

Validity of lock-in periods in Indian employment contracts upheld

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In a recent ruling, the Delhi High Court (“DHC”) upheld the validity of reasonable lock-in periods in employment contracts and also held that disputes arising from these clauses are arbitrable under the Arbitration and Conciliation Act, 1996 (the “Arbitration Act”).

Background

The case involved an Indian company, Lily Packers Private Limited, which sued its former employees, Vaishnavi Umak, Meetkumar Patel and Rahul Sharma, for resigning before completing their three (3) year lock-in periods under their respective employment contracts. The company was engaged in the business of manufacturing and trading of corrugated packaging, and the employees were engaged in the capacity of a fashion designer, an autocad design engineer and a general supply chain manager, respectively.

The employment contracts provided for arbitration as the dispute resolution mechanism, and accordingly, the Petitioner company issued notices on the employees invoking arbitration under the Arbitration Act. However, the employees did not submit to arbitration contesting that the lock-in period provisions were violative of their fundamental rights under the Constitution of India and, therefore, not arbitrable. As a result, the Petitioner company filed petitions before the DHC seeking the appointment of an arbitrator.

Ruling of the Delhi High Court

The DHC upheld the validity of the lock-in period in the employment agreements.

The DHC examined the well-established principles on validity of restrictive covenants in employment contracts. It relied on Supreme Court rulings that have consistently held that reasonable negative covenants operating during the term of the employment contract are not considered a restraint of trade and are, therefore, valid and enforceable. The DHC emphasized that the terms of an employment contract such as the lock-in period, salary, benefits, etc., are a subject matter of negotiation and are agreed by parties on their own volition. The DHC further observed that, generally, disputes arising from employment contracts are contractual in nature and cannot be regarded as violative of fundamental rights. The DHC also noted that such clauses in employment contracts are, in fact, necessary for the health of the employer institution as it provides the required stability and strength to the employer institution and its framework.

As the issues in dispute in the instant case were within the four-corners of the employment contracts entered into between the company and the employees, the DHC held that the disputes were clearly arbitrable under the Arbitration Act and, thus, appointed an arbitrator to adjudicate the disputes. In this regard, the DHC clarified that the observations made in

the DHC's order would not be binding on the arbitrator, and the arbitrator should take an independent view on all the issues without being influenced by such observations.

Our comments

The DHC's ruling strengthens the case for employers and safeguards them against the high cost of employee turnover, especially when an employer invests heavily in training new recruits. By incorporating a clearly defined lock-in period in employment contracts, employers can secure a level of commitment from new employees. Nonetheless, it is crucial for employers to ensure that these clauses are reasonable in length and clearly communicated at the time of recruitment. Further, the employer should also ensure that the concerned employee is a beneficiary of a special concession or specialised training and prove that the company will incur a quantifiable loss in case the employee leaves the company during the lock-in period.

Lastly, the judgement confirms that disputes over lock-in clauses are arbitrable under the Arbitration Act. This allows for resolving disagreements over these clauses through a private arbitration process, which is quicker and more cost-effective as compared to filing a case in an Indian court.