

RESTRICTIVE COVENANTS: AN INDIAN APPROACH

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ABSTRACT

Organizations make an attempt to protect their trade secrets and confidential information by the use of 'restrictive' agreements between employers and employees, which place limitations and restrictions on the latter, pertaining to the knowledge and information gained in the course of employment and how it shall be disseminated. It is a moot debate that disputes arise as a result of diverging interests between the employer and employees and there is a need to protect the interest of each party. However, where the employer has the right to protect the invented and technical secrets, the employee has a right to strive for progress and to earn his livelihood.

Article 19(1)(g) of the Constitution of India grants every citizen the right to practice any profession, trade or business. This is not an absolute right and reasonable restrictions can be imposed on this right in interest of public. The use of restrictive covenants such as Non- competition agreement, Non- solicitation agreement and Non- disclosure agreements by the employers for protecting their trade secrets and to retain the competitive edge deprives the employee of their growth and livelihood.

The Indian precedents have, however, highlighted the need for protection of rights of an employee seeking employment, as priority, over protecting the interests of the employer seeking to avoid competition. The numerous precedents have, in light of the constitutional and statutory provisions under the Indian Contract Act, 1872, held that the right to livelihood of the employees must prevail inspite of an existing agreement between the employer and the employee.

The author through her research, attempts, to decipher the legal framework existing in India to address the validity and enforceability of such restrictive covenants between the employers and employees that seek to determine their rights post-termination of employment.

KEYWORDS: Non- Compete Agreement, Non- Solicitation Agreement, Restrain on Trade, Trade secrets, Right to Livelihood

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INTRODUCTION

A restrictive covenant or a covenant which restrains an employee to profess a certain profession after the termination of his employment is a clause used in contracts under which the employee agrees to not pursue a similar profession, trade or business in competition against the employer. It is a clause forming a part of the contractual agreement of employment between an employee and employer. Such covenants restrict the employee, for a pre-determined time period, from using the knowledge acquired during the term of employment in their subsequent businesses. The effect of the provision diminishes the possibility of the employee misusing the trade secrets, trade connections or confidential information in a competing business after he has given his resignation or his employment has been terminated. Apart from the regular employment agreements, such covenants are also at times included in the agreements relating to sale of goodwill of business or professional practice, franchise agreements, partnership agreements, employment exit agreements and other exclusive dealings and service arrangements. The Indian Contract Act, 1872 provides for such agreements, the validity and enforcement of which has been under constant scrutiny as understood through the conflicting judicial decisions that vary according to the extent and reasonableness of the negative stipulation.

Section 27 of the Contract Act, is the governing principle of such agreements and has been evaluated to determine that which restriction would amount to be reasonable in law. The provision states that *“Every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.*

Exception: *Saving of agreement not to carry on business of which goodwill is sold.-One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the goodwill from him, carries on a like business therein, provided that such limits appear to the Court reasonable, regard being had to the nature of the business.”²*

² Indian Contract Act 1872, S.27

Indian courts have consistently refused to enforce post-termination restrictive covenant clauses in employment contracts since they restrain trade and violate the fundamental right to work and profess a particular profession. The courts view them as "restraint of trade" which is not only impermissible under the aforementioned governing law i.e. section 27 of the Indian Contract Act, 1872, but also violates the constitutional right under article 19(1)(g). It is considered to be against the public policy since it deprives the individual of his right to earn a livelihood by utilizing his full potential. The Indian courts have reiterated in various judicial decisions that a restrictive covenants and the clause that restrains trade is to be rendered futile if it prevents the employee from using his developed skills in another business effort or forces them to work outside the contours of his field of expertise.

However, in the light of numerous judicial pronouncements, the courts have permitted certain reasonable restrictions in favour of the employer in order to ensure that he can get adequate assistance from his skilled employees without the fear that his employees would terminate the employment contract and convert into his competitors. Moreover, the reasonableness would vary depending upon the profession or trade, and the restraint would be valid only to the extent that it protects the trade secrets and business connections of the employer. The imposition of the restriction should have a striking balance between the rights of the employer and employee and simultaneously be in consonance with the public interest.

The Supreme Court gave its view in the case of *Niranjan Shankar Golikari v. The Century Spinning and Manufacturing Company Ltd*³ that negative covenants can hold validity if the restriction imposed on them is reasonable. It was held that the 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 which it is to operate during the period of the contract. Negative covenants operative during the period of the 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 the ambit of section 27 of the Contract Act. But even if a negative covenant restricts the employee from engaging in a particular trade or business where he is required to perform same functions is not a restraint of trade *ab-initio*, unless the contract

³Niranjan Shankar Golikari Vs. The Century Spinning and Mfg. Co. Ltd. AIR1967SC1098

as aforesaid is *unconscionable or excessively harsh or unreasonable or one sided*. Thus, a restrictive covenant can be enforced only when the restrictions are reasonable and the clauses are consistent with the public policy.

In *Percept D' Mark (India) Pvt. Ltd v Zaheer Khan*,⁴ the Supreme Court held that “*a compulsion on the respondent to forcibly enter into a fresh contract with the appellant even though he has fully performed the previous contract, is therefore, a restraint of trade, which is void under Section 27 of the Indian Contract Act, 1872.*”

The court further laid down that under Section 27 of the Contract Act, the doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applies only when the contract comes to an end. The doctrine is not confined only to contracts of employment, but is also applicable to such other contracts which impose any kind of restriction to trade.

The terms must be plausible to the extent that adequate protection is granted to the employer for his trade secrets, confidential information and expert technologies.

TYPES OF RESTRICTIVE COVENANTS

1. NON- COMPETE AGREEMENTS

Non-compete clause is a clause forming a part of the employment contract which restrains an employee from practicing a similar profession that requires him to perform similar duties so that the trade secrets of the employer are not divulged. Even though non-compete provisions that restrict the employee are held to be against the right to profess profession and earn his livelihood; an employer is still entitled to protect his business interest. He has the right to ensure that the knowledge, training and confidential information acquired under his expertise is not promulgated and used against his business interests by the competitors. This clause protects the employer from misuse of his business secrets, or unauthorized disclosure of secret information pertaining to his field of trade.

⁴AIR 2006 SC 3426

The court explained a non-compete clause to be, either a paragraph that forms a part of the employment agreement or can be an entirely separate document which the employees are bound to sign when hired. The courts have, through their judgments, provided that the various types of restraint clauses may relate to:

- Goodwill;
- competitive business during the term of contract, franchise/collaboration agreement in a specified area during the period of contract;
- the partnership agreements providing for restraint of trade after dissolution of the partnership;
- restrictions put on employees joining during the course of employment in another business; restraint of using information acquired during employment, after employment etc.⁵

Such non-compete clauses are operative in franchise agreements as well so that the franchiser can protect his confidential information and the technical know-how from a franchisee who may exploit such trade secrets or divulge them to a significant competitor. The non-compete clause would restrict the franchisee owner to conduct business within certain geographical limits so as to not hamper the business of the franchiser or may but in other conditions as agreed to by the parties. However, the reasonableness and the enforceability would depend on the facts of the case.

In the case, *Gujarat Bottling Co. Ltd. and others v. Coca Cola and ors*, an agreement for grant of franchise by Coca Cola to Gujarat Bottling Company to manufacture, bottle, sell and distribute beverages under trademarks held by the franchiser contained a restrictive stipulation restraining the franchisee from carrying out the same functions for any other competitor during the subsistence of the franchise agreement.

The court held that the restriction was intended to promote the trade and protect the trade secrets and formulas. The stipulation was only a restriction for the period till the contract was

⁵IEC School of Art & Fashion Vs.Mr. Gursharan Goyal and Others 1998(18)PTC493(Del)

valid and not after the termination. It was held not to be in restraint of trade. The Supreme Court stated that: “*There is a growing trend to regulate distribution of goods and services through franchise agreements providing for grant of franchise by the franchiser on certain terms and conditions to the franchisee. Such agreements often incorporate a condition that the franchisee shall not deal with competing goods. Such a condition restricting the right of the franchisee to deal with competing goods is for facilitating the distribution of the goods of the franchisor and it cannot be regarded as in restraint of trade.*”

2. NON- SOLICITATION AGREEMENTS

A non-solicitation clause is also a restrictive stipulation that prevents any employee, existing or former, to indulge into any business activities with the other employees or customers of the company in a way that it would prove to be against the interest of the company of the existing employer.

In a recent judgment, where *Desiccant Rotors*⁶ prayed to the Delhi High Court to grant an injunction against the manager, prohibiting him from soliciting the customers and connections of the employer company, the court held in favour of the plaintiff. The court also observed that a marketing manager cannot be accused of holding all major confidential information and his written declaration in the employment agreement with respect to the same is immaterial. The claim to enforce a confidentiality clause against the defendant was rejected by the court.

The Delhi High Court, in the *Wipro case*⁷, held that “*the non-solicitation clause does not amount to a restraint of trade, business or profession and would not be hit by Section 27 of the Indian Contract Act, 1872 as being void*”.

But in the case of *Pepsi Foods Ltd. and Ors Vs. Bharat Coca-cola Holdings Pvt. Ltd. & ors*⁸ the Court held that the non-solicitation clause is within the purview of Section 27 of the Indian Contract Act. It was further held that encouraging the employees of a competitor company to

⁶Desiccant Rotors International Pvt. Ltd vs Bappaditya Sarkar &Anr CS(OS) No.337/2008

⁷Wipro Limited Vs. Beckman Coulter International S.A 2006(3)ARBLR118(Delhi)

⁸1999(50)DRJ656

work in the company of the inducing company is prohibited and opposed to the contract of employments.

3. NON-DISCLOSURE AGREEMENT (CONFIDENTIAL INFORMATION AND TRADE SECRETS)

The employee is directed not to divulge any trade secrets, business connections and confidential information to any competitor, or any person or entity, which poses reasonable threat to the business interest of the employer. The employee must not succumb to any monetary or employment benefits offered by a competitor which will eventually force him to divulge the confidential information of his employer and his business efforts. There shall be no disclosure of any information by the employee to any unrelated person except under the mandatory provisions of law.

In *Diljeet Titus v. Mr. Alfred A. Adebare and Others*⁹, it was held that the plaintiff has a clear right in the confidential business material data such as client lists and proprietary drafts. If the defendant, who is a mere employee of the employer's law firm, claims that he has a copyright over certain drafts since they were created while their employer-employee relationship was subsisting, it was held to be impermissible under law and his contention was rejected.

The Court put an injunction on the defendant only for the purpose of using the information he took from the advocate's law firm so that the interest of the plaintiff could be protected. The defendant could, however, carry out similar profession.

4. NON-POACHING AGREEMENTS

This agreement is executed between two competitors wherein they agree not to encourage or entice the employees of the other party to extract confidential information or to get the benefits of the trained skills of the employees. In the ongoing development and industrialization phase, where every profession and trade requires a niche talent, the employers expend heavy amounts to train the employees as per the requirements of their concerned businesses. When such employees join the firms of the competitors by will, or when the competitor employer poaches such trained employees, it causes immense loss to the former employer. This agreement does not explicitly form a part of section 27 of Indian contract Act, 1872, as it does not put a restrain

⁹2006 (32) PTC 609 Del

on trade or prohibit an employee from seeking an employment. Such an agreement simply puts an imposition on the contracting parties to refrain from hiring the employees of one another.

5. TRAINING BOND

The employer seeks to ensure that his interests are safeguarded and his investments are channelized for his own business efforts for which he makes the employee sign a specific training bond. Such a bond imparts an obligation on the employee to utilize the training received from the employer for the benefit of the business of the employer for certain specified duration. The employee must perform his part of the contract and if the employee fails to comply with the contractual obligation, the employer can recover compensation for the investments made in the training of that particular employee. The recovery is only of the amount of investments made and not an imposition of penalty for terminating the employment contract.

Where the Defendant, who terminated the employment without due notice, was sued by the plaintiff company to pay liquidated damages to suffice for the investments made on his training. The amount charged by the employer as per the stipulation in the employment contract included damages and penalty amount. The Andhra Pradesh High Court held that the amount demanded by the plaintiff company is not equivalent to the loss incurred by them and hence, reduced the amount of compensation. The employer must, however, establish that he had incurred expenses in the training of the employee and the employee has not performed his part of the contract of working for the business of the employer for a stipulated time period.¹⁰

Non-compete clauses have a significant effect on competition and an aspect of it has been adjudicated within the ambit of the Competition Act, 2002. The Competition Commission held in the case of Mr. Larry Lee McCallister v. M/s. Pangea3 Legal Database Systems Pvt. Ltd. &Ors.¹¹, that the non-compete clause does not violate **Section 3** of the Act which prohibits person from entering into agreements which cause an adverse effect on competition within India. The CCI further held that “*the relevant dominant position enjoyed by the company is*

¹⁰LadellaRavichandar v. Satyam Computer Services Limited 2011 SCC AP 76

¹¹Case No. 66 of 2013

with respect to its competitors, not its employees, and that an employment contract has nothing to do with the market of the company.”

EFFECT OF COVENANTS ON STATUS OF EMPLOYMENT

The considerations against restrictive covenants are different depending upon its application in the period after the termination of the contract or in a case where it shall operate during the period of the contract.

1. RESTRAINT DURING EMPLOYMENT

Restraining the employees during the period of employment is a very common practice and it is done by inserting a negative stipulation in the employment contracts in order to protect the trade secrets and the confidential information of the employer's business. However, this violates the fundamental right of the employee to carry out a profession or business of his choice by prohibiting him to carry out the profession of his choice and earn his livelihood. The courts have time and again disallowed the validity of restrictive clauses. The employee is well within his rights to cease the employment with his former employer in exploring better prospects or to enhance personal growth. However, any restriction imposed by the employer during the course of employment is held valid in law since it is the obligation of the employee to serve his employer with honesty. Negative stipulations are not void under section 27 when imposed during employment.

In *Wipro Limited Vs. Beckman Coulter International S.A*¹² the court, while determining whether the contract is in restraint of trade or not, held that such a contract is more stringent for an employer-employee contract than in partnership contract, collaboration contract, franchise contract or commercial contracts. The reason behind this is the wide gap between the employer and employee which has given the employer a more dominant position over the employee whereas, in other contracts, both the parties deal with each other on an equal footing.

¹² 2006(3)ARBLR118(Delhi)

Freedom of changing the employment cannot be extinguished if an employee, during employment, is in possession of regular data, which is basic to functions expected to be carried out of him and does not *per se* connect with any trade secrets of the employer. It cannot be a ground for the employer to restrict the employee from accepting a better employment opportunity to enhance growth prospects even when the current employment is subsisting.

In a recent judgment of Delhi High Court, it was held that banks cannot create monopolies on the ground that they have developed exhaustive data of their clients/customers. Mere knowledge of names and addresses and even the financial details of a customer will not be material. The option of the customers/clients to bank with anyone cannot be curtailed on the plea of confidentiality of their details with any particular bank. Rights of an employee to seek and search for better employment are not to be curbed by an injunction even on the ground that she has confidential data in the present facts and circumstances. Freedom of changing employment for improving service conditions is a vital and important right of an employee which cannot be restricted or curtailed on the ground that the employee has employer's data.¹³

It was reiterated in *Ambiance India Pvt. Ltd. Vs. Shri Naveen Jain*¹⁴ that everybody has the right to strive for progress and career, thus, any restrictions imposed by the employer are void and unconscionable. A trade secret and the confidential information which the employee has acquired in the course of his employment require protection and should not reach other competitors to safeguard the interest of the employer. However, routine day-to-day affairs of employer which are in the knowledge of many who are employed by him and are commonly known to others cannot be called trade secrets.

It was held by the Bombay High Court, that an injunction is always to be granted on the basis of equity and good conscience and if such an injunction would cause an irreparable loss to the defendants by compelling them to remain idle, it should *prima facie* not be granted. Thus, compelling the pilots to remain idle would certainly tantamount to ruining their career as well as family life. The Court cannot be oblivious to the human consequences which an order of

¹³American Express Bank Ltd. Vs Ms. Priya Puri 2006(110)FLR1061

¹⁴122(2005)DLT421

injunction would cause. On the other hand non-grant of injunction would not cause any irreparable loss to the plaintiffs¹⁵

In the *Wipro Case*¹⁶, the court held that negative covenants between employer and employee contracts pertaining to the period post termination and restricting an employee's right to seek employment and/or to do business in the same field as the employer would be in restraint of trade and void. No employee can be confronted with the situation where he has to either work for the present employer or be forced to idleness.

In the *Pepsi Foods case*¹⁷, the court held that injunction that would have a direct impact of curtailing the freedom of employees for improving their future prospects and service conditions by changing their employment and restrict their right to seek and search for better employment shall not be granted.

Moreover, If the employer has right to terminate the contract on the ground of misconduct the employee must also have the right to resign from the employment on account of better prospects or other personal reasons and cannot be tied down under the Contract.¹⁸

If there is confidential information in question, then the employee will be restrained by the restrictive covenant not to divulge or misuse the acquired information.

Even compilation of clients' database has been held to be amounting to literary work wherein the author has a copyright. When the employee cannot prove that the information is not easily available in the public domain, the benefit of Section 27 shall not be granted. The ownership of all rights, titles and interest of the intellectual propriety rights were to vest in the employer and in breach thereof the employer was to take recourse of legal remedies.¹⁹

¹⁵Jet Airways (I) Ltd. Vs. Mr. Jan Peter Ravi Karnik 2000(4)BomCR487

¹⁶Wipro Limited Vs. Beckman Coulter International S.A 2006(3)ARBLR118(Delhi)

¹⁷Pepsi Foods Ltd. and Ors Vs. Bharat Coca-cola Holdings Pvt. Ltd. & others 1999(50)DRJ656

¹⁸Star India Private Limited Vs. Laxmiraj Seetharam Nayak and Anr. 2003(3)BomCR563

¹⁹M/s Vogueserv International Pvt. Ltd. Vs. Raajesh Gosain & Ors 2013 (137) DRJ 244

In *LE Passage to India Tours & Travels*²⁰ the court held that it is evident that a contract of employment which debar an employee by restraining him to carry on an employment, after the term of employment, is not protected under Section 27 of the Contract Act.

2. RESTRAINT AFTER TERMINATION/CESSATION OF EMPLOYMENT

An agreement which restricts trade and the employee party agrees not to carry out a specific business or trade in present or until certain future years without the express permission of the employer party is an agreement in restraint of trade. In other words, it is an agreement which expressly restricts the employee from competing with his employer in present or future in the specific trade or profession.

In the recent *LE Passage to India Tours & Travels Pvt. Ltdvs.Deepak Bhatnagar*²¹ the court held that in the garb of the alleged sale of goodwill of the trade, the plaintiff tried to enforce a restraint on the employment of the Defendant even after the Defendant has ceased to be an employee. As held in case, the Court is required to give a construction to the covenant so as not to be greater than necessary to protect the employer nor be unduly harsh and oppressive on the employee. Thus, any restriction that is expressly harsh on either of the parties is deemed unreasonable. Post- termination restriction is a hurdle in the development and growth of the professional life of the employee and should not operate under the law.

A contract containing a clause which restrains an employee to carry out a particular trade is unenforceable, void and against public policy and since it is prohibited by law it cannot be allowed by the Courts injunction. If such injunction was to be granted, it would directly curtail the freedom of employees for improving their future prospects by changing their employment and such a right cannot be restricted by an injunction. It would almost be a situation of "economic terrorism creating a situation alike to that of bonded labour."²²

As per the *Niranjan Shankar case*, it is well settled that where the employee quits the services of the employer in order to start his own business and trade by using the trade secrets of the employer company then there is nothing to prevent the court from granting a limited injunction

²⁰209(2014)DLT554

²¹209(2014)DLT554

²²Pepsi Foods Ltd. and Ors.v. Bharat Coca-Cola Holdings Pvt. Ltd. and Ors. 81 (1991) DLT 122

to the extent that is necessary to protect the employer's interests and in such cases the negative stipulation is not void. The injunction issued against the party is restricted as to *time, the nature of employment and as to area* and cannot therefore be said to be too wide or unreasonable. The injunction is to restrain the employee from divulging any and all information, instruments, documents, reports etc. which may have come to his knowledge while he was serving the employer.²³

It was held in *Pepsi Foods Ltd. and Ors Vs. Bharat Coca-cola Holdings Pvt. Ltd. & others*²⁴ that where there was a negative covenant clause restraining an employee from engaging or undertaking employment for 12 months after he has left the plaintiffs' services in not enforceable in law. It is well settled that such post termination restraint, under Indian Law, is in violation of Section 27 of the Contract Act. Such contracts are unenforceable, void and against the public policy. What is prohibited by law cannot be permitted by Court's injunction.

It was held by the Apex court in *Superintendence Company of India (P) Ltd. Vs. Krishan Murgai*²⁵ that an employer is not entitled to protect himself against competition per se against an employee after the employment has ceased, but he is entitled to protection of his proprietary interest and his trade secrets. A contract of restraint of trade is prima facie void, but is becomes binding upon proof that the restriction is justifiable in the circumstances as being reasonable from the point of view of the parties themselves and also of the community.

Further, in *Arvinder Singh and Ors. Vs. Lal Pathlabs Pvt. Ltd. and Ors*²⁶ it was held that as per Section 27 of the Contract Act every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind is, to that extent, void. It is the exception which protects an agreement from being void, provided that the conditions envisaged by the exceptions are satisfied. The condition for the exception is that if the goodwill of a business has been sold, an agreement to refrain from carrying on similar business, if it appears to the Court to be reasonable, would be protected and would be enforced. The heart of the exception is the

²³Niranjan Shankar Golikari Vs. The Century Spinning and Mfg. Co. Ltd. AIR 1967 SC 1098

²⁴1999(50)DRJ656

²⁵AIR 1980 SC 1717

²⁶2015(149)DRJ88

phrase 'sells the goodwill of a business'. The exception makes enforceable the agreement to refrain from carrying on similar business.

If the restrictive covenant is posing a restraint on trade, then such an agreement can be held to be void only if the court comprehends the reasonableness to be valid in the eyes of law.

In the case of *V.V. Sivaram and others v. FOSECO India Limited*²⁷, where an employee was restrained from using secrets and confidential information which he gained during job after terminating the employment since he had access to the confidential information. This information was inclusive of the information of the patent 'Turbostop', alongwith details of other products. Since he had terminated the employment under the voluntary retirement scheme, an injunction restraining him from manufacturing and marketing a product similar to 'Turbostop' was held to be valid and not in violation of Section 27.

CONSTITUTIONAL VIOLATION

The insertion of restrictive covenants in the contracts of employment has an implication that directly violates a fundamental right. The Constitution of India grants *the freedom to practise any profession, or to carry on any occupation, trade or business*²⁸. All the freedoms that are enshrined in Article 19(1) are not unconditional or absolute in nature. There are certain reasonable restrictions that need to be imposed to limit the right so that it is not exploited. Within this ambit comes the reasonableness of Section 27 which states that any agreement is restraint of trade is void *ab-initio*, however, if the restraining clauses are legitimate and considered reasonable by the court of law, such covenants can be enforced.

Reasonableness can vary from situations such as inadequate use of confidential information of the employer, or promulgating the trade secrets and product information of the employer's product and so on. Thus, in order to protect the business interests of both the parties and to encourage trade, the exception to the section has been inserted. However, the right of the employer to protect his monetary and business interests cannot overpower the right to livelihood of the employee and an unreasonable non-compete restriction on him to prohibiting him from carrying out a profession or trade of a similar nature, holds no ground. Each

²⁷ 2006 133 CompCas 160 Kar

²⁸ Constitution of India 1949, A.19(1)(g)

individual has a right to earn his own livelihood and such a right cannot be shunned for the monetary welfare of another individual.

The court reiterated that the protection of right to livelihood must prevail over any other cause in *Desiccant Rotors International Pvt. Ltd. Vs. Bappaditya Sarkar and Anr.*²⁹ The view of the employer was also duly considered and the court observed that the employers, by executing a restrictive covenant or a negative stipulation in the contracts of employment, only seek to protect their private and confidential information and the secrets of their own trade. Where there is a clash between the two, and the negative stipulation is hampering the right of livelihood of an individual, the latter shall unquestionably prevail.

Thus, the intent behind such agreements is not to restrict future employment of an employee but only to protect the business interests of the current employer. The court has granted due consideration to such valid restrictions but has held that no such restriction can deprive an individual of his right to earn his livelihood.

GARDEN LEAVE CLAUSE

The concept of 'Garden leave' was originated to protect the interest of the employer under whom the employee has gained experience and expertise in particular trade or business. It is a provision that is similar to a restrictive covenant but it does not deprive the employee of his basic remuneration and does not expressly violate the right to livelihood. It provides that the former employee, post the termination of his employment, will be paid his monthly pay.

The employer pays the former employee a consideration in the form of his base salary, while such an employee is prohibited to work at any other business concern with any competitor. He shall still remain an employee of the employer but shall remain oblivious to the business operations and the developments that arise after his resignation or termination. It is an opportunity for the employer to protect his current trade secrets and business connections from being divulged to a competitor while at the same time the employer is not deprived of his remuneration. He remains on a monthly payroll and the information that is under threat is being

²⁹CS(OS) No.337/2008

protected by the employer. Any employee with whom a Garden Leave provision is executed is mostly someone who has access and knowledge of the confidential information, which if promulgated to a competitor can cause immense economic damage to the employer.

Garden leave clause has its origin in UK in the case *Standard Co. Ltd. v. Henderson*³⁰ where the court held that the defendant should not be violating the obligation to the effect of which the contract was executed, i.e. to work for a competitor or any other business concern while the contract was in effect. This clause has not been widely accepted by the Indian courts. It has not received much appreciation since it puts a disguised restraint of trade which goes deep into the root of freedom of contract, which is fundamental to the validity of a contract.

When this clause came for consideration before the Bombay High Court in the case of *VFS Global Services Private Limited v. Mr. Suprit Roy*³¹ the contention raised was that the Garden Leave concept is not a clause that is independent of section 27. The clause, *prima facie* is in restraint of trade and it explicitly prohibits the employee from taking up any other employment for a certain period. The Court had accepted this contention and held that "*to obstruct an employee who has left service from obtaining gainful employment elsewhere is not fair or proper*"

CONCLUSION

Restrictive covenant clauses can be enforceable if their restrictions are held to reasonable and it strikes a balance between the rights of the employer as well as that of the employee. Restrictions on distance, time limit, protection of confidential information and non-disclosure of trade secrets and goodwill are imposed on employees who terminate their employment contracts. The section has a wide interpretation that is open to grant relief to both the parties provided that there is some significant loss that the employer will incur in case the trade secrets are misused by the employees. However, on the flip side, the court shall not allow any negative

³⁰[1987] I.R.L.R. 64

³¹2008(2) Bom CR 446

stipulation to hold validity if it extinguishes the right to livelihood and right to practice a profession of the individual's choice and area of expertise.

Thus, it can be concluded that in the name of confidentiality, goodwill and trade secrets, the employee cannot be restricted to take up another employment or commence his own business for the welfare of his own. A negative stipulation that prevents him from earning a livelihood, and breaches his fundamental rights will be groundless in the eyes of law. The protection available to the employer is only limited to the technical and invented trade secrets or to the poaching of his existing clients so that his competitors do not gain an undue advantage. The employee shall have an everlasting right to strive for progress and practice the profession of his own choice and area of expertise. It can further be derived that the courts have given a stricter view by making it comprehensible that every agreement in restraint of trade after its termination is void. The courts ought to provide flexibility to the rule depending upon the facts and circumstances of a particular case.