

Enforceability of Non-compete Covenants in India

Often the Employers in knowledge driven sector are afraid of the talent pool leaving the organisation for the benefit of the competitor. Therefore, most employment contracts contain non-compete and non-disclosure covenants.

The Indian Contract Act, 1872 (the "Contract Act"), a relevant statute, governs the post-employment restrictive covenants in India and various sections dealing with the same. Section 27 of the Contract Act, deals with the covenants restraining any person from exercising any lawful profession, trade or business of any kind, which are unenforceable and void, with an exception to sale of the goodwill of a business.

The person who sells the goodwill of 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, carrying on similar business therein provided that such limits appear to the Court having reasonable regard to the nature of the business. However, subject to this any post-contractual non-compete covenants are void and unenforceable under Section 27 of the Contract Act.

The Supreme Court of India in a landmark decision¹ held that negative covenants, operative during the term of contract of employment and during the the time when employee is bound to serve his employer exclusively, are not generally regarded as restraints of trade and are excluded from the purview of Section 27 but a negative covenant which restricts rights of employee after termination or cessation of the employment, would then be considered void

¹*Niranjan Shankar Golikari v The Century Spinning and Manufacturing Company Limited* AIR 1967 SC 1098, 1967(2) SCR 367 and in *Superintendence Company of India Private Limited v Krishna Murgai*, AIR 1980 SC 1717

The approach of courts is much stricter when considering covenants in restraint of trade in employment contracts than in other business agreements because there is greater equality of bargaining power between the parties in respect of business agreement than in respect of an employment contract. However, if such confidentiality covenant is in respect of trade secrets or intellectual property rights and if such covenant is breached after the expiry or termination of the contract, the covenant can be validly enforced. To enforce post contractual confidentiality covenant it would be difficult to prove whether the information has remained confidential in order to restrain an employee from disclosing confidential information.

The Legitimate interests which an employee is entitled to protect are:

1. Where the ex-employees breaches obligation of confidentiality and the Plaintiff was granted an injunction²
2. The master is entitled to be protected in regard to his interests in trade secrets and secret manufacturing processes. This protection is secured by restraining the employee from divulging those trade secrets or putting them to the use of the

servant. The master is also entitled to be protected against invasion of his customers or clientele but the master is not entitled to be protected against competition³

Categories of covenant

There are various categories of restrictive covenant which are commonly used by employers to protect the main proprietary interests referred to above are –

1. **Covenants which seek to prevent:**
 - a. Non-Competence and area covenants—an employee working or carrying on a business competing with the ex-employer within a defined geographical area.
 - b. Non-dealing and non-solicitation covenants - the ex-employee from dealing with and/or soliciting business from customers or suppliers of the ex-employer ().
 - c. Non-poaching covenants - the ex-employee from enticing away or poaching other members of the ex-employers workforce.

²*INTEC Polymers Ltd. Vs. Mr. Rajendra Eknathrao Tambe IPLR 2005 January 48*

³*Shree Gopal Paper Mills Ltd. Vs. Surendra K. Ganeshdas Malhotra AIR 1962 Cal 61(66)*

d. Confidentiality covenants - the ex-employee from disclosing confidential information of the ex-employer and his clients.

The enforceability of a particular restrictive covenant will depend on the facts and circumstances of the individual case. There are a number of cases which govern the principles relevant to enforceability, relating to each category of covenant.

In Pepsi Foods Limited & Ors. v/s. Bharat Coca-Cola Holdings (P) Ltd. & Ors. (1999) 4 Company Law Journal 138 (Delhi), the plaintiff alleged that the defendants induced their employees to breach the existing contract with the plaintiff and it was also alleged that employees trained by plaintiff had acquired, during employment, confidential and exclusive business information causing damage to the business of plaintiff and filed for injunction against defendants to restrain them from any such further acts and restrain them from employing them. The Hon'ble Delhi High Court held that negative covenant in contract restraining employee from engaging or undertaking employment for twelve months after leaving the services of plain

tiff was held to be contrary and in violation of Section 27 of the Indian Contract Act, 1872 and injunction was declined⁴.

• **Non-Poaching Covenants:-**

There is no law prohibiting an individual or a group of individuals from poaching clients of their former employer. An order of restraint against the ex-employee and his new employer may be obtained if there is any use of confidential information by the ex-employee for his own benefit in breach of the restrictive covenant⁵. Similar issues were observed in various cases where defendants had breached the confidentiality obligation under their contract of employment and therefore the plaintiff was granted an injunction.

• **Unreasonable:-**

It was held that trade secrets in its ambit do not include such routine day to day affairs of employer which are common and known to many⁶.

⁴ This decision in *Pepsi Foods (Supra)* was relied on in various judgements such as *Weiler International Electronics Private Limited v. Punita Velu Somasundaram* 2003(3) *Bombay Cases Reporter* 5 ; [*In High Polymer Labs. Pvt. Ltd. v. R.K. Mutreja* reported in *ILR (Delhi Series) 1983 Vol 1 213*]; [*In Jet Airways (I) Ltd. V. Mr. Jan Peter Ravi Karnik* reported in 2000 (4) *Bom.C.R.* 487]

⁵ *V.V. Sivaram and Ors. Vs. Foseco India Limited* 2006 (1) *Kar LJ* 386

⁶ *Polaris Software Lab. Limited rep. by its Company Secretary v/s Suren Khiwadkar*

The injunction prayed for by the plaintiff was not granted citing that such would curtail the freedom of defendant in their future prospects and service. Such a restriction will be hit by section 27 of the Contract Act and the common law and equitable doctrine of English Law will not be applicable. There are certain duties of employee which are to be adhered to even in absence of contract. They are to perform their duty in good faith and fidelity and with trust and confidence. Directors are also under obligation to perform their fiduciary duties and act in best interest of the company, not make secret profits and perform duties with utmost care and diligence by using their skills. An employee must not engage in competition with his employer during normal working hours.

Activity during & Post the course of employment

It is important to note that Indian courts have consistently held that any restriction operating during the subsistence of contract of employment will not attract section 27 of the Contract Act and hence, such covenants existing during the term of the contract would be valid, binding and legally enforceable. . The duty has long been recognized by the common law in Robb Vs. Green 1985 2 QB 315 which held that an employee cannot use confidential information to advance

some personal business to the injury of his or her employer's interest and to use materials from ones employment to promote the interests of a later employer, being contrary to good faith.

There is no law which prohibits an individual or a group of individuals from poaching clients of their former employer. An order of restraint can be obtained if an employer can demonstrate that its client information is in the nature of a trade secret and that information has been used or disclosed by a former employee. The same legal principles apply across different professions.

In India, non-solicitation clause after the termination of contract is void and unenforceable under section 27 of the Contract Act. In case if the information about staff is in nature of trade secret the former employer can prevent the employee from disclosing it and is entitled for protection of the same and obtain damages for breach of duty.

In India, an individual employee may not be willing to challenge the negative covenants post-employment period because it it would mean to incur heavy litigation cost against big corporations who have deep pockets which is expensive as well as time consuming. The Companies which

proceed on such issues often look for an interim ex parte order of interim and interlocutory relief such as injunction to prevent ex-employee from divulging or using confidential information.

In order to obtain an ex parte order of injunction, the applicant must prove that:

1. It has a prima facie case;
2. The balance of convenience lies in its favour; and
3. The plaintiff would suffer irreparable damage and injury if the injunction is not granted.

All these factors have to be shown to co-exist by a plaintiff to claim and/or sustain a grant of interim injunction⁷

Under Indian law, the remedy of injunction will not be available if the injury can be compensated in the monetary terms. Due to this reason, relief of injunction and damages are claimed in alternative.

The companies who lose their teams to their competitors often retaliate by poaching the employees of their competitors i.e. the company who poached their employees. Quite often to avoid such rolling in and out of employees, the companies enter into non-poaching agreements.

Please note that such non-poaching agreements between the companies are not hit by section 27 of the Contract Act⁸.

⁷ *Rajendra Prasad v. Atul Kumar*, 2004 (4) MPLJ 126 (128) (MP)

⁸ *Wipro Limited vs. Beckman Coulter International S.A.* 131 (2006) DLT 681



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