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Restrictive Covenants in Employment Agreements: A Comparative Study of Legal Position in India and US

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ABSTRACT

In the world of corporate, the competition is increasing at an unprecedented rate and hence the companies are not willing to take any chances with their trade secrets and work mechanisms. It is a common phenomenon for employees to change organizations especially in the current era of competition when everyone wants to earn. In such circumstances, it becomes important for companies to devise some way of protecting their inner working mechanisms from becoming a matter of common knowledge by way of such employees. This is why the concept restrictive covenants in employee contracts developed. The researcher has analyzed the same in detail – and compared the laws on this topic in India and US.

Keywords: *employee, contract, agreement, India, US, information.*

I. INTRODUCTION

The The term "employment agreement" or "employment contract" refers to a legally binding document that outlines the rights, responsibilities, and obligations of both the employee and the employer. It frequently includes information about compensation, duration, job responsibilities, benefits, and other employment-related terms and conditions, as well as additional information.

Certain pieces of information are vital and priceless to the overall performance of a company's operations. Restriction on the use of this information by former workers may be necessary to protect your business or customer contacts after their employment with you has ended.

If a former employee has knowledge of your technology, strategic information, or customers or clients, a competitor would consider that person as a significant asset. During the time that the employee is employed by the company, employee contracts may contain provisions that provide the employer with some level of protection. The use of restrictive covenants, on the other hand, by employers to protect this information both during and after the employee's

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employment is permissible.[2]

A large number of organizations include these criteria in the employment contracts of senior or highly trained employees, particularly at the beginning of the working relationship. It may be good to incorporate such provisions in the contract from the beginning in order to discourage employees from leaving and hinder possible new employers from entering the market.

Former employees are prohibited from competing with their former employers for a specified period of time after leaving the company, as well as from soliciting or dealing with former employer's clients based on information gleaned during their employment with the company, for a period of time following their departure from the company.

Aside from that, an employment agreement may contain restrictive covenants or interim clauses that give employers with additional legal protection. Examples of such clauses are as follows:

An agreement on secrecy is a contract between two parties that binds them to keeping sensitive and secret information confidential. A Non-Disclosure Agreement (NDA) is sometimes used to refer to the agreement because the parties agree not to disclose certain confidential information. Trade secrets, for example, are typically included in the category of confidential information since they are sensitive, technical, and financially significant to a corporation.

An agreement prohibiting employees from competing with their employer upon the end of their employment is known as a non-compete agreement. Exercising your right to compete is legal in a number of jurisdictions.

In a non-solicitation agreement between an employer and an employee, the employee is prohibited from exploiting the company's clients, customers, or contact information for personal gain once the employee's employment has come to an end.

While it is a well-established legal concept that such restrictive covenants are binding on employees for the duration of their employment and are considered acceptable because they protect the company's commercial interests, there is a growing body of evidence that such covenants are harmful to employees. Nonetheless, the constitutionality of such restrictions that extend beyond the workday has been called into question and has been addressed by the courts on several occasions.[3]

[2] Suneeth Katarki and Mini Kapoor, "Employment Contracts - Enforcement Of Restrictive Covenants Under Various Jurisdictions", The Mondaq (December 14, 2021) https://www.mondaq.com/india/employee-rights-labour-relations/486496/employment-contracts--enforcement-of-restrictive-covenants-under-various-jurisdictions

[3] Supra note 2.

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TYPES:

Companies can impose conventional forms of restrictions on their employees, including the following:

- The use of non-competition agreements, which ban a former employee from working in a similar position for a competitor, is common.
- The former employer's clients, customers, and suppliers are prohibited from being poached under non-solicitation covenants.
- The use of non-disclosure contracts, which prevent a former employee from associating with former clients/customers/suppliers, regardless of who approached whom, is prohibited.
- Non-poaching covenants — these agreements ban employees from poaching former coworkers from their current employers.

II. LEGAL POSITION IN INDIA

Indian law is very clear and strict on enforceability of non-compete clauses extending beyond the period of employment, any such agreement shall not be binding on both the parties and shall be treated as null and void. The courts have consistently refused to enforce post-termination non-compete as it is in direct contravention to the Section 27 of the Indian Contracts Act, 1872.

SECTION 27 OF THE INDIAN CONTRACT ACT, 1872 *reads-*

"Every agreement by which anyone is restrained from exercising a lawful profession or trade or business of any kind, is to that extent void".

Exception 1. —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."[4]

It is treated null and void as it may potentially deprive an individual from his/her fundamental right to earn a living. The court also held that negative covenants operative during the employment period are not regarded as a restrain to trade and do not fall under the purview of this section as an employee is duty bound to serve his employer exclusively.

[4] The Indian Contract Act, 1872, Sec. 27, Exception 1.

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INDIAN CONSTITUTION & RESTRCITIVE COVENANTS

Article 21 of the Indian Constitution-

"No person shall be deprived of his life or personal liberty except according to procedure established by law"[5]

Article 21 is a fundamental right available to all citizens of India. Right to life under Article 21 does not mean a 'mere act of breathing' but guarantees the right to a dignified life.

Right to livelihood[6] is an inviolable right as **no person can live without the means of living**. The judiciary is of the view that post- employment restrictive covenant deprives a person from earning bread and butter for his/her family. This makes enforcing of non-compete clauses very difficult in India.

Article 19 (1) (g) of the Indian Constitution-

"All citizens have the right to practice any profession, or to carry on any occupation, trade or business"[7]

Fundamental right under Article 19 (1) (g) encourage citizens to practice any profession of their choice. Engaging into any sort of business or adopting a particular profession helps an individual lead a life with dignity. No authority shall compel a person against carrying out business or trade of any legal nature. Restrictive covenants might restrain a person from taking up employment or carry-on trade even after completion of employment period.

JUDICIAL PRONOUNCEMENTS/ CASE LAWS

- Delhi High Court in ***Pepsi Foods Ltd. and Others* v. *Bharat Coca-cola Holdings Pvt. Ltd.***[8]

"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."[9]

Brief Summary:

Pepsi started its business operations in India in the year 1990 by making considerable

[5] The Constitution of India, Art. 21.
[6] Also see Olga Tellis v. Bombay Municipal Corporation, 1985 SCR Supl. (2) 51; M.J. Sivani And Ors vs State Of Karnataka And Ors, Appeal (civil) 4564 of 1995; Sodan Singh v. New Delhi Municipal Committee, 1989 SCR (3)1038.
[7] The Constitution of India, Art. 19(1)(g).
[8] 81 (1991) DLT 122
[9] Ibid

investments and successfully establishing a world-class infrastructure from scratch. Pepsi alleged that Coke, who is a direct competitor of the company approached and induced Pepsi's most valuable employees from all over the country by offering huge salary hikes. Most of these employees had confidential undertakings and had an existing non-compete agreement which prohibits them to take up any employment with the competitor for a period of 1 year from termination of employment with Pepsi. The court observed that post-termination restraint is in violation of S 27 of Indian Contracts Act, 1872 and any contract cannot force employee into idleness by enforcing postemployment covenant. As for Pepsi's allegations on Coke for poaching employees, the court believes that everyone has the right to offer better terms to another's employee.

- ***Superintendence Company of India (P) Ltd.* v. *Sh. Krishan Murgai*[10]**

The hon'ble Supreme Court of India in the case observed that "**restrictive covenant extending beyond the period of employment is a restraint of trade and would fall under the mischief of Section 27 of the Indian Contract Act, 1872."**[11]

Brief summary:

Superintendence Company of India carries out business of inspecting quality, weighment, sampling of merchandise and commodities etc. as valuers or surveyors and have established a goodwill and reputation in the business. Shri. Krishnan was hired as the Branch Manager at their New Delhi office in 1971 and his services were terminated 7 years later in the year 1978. Therefore, Krishnan started his own venture in the same industry after termination of his employment with them. The company brought a suit for 55,000 Rupees against Krishnan as damages incurred by them due to his business. They alleged that Krishnan breached the non-compete clause and became a direct competitor to the company within a year of termination of employment. The Apex court dismissed the appeal on the grounds that restriction is too vide and violative of sec 27.

- ***D'Mark (India) Pvt. Ltd. v Zaheer Khan and Anr.*[12]**

The Supreme Court of India in this case sheds some light on legality of non-compete clauses. The court observed,

"Under Section 27 of the Contract Act

[10] AIR 1980 SC 1717
[11] Ibid
[12] (2006) 4 SCC 227

a) ***A restrictive covenant extending beyond the term of the contract is void and not enforceable***
b) ***The doctrine of restraint of trade does not apply during the continuance of the contract for employment and it applied only when the contract comes to an end.***
c) ***The doctrine is not only confined to contracts of employment, but is applicable to all other contracts."***

Brief summary***:***

D' Mark is a company incorporated under the Companies Act which carries out operations like event management, model and celebrity endorsements, organizing charity events and other entertainment related activities. Zaheer Khas who is an international cricketer entered into a 3-year agreement with the company for managing his media affairs, endorsements etc. Upon completion of the third year, cricketer entered into an agreement with third party which was in contravention to the contractual obligations. Supreme Court in the case differentiated between the pre completion period with the post- employment period. The non-compete clause would not have an effect in the post-employment period and held that the doctrine is applicable to all kinds of contracts and not just employment agreements.

EXCEPTIONS

- ***Niranjan Shankar Golikari v Century Spinning & Mfg. Co*** [13]

The Supreme Court goes on to clarify that-

"A negative covenant that the employee would not engage himself in a trade or business or would not get himself employed by any competitor for whom he would perform similar duties is not a restraint of trade unless the contract is unconscionable or excessively harsh or unreasonable or one sided".

Brief Summary:

Niranjan Shankar Golikari (Appellant) joined Century Spinning as a Shift Supervisor and entered into a 5-year contract with the company. The contract prohibited Niranjan from working in a similar capacity during the said period and also to maintain secrecy with respect to the technical aspect of the work. As soon as the training period ended, Niranjan joined a rival company for higher emoluments. The company brought this suit to safeguard their interest and trade secrets from competition. The court held that the negative covenants operative during the period of employment are valid and do not fall under the purview of Sec 27. So far to be

[13] Air 1967 Sc 1098

enforceable by statute, it is necessary that the conditions imposed by the employer are unreasonable and excessively harsh.

Therefore, **"Non-solicitation" and "non-disclosure"** may be viewed as an exception to the rule. The non-solicitation clause may be interpreted as negative or restrictive in nature but they are valid and enforceable by law.

- ***Wipro Limited v. Beckman Coulter International S.A. Most imp case***[14]

The Delhi High Court held that-

"non-solicitation clause does not amount to a restraint of trade, business or profession and would not be hit by Section 27 of the Contract Act as being void."

Brief Summary:

Wipro Limited and Beckman Coulter International share a distributor- principal relationship wherein Wipro has been an exclusive distributor of Beckman Coulter products in India for the past 17 years. In the year 2005, Beckman started preparing for direct operations in India ending their long-standing relationship with Wipro. Beckman started hiring employees to carry out operations like sales, marketing, service and support etc. and gave special consideration to people having experience with handling Beckman products. Wipro alleged that the advertisement and hiring scheme was in direct violation to their solicitation agreement which prohibits either party to induce or encourage employees to terminate their employment with the other for a period of two years. The counsel for Beckman alleged that any restraint on employment would constitute a direct violation of Section 27 and freedom to seek employment which cannot be curtailed.

The court made the following observations-

- Negative covenants operative during the period of employment are not void and do not fall under the purview of Sec 27. The contract between the parties was operational at the time when advertisement was posted by Beckman
- 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 present case, non-solicitation agreement is not a contract between an employer and employee but between two parties in a contract. The covenant only prohibits parties from enticing each other's employees and does not hamper freedom to seek employment of the

[14] 2006 (2) CTLJ 57 Del

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employees. Therefore, non-solicitation clause does not put any restriction on the employees directly but on the companies to not solicit employees from one another.

The court held that Beckman would be entitled to compensate Wipro for breach of their non-solicitation agreement but the employees at Wipro cannot be barred or restrained to take up employment with Beckman who were allured by their advertisement.

- ***Mr. Diljeet Titus, Advocate* v. *Mr. Alfred A. Adebare and Ors.,*[15]**

The Delhi High Court clarified that "**classified or confidential information of the employer can be protected even in the post-employment period**."

Brief:

Mr. Diljeet Titus is an advocate with substantial years of experience in the field. He runs his own law firm with 27 junior associates working with him on full-time employment basis. The associates had complete access to company's extremely confidential and crucial electronic records along with client list and information. In March 2004, few of the associates including Mr. Alfred came together to set up their own law firm. Just two days before leaving, Alfred visited Mr. Titus's office after the usual working hours and copied company's confidential information with help of a CD-Writer. Alfred also stole hard copy of various documents along with 3,000 visiting cards belonging to the plaintiff. The court held that the matter is of great importance as it hinders attorney-client relationship which is solely based on trust and confidence. They also observed that the advocate- associate relationship might be more complex and different from traditional employer- employee relationship but it does not give associates any right to misuse, copy or utilize information belonging to the employer and his clients. The defendants may carry on with their profession, utilize their skills and even use information they have mentally retained over the course of employment but the court strictly prohibits them from using any wrongfully gathered information, list of clients and other material data belonging to the plaintiff.

Indian courts may enforce restrictions in the form of non-disclosure of confidential information and non-solicitation of customers and employees. But it is highly unlikely that the courts would permit the enforcement of such restrictions beyond the period of employment.

In order to enforce a post-termination covenant, it is important to ensure that it falls under the **sole exception of Section 27 Indian Contracts Act** i.e., there should be a sale of goodwill of

[15] 2006 (32) PTC 609 (Del)

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a business, and it should be evident from acquisition agreement. In India, **neither the test of reasonableness nor the principle of the restraint being partial would be applicable unless it comes under this exception.**

III. LEGAL POSITION OF RESTRICTIVE COVENANTS IN UNITED STATES OF AMERICA

With a few exceptions, a non-compete agreement, also known as a Covenant Not to Compete (CNC), is legal and enforceable in the majority of states. States such as California, Oregon, and Colorado do not feel that every contract that restricts a person's right to practise law is voidable under the law.[16]

Covenants not to compete are frequently utilised to safeguard the interests of a company's shareholders. A firm will suffer considerably if an employee steals or loses its clients, customer lists, price lists, proprietary or confidential information, or trade secrets, all of which are valuable to the organisation. It is likely that non-competition agreements will impair an employee's ability to acquire new employment or to take advantage of information or contacts gained during their employment with the company if they leave the company. When dealing with these difficulties, courts frequently reach a balance between the employer's need for security and the employee's need for remuneration, as well as the right of an employee to work for a different organisation. In the United States and around the world, employment lawyers must deal with legal concerns stemming from non-compete agreements and other restrictive covenants, as well as altering legal frameworks.

LEGAL POSITION IN USA

Large companies frequently want restrictive covenants that can be enforced in other jurisdictions than their own. The laws of different countries can be rather varied from one another. In the United Kingdom, confidentiality and non-competition agreements are viewed as a kind of trade constraint, according to the government.[17] In the United Kingdom, covenants of non-competition must be fair, limited in scope, and limited in duration in order to protect legitimate business interests of the parties involved.[18] A non-competition agreement is less likely to be enforced in the United Kingdom than it is in the United States, according to the courts there. "The courts in the United Kingdom have accepted a 12-month restriction as reasonable in certain circumstances, but have stated that it would be extremely improbable that

[16] "Non-Competition Agreement", Colorado Employee Advocates (December 14, 2021) https://www.coloradoemployeerights.com/blog/2021/march/non-competition-agreement/
[17] Fifield, v. Premier Dealer Servs., Inc., 933 N.E.2d 938, 941; Lawrence & Allen, Inc. v. Cambridge Human Res. Grp., Inc., 685 N.E.2d 434, 442.
[18] Ibid.

limits lasting longer than 12 months would be enforced," according to one author. The usage of "garden leave" arrangements by employers in the United Kingdom is common, and they are legally enforceable. It is necessary for employees who plan on leaving the company in order to work for a competitor to notify the company several months in advance.[19] During this time, the employee receives income but does not work, and as a result, does not compete or obtain access to confidential information. Despite the fact that they are expensive, "garden leave" provisions are likely to be enforced, resulting in a major reduction in competition for an extended period of time.

According to comparisons with other states' non-compete agreements legislation, Florida's regulations lean slightly in favour of employers. The court will usually uphold a non-compete agreement if it is reasonable in the circumstances. It is generally agreed that non-compete agreements should be for no more than six months, and that longer than two years is considered excessive in most cases. In order to enforce a non-compete agreement, the court will consider a variety of factors, including geographical restrictions and the specific commercial interests at stake.

It is possible that if you sign a legally binding non-compete agreement, you will be barred from working in particular firms or in specific locations for a predetermined length of time. If the agreement is regarded unreasonable or unjustly inhibits employment, there are some exceptions to this requirement, which include the following:

- The validity and enforceability of non-compete agreements in the United States is subject to the fulfilment of certain reasonable conditions.
- Rights guaranteed to citizens of the United States by the Constitution.

JURISDICTION:

"Courts normally enable parties to choose the law that governs their agreements, while a few courts have decided in the opposite direction in the past. Specific choice-of-law provisions in contracts have lately been struck down by New York state courts, which have instead relied on New York law."

Brown & Brown, Inc. v. Johnson & Johnson, Inc.[20]

Brief:

An appellate court in New York acknowledged that if the chosen legislation is fairly related to

[19] Wendi S. Lazar, "Confidentiality, Trade Secret and Other Restrictive Covenants in a Global Economy" , 24 AMERICAN BAR.ORG (2008).
[20] 980 N.Y.S.2d 631 (2014)

the parties or transaction, it will generally be enforced in order to carry out the parties' wishes, according to this ruling.

The public policy of New York, on the other hand, must not be "very annoying" to the law that has been chosen.

Prosperity Bank v. Cardoni (26th Circuit)[21]

Brief:

For example, in the aforementioned case, a federal court in Texas opted to disregard the parties' clear choice of law because Oklahoma's public policy prohibited it from doing so. As part of the transaction, F & M Bank and Trust Company, a Tulsa-based bank, was purchased by Prosperity Bank, according to the company. Following the sale, employees of F & M Bank signed a non-compete agreement that included a language stating that Texas law would be used. The employees in Oklahoma sought a declaratory decision from the court because they were dissatisfied with their non-compete agreements. In this case, the district court sitting in diversity applied Oklahoma law because "prosperity sought to restrict the hiring of Oklahoma citizens at an Oklahoma bank and protect relationships with customers in Oklahoma."[22]

SCOPE:

Employees who sign non-compete agreements are barred from working for a competitor of the company they work for. Moreover, these agreements contain time constraints as well as regional and customer restrictions. While leaving their prior employer, it is not commonplace for employees to sign a confidentiality or non-disclosure agreement to protect their identities. If you are an employee or an employer, you should carefully review confidentiality agreements to ensure that they are comprehensive and have a reasonable term in compliance with state law. The duration and breadth of nondisclosure agreements are restricted in a few states under particular circumstances in certain circumstances.

JUDICIAL PRONOUNCEMENTS:

Edwards v. Arthur Andersen and Co.[23]

"*Specifically, the California Supreme Court decided that the legislation should be strictly construed to nullify all non-compete agreements, with the exception of the ones expressly permitted under the California Code of Civil Procedure as exceptions*."

[21] 2014 WL 4982600
[22] No. 4:14-cv-01946, 2014 WL 4982600 (S.D. Tex. Oct. 6, 2014), reconsideration denied, No. 4:14-cv-01946, 2014 WL 4982600 (S.D. Tex. Nov. 18, 2014).
[23] 189 P.3D 285

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Brief:

Plaintiff Raymond Edwards, a certified public accountant, was employed by the company at the time as a tax manager in the Los Angeles office of Arthur Andersen & Company. He eventually rose through the ranks to a more senior position. In 1997, Edwards was hired as a consultant for the company. His job with Andersen was contingent on his signing a non-competition agreement with the company.

Immediately following Andersen's departure and continuing to carry out the same responsibilities for the next 18 months all clients, regardless of their financial situation, can benefit from professional services. Andersen insisted on Edwards signing the TONC, and Edwards complied. Edwards' claim that he purposefully interfered with the process is fair enough to sustain his claim there is the possibility of financial gain

Selmer Co. v. Rinn[24]

"A restrictive covenant is considered in light of the totality of the circumstances, according to this judgement, and covenants not to compete are treated as contracts, which fall under the jurisdiction of the common law."

Brief:

Selmer, a full-service construction manager, design-builder, and industrial services contractor, is available to meet any and all of your construction management needs. After being hired as a sales representative, Rinn swiftly progressed through the ranks, eventually becoming director of business development. The following non-solicitation and confidentiality provisions were inserted into the stock option agreement by the company. On August 29, 2007, Rinn formally resigned from his position as director of operations at Selmer. A restrictive covenant included in a document other than an employment agreement has been upheld by Wisconsin courts in cases when the employer retains a negotiating advantage over its employees despite the inclusion of the restrictive covenant in a different document.

EXCEPTIONS:

- Executive I's failure to comply with any non-solicitation, non-competition, or non-disclosure agreement or provisions that he or she may at any time sign in favour of Levitt or any of their affiliates (collectively, "Restrictive Covenants") shall not be deemed a violation of any Restrictive Covenants if the Executive I owns, directly or indirectly, any intellectual property that is subject to the Restrictive Covenants; and Has a business relationship with the

[24] 789 N.W.2d 621

Company; (iii) has a business relationship with Levitt; (iv) has a business relationship with the Company; and (v) has a business relationship with Levitt.[25]

- After being terminated by the Company for any reason, Employee agrees not to act in any capacity as a partner, officer, director, stockholder holding five percent or more of the Company's outstanding shares of common stock, employee, employer or consultant for the remainder of the Term and for one year after being terminated by the Company, provided that Company has met and continues to meet its obligations under the terms of this Agreement. Employee agrees that if he is terminated from his employment with the Company for any reason, he will not hire or offer to hire any employees of the Company or any Affiliate, call on, solicit, actively interfere with, or attempt to divert or entice away any employees of the Company or any Affiliate for a period of one year following his termination from his employment with the Company.[26]

- Except in the case of executive employment agreements and the transfer of businesses or practises, restrictive covenant agreements are normally executed with little or no debate between the employer and the employee before being signed. Contractual obligations are typically included in the paperwork that a new employee is obliged to sign as part of their new employment contract or offer letter. A restrictive covenant agreement in place may make it more difficult for a former employee to find work in a similar sector in the future, assuming that employment is available. Employer-sponsored restrictive covenant agreements are more likely to be upheld by the courts if their breadth and length are reasonable, and if they are designed to protect the employer's legitimate interests. Despite the fact that legal defences to the enforcement of restrictive covenants varied from state to state, there are a number of well-known ones to consider.[27]

IV. CONCLUSION

There has been no significant change in our country's legal stance on post-contractual covenants or limitations. In our nation, the legal position is that Sec 27 doesn't apply the test of reasonableness or concept of partial constraint unless it comes under an explicit exemption included in Sec 27. States, not federal government, decide whether or not restrictive covenants may be enforced in United States. To determine whether a limitation is reasonable, most American courts look at three different aspects: the length of the restriction, where it is located geographically, and what kind of activity it restricts. Non-solicitation is subjected to reasoning

[25] BDO Seidman v. Hirshberg, 712 N.E.2d 1220, 1222 (N.Y. 1999)
[26] Davies & Davies Agcy., Inc., v. Davies, 298 N.W.2d 127, 131
[27] Lanmark Technology, Inc. v. Canales, 454 F. Supp. 2d 524, 529 (E.D. Va. 2006)

tests that are quite similar. A broad restriction on restrictive covenants restricting an individual's right to do business or commerce is in place in California. Hence restrictive covenants are mostly unenforceable there. When a person sells all of his or her business stake in a firm or partnership, including the goodwill, he or she may enter into a non-compete agreement with the exclusions comparable to those under Indian law. Restriction covenants in California may only be upheld under certain circumstances if they are fair in terms of their length, geographic breadth, and substantive content. United States law permits an employer to safeguard its private information and trade secrets, but the information the employer wishes to preserve as confidential information and trade secrets is put to the test to determine whether it is indeed a trade secret or confidential information.

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