

REASONABLE LOCK-IN PERIOD DURING EMPLOYMENT NOT VIOLATIVE OF FUNDAMENTAL RIGHTS

INTRODUCTION

In a judgement delivered on 11th July 2024 in the case of Lily Packers Private Limited v. Vaishnavi Vijay Umak (hereinafter referred to as the “**Case**”), the Delhi High Court bench of Justice Pratibha M. Singh (the “**Court**”) held that reasonable lock-in periods during the period employment is not violative of the fundamental rights enshrined in the Constitution of India (hereinafter referred to as the “**Constitution**”). The Court further held that disputes in relation to such lock-in periods are arbitrable under the Arbitration and Conciliation Act, 1996 (“**Arbitration Act**”).

BACKGROUND

Ms. Vaishnavi Vijay Umak (“**Respondent 1**”), Mr. Meetkumar Patel (“**Respondent 2**”) and Mr. Rahul Sharma (“**Respondent 3**”) (Respondent 1, Respondent 2 and Respondent 3 are hereinafter collectively referred to as the “**Respondents**” and individually as “**Respondent**”, as the context may require) were employees of Lily Packers Private limited (“**Petitioner**”). The Petitioner had entered into ‘service agreements’ with each Respondent, which included various clauses governing the employment conditions such as salary, benefits, working hours, a lock-in period of 3 (three) years after completion of probationary period, intellectual property and confidentiality clauses, data protection, a non-compete period of 6 (six) months post termination of employment, an arbitration clause in case of any disputes, etc.

Thereafter, the petitioner alleged that Respondent 1 had only worked for 1 (one) year and 2 (two) months after which she went on leave and never came back to work, and Respondent 2 and 3 resigned before the completion of the lock-in period of 3 (three) years. The Petitioner then sent a notice of demand to each of the Respondents and invoked the arbitration clause in their respective service agreements. While Respondent 1 replied to the Petitioner’s notice and alleged harassment and humiliation and refused to return to work, Respondent 2 never replied to the Petitioner’s demand notice and Respondent 3 had already joined a new organization. As such, the Petitioner filed separate petitions before the Court, with respect to the dispute against each of the Respondents, for the constitution of an arbitral tribunal.

ISSUES BEFORE THE COURT

The two issues placed before the court were as follows:

- i. Whether a lock-in period in an employment contract is valid or does it violate the fundamental rights enshrined in the Constitution?
- ii. Whether a dispute in relation to lock-in period is arbitrable under the Arbitration Act?

SUBMISSIONS ON BEHALF OF THE PETITIONER

The counsel for the Petitioner made the following submissions:

- i. that the Petitioner had made enormous investments in training the Respondents and as such the lock-in period in their respective service agreements ought to be honoured;
- ii. that the service agreements contain an arbitration clause which have been agreed to by the Respondents and as such these employment disputes must be submitted to an arbitral tribunal.

SUBMISSIONS ON BEHALF OF THE RESPONDENTS

The counsels for the Respondents made the following submissions:

- i. that the issues raised by the Petitioner are not arbitrable in accordance with the Arbitration Act;
- ii. that the clause on lock-in period for 3 (three) years in the service agreements is contrary to law and is violative of the fundamental right to employment and life of the Respondents under Article 19 and 21 of the Constitution respectively;
- iii. that disputes involving the violation of fundamental rights under the Constitution is not arbitrable. The counsel relied on the decision of the Hon'ble Supreme Court of India ("**Supreme Court**") in *Lombardi Engineering Limited v. Uttarakhand Jal Vidyut Nigam Limited* [(2023) SCC OnLine SC 1422], wherein the issue before the Supreme Court was the validity of the arbitration clause which provided for a pre-deposit of a certain percentage of the arbitral claim as a pre-condition for invoking arbitration under the Arbitration Act. The Supreme Court had held that such an arbitration clause in relation to fundamental rights was violative of Article 14 of the Constitution and that there can be no agreement to waive the fundamental rights enshrined in the Constitution; and
- iv. that the clause on lock-in periods in the service agreements is a clause in restraint of trade and as such is violative of Section 27 of the Indian Contract Act, 1872 ("**Contract Act**").

ANALYSIS OF THE COURT

- a. Validity of the lock-in period clauses in employment contracts
 - i. Section 27 of the Contract Act

In its analysis, the Court relied on the judgement of the Civil Appellate Court in Calcutta in the 1885 case of *The Brahmaputra Tea Co. Ltd. v. Scarth* (I.L.R. 11 Cal. 545). The court in the case had held that a covenant restraining an employee from engaging in the cultivation of tea for a period of 5 (five) years post termination is void, however, a covenant binding an employee to serve the employer exclusively for a particular term, *during the term of the agreement*, is valid.

The Court also relied on the judgement of the Supreme Court in *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co.* [(1967) SCC OnLine SC], wherein the court drew a distinction between negative covenants applying during the period of employment (such as a lock-in period) and negative covenants operating post

termination of employments (such as a non-compete clause) and held that the former is generally not violative of Section 27 of the Contract Act unless the contract is unconscionable, excessively harsh, unreasonable or one-sided. The Court observed that this position was reiterated by the Supreme Court in *Percept D' Mark (India) (P) Ltd. v. Zaheer Khan & Anr.* [(2006) 4 SCC 227] and various other benches of the Hon'ble High Court of Delhi.

ii. Constitution of India

In its analysis, the Court observed that clauses in employment/service agreements, such as clause in relation to lock-in period, pay fixation, emolument benefits, etc. are usually negotiated and are agreed to by the employees voluntarily, and that employment contracts are entered into by parties by their own individual consent and volition. The Court also observed that such clauses may in fact be necessary for the health of an organization as it provides stability and strength to the organization and its framework, and reduces employee attrition levels.

The Court reiterated the position taken by the courts in *The Brahmaputra Tea Co., Niranjana Shankar Golikari* and *Percept D' Mark* and held that it cannot be argued that such a reasonable covenant operating during the term of employment was violative of the fundamental rights under the Constitution. The Court further observed that employment contracts in general are contractual disputes and not disputes which raise issues of violation of fundamental rights in such fact situations. The Court further held that a 3 (three) year lock-in period is not an unreasonable curtailment of an employee's right and as such does not raise an issue of violation of fundamental rights.

b. Arbitrability of the dispute

On this issue, the Court applied the rationale laid down in the judgement of the Supreme Court in the case of *Lombardi Engineering Limited* and the Delhi High Court in *BLB Institute of Financial Markets Ltd. v. Ramakar Jha* [(2008) SCC OnLine Del 1075], and held that reasonable lock-in period, such as the lock-in periods in the service agreements in the present Case, are not violative of fundamental rights enshrined in the Constitution and thus, disputes arising therein are arbitrable under the Arbitration Act as such clauses do not amount to waiving of fundamental rights.

CONCLUSION

The Court in this case re-iterated the settled principle of law that a negative covenant operating during the term of employment, such as a lock-in period, is valid in law, unless the same is unreasonable, and since these lock-in periods are not violative of the fundamental rights provided in the Constitution, any agreement to arbitration for dispute(s) arising from such lock-in periods do not amount to waiver of fundamental rights. Through this Case, the

Court re-emphasized the reason why such reasonable negative covenants operating during the period of employment are valid in law, that is protection of the interests of the employer.

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