitution and were in restraint of trade⁸ and opposed to public policy under the Indian Contract Act, 1872 ("Contract Act").
- The HC allowed the writ petition, which decision was also upheld by the Division Bench. Vijaya Bank appealed to the SC.

Vijaya Bank's Contentions.

- The restrictive covenant⁹ is valid and is not in restraint of trade nor does it oppose public policy.
- The indemnity bond and minimum service tenure were to secure its interests.

¹ *Vijaya Bank and Another v. Prashant B Narnaware*, 2025 SCC OnLine SC 1107.

² Section 27 of the Contract Act voiding agreements in restraint of trade.

³ Section 23 of the Contract Act prescribing what consideration and objects are lawful, and what are not.

⁴ Equality before law.

⁵ Protection of certain rights regarding freedom of speech, *etc.*

⁶ Clause 9(w).

⁷ Clause 11(k)

⁸ Section 27 of the Contract Act.

⁹ clause 11(k).

- Premature resignations prejudice the Bank. Being a public sector undertaking, cannot make *ad-hoc* appointments.
- The quantum of LD was not disproportionate, considering Prashant's senior managerial grade and lucrative pay package.

Prashant's Contentions.

- The clause is part of a standard form contract, and he was compelled to accept it to advance his career.
- The terms were imposed through an unequal bargaining mechanism. The clause is unreasonable, onerous, ex-proportionate, and thus opposed to public policy. It amounts to a restraint of trade under the Contract Act.
- The clause is opposed to public policy and thereby contrary to the Contract Act¹⁰ and violative of Articles 14 and 19 of the Constitution.

SC's Judgement & Reasoning.

Allowing the appeal, the SC:

- Relying on its previous judgements¹¹ reiterated that negative covenants, that are operative during the period of the contract of employment when the employee is bound to exclusively serve his employer, are generally not regarded as restraint of trade.
- Held that a restraint by which a person binds himself during the term of the agreement not to take service elsewhere or be engaged by a third party has been held not to be void under Section 27 of the Contract Act.
- Held that clause 11(k) imposed a restraint on Prashant to work for a minimum term of three years, with LD payable in default. The object was in furtherance of the employment contract, and not to restrain future employment. Thus, the restrictive covenant is not violative of Section 27 of the Contract Act.
- Referring to an earlier judgement,¹² noted that standard form contracts between parties with unequal bargaining power, if unconscionable, unfair, unreasonable, and injurious to public interest, can be deemed void under Section 23 of the Contract Act as opposed to public policy.
- Standard form employment contracts *prima facie* evidence unequal bargaining power. The onus to prove that a restrictive covenant is not against public policy is on the employer.
- The minimum service tenure was incorporated to reduce attrition and improve efficiency. Viewed from this perspective, it found the restrictive covenant prescribing a minimum term cannot be said to be unconscionable, unfair or unreasonable and thereby in contravention of public policy.
- Regarding the LD, disagreed with the argument that the quantum was disproportionate.
- Found the stance of the appellant-bank neither unjust nor unreasonable.

Comment.

This judgement is testimony to the fact that the law is in a constant state of evolution. The SC, in 1986 in *Central Inland Water Transport Corpn. case (supra)* had held that: "[B]y entering into a contract of employment a person does not sign a bond of slavery and a permanent employee cannot be deprived of his right to resign. A resignation by an employee would, however, normally require to be accepted by the employer in order to be effective." This judgment could have a profound impact on employment contract in the days to come.

This *Counsellence Connect* contains information in a nutshell on a recent change in law.

This is not legal advice and must not be treated so. For any clarifications, please contact us at: info@counsellence.com. Past issues of *Counsellence Connect* are available at the 'Newsletters' page of our website (www.counsellence.com).

¹⁰ Section 23.

¹¹ *Niranjan Shankar Golikari v. Century Spg. and Mfg. Co. Ltd.*, 1967 SCC OnLine SC 72 and *Superintendence Co. of India v. Krishan Murgai*, (1981) 2 SCC 246.

¹² *Central Inland Water Transport Corporation Ltd. v. Brojo Nath Ganguly*, 1986 SCC OnLine SC 119.