

## ENFORCEABILITY OF EMPLOYMENT BONDS IN INDIA: SC CLARIFIES INDIAN CONTRACT ACT PROVISIONS

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### Introduction

In the recent case of *Vijaya Bank & Anr. v. Prashant B. Narnaware* (2025 INSC 691), India's Supreme Court (the “SC”) examined the validity of an employment bond, which requires an employee to pay liquidated damages to the employer in case of failure to complete a minimum-service tenure requirement. The SC examined: (i) restraint of trade under Section 27 of the Indian Contract Act, 1872 (the “ICA”); (ii) public policy; and (iii) interpretation of standard form employment contracts.

### Background

Prashant B. Narnaware (the “Respondent”) joined Vijaya Bank (the “Bank”) as a probationary assistant manager in 1999 and was subsequently promoted. In 2006, the Bank conducted a recruitment drive to appoint officers across various grades. Clause 9(w) of the recruitment notification issued by the Bank required the selected candidates to execute an indemnity bond of INR200,000, under which employees who resigned from the service of the Bank before completing three (3) years of service would have to pay this amount to the Bank. The Respondent applied for the post of senior manager-cost accountant and was selected.

On August 7, 2007, the Respondent received an appointment letter from the Bank, which included a Clause 11(k) reiterating the requirement to work in the Bank for a minimum period of three (3) years and execute an indemnity bond for INR200,000. This amount was required to be paid in case of failure to serve the minimum service period. The Respondent accepted these terms and executed the bond. However, in 2009, prior to completing the stipulated three (3) year period, the Respondent resigned to join another bank and paid the bond amount of INR200,000 under protest.

Subsequently, the Respondent challenged the validity of the employment bond in Clause 9(w) of the recruitment notification and Clause 11(k) of the appointment letter before the Karnataka High Court. The Respondent argued that the foregoing clauses violated Articles 14 and 19(1)(g) of the Constitution of India, as well as Sections 23 and 27 of the ICA. The Karnataka High Court allowed the Respondent's writ petition and held that the employment bond constituted a restraint of trade under Section 27 of the ICA. The Karnataka High Court further directed the Bank to refund the amount of INR200,000 paid by the Respondent. The Bank appealed this decision to the SC.

### Issues raised and the SC's ruling

The core legal issues before the SC were:

- (i) Whether Clause 11(k), which imposed a penalty of INR200,000 for resigning within three (3) years, was in restraint of trade under Section 27 of the ICA?
- (ii) Whether Clause 11(k) was opposed to India's public policy under Section 23 of the ICA?

### *Restraint of trade*

The SC analyzed whether Clause 11(k) of the appointment letter, which imposed a penalty of INR200,000 for resigning before completing the stipulated three (3) years, constitutes a restraint of trade under Section 27 of the ICA.

Section 27 of the ICA provides that agreements which restrain a person from exercising a lawful profession, trade, or business of any kind is void to that extent, with exceptions for sale of goodwill. The SC relied on its earlier decision in *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co* (AIR 1967 SC 1098) to distinguish between restrictive covenants operative during the course of employment and those operating post-termination. In *Niranjan Shankar Golikari* (supra), the SC held that negative covenants operating during the term provided in an employment contract are valid because the employee is mandated to serve the employer exclusively during that period. However, negative covenants are not enforceable after the termination of an employment contract.

The SC observed that the intent of Clause 11(k) was merely to ensure a minimum service period and to put a restriction on the Respondent's ability to resign rather than restraining his future employment. Hence, the SC held that Clause 11(k) was not violative of Section 27 of the ICA.

### *Public policy*

The Respondent argued that given the unequal bargaining power between the Bank and the Respondent, he was forced to sign the contract so as to avoid harm to his career. He argued that Clause 11(k) was unreasonable and onerous and led to unjust enrichment for the Bank. He argued that this was against public policy and his fundamental rights.

Section 23 of the ICA prescribes that agreements that are opposed to public policy are void. Relying on *Central Inland Water Transport Corporation Limited. v. Brojo Nath Ganguly* (AIR 1986 SC 1571), the SC analysed whether standard form employment contracts give rise to unequal bargaining power between employers and employees and summarized as follows:

- (i) Standard form employment contracts, *prima facie*, reflect an unequal bargaining power between the employer and the employee.
- (ii) When the employee, being the weaker party, claims that the contract was entered into undue influence or coercion or that any term of the contract violates public policy, the court should evaluate these claims in light of the inequality between the

- employer and the employee, and the circumstances under which the contract was executed.
- (iii) It is the employer's responsibility to prove that any restrictive clause in the employment contract is reasonable, lawful, and not contrary to public policy.

The SC further observed that factors like advancements in technology impacting the nature of work, need for constant re-skilling, and retention of scarce, specialized talent in a free-market economy are becoming important public policy concerns in employer-employee relationships. These factors should be considered while assessing whether the terms of an employment contract are in alignment with public policy or against it.

The SC held that the clause 11(k) was incorporated in the employment agreement to ensure a minimum tenure for employees and to reduce employee attrition. Hence, it was not unconscionable, unfair, unreasonable, or against public policy.

### *Liquidated damages*

On the issue of liquidated damages, the Bank clarified that it would have to suffer financial losses due to early resignations and would have to bear the cost of untimely recruitment drives, as well as loss due to the recruitment drives conducted earlier. Premature resignations would also impact its day-to-day operations. The Respondent argued that liquidated damages of INR200,000 were disproportionately high and unjustly enriched the Bank. The SC sided with the Bank and acknowledged that as the Bank was a public sector undertaking ("PSU") it could not resort to *ad hoc* or private appointment and would have to undertake an extensive recruitment process in case of untimely resignations. In light of this, the Bank was right in including a liquidated damages clause in the contract.

The SC acknowledged the changed landscape of the Indian economy after liberalization and the increased competition faced by PSUs from private companies. The SC recognized their need to retain their skilled and experienced employees to remain competitive and, therefore, opined that including a minimum service tenure in employment contracts is reasonable for PSUs to reduce attrition and enhance operational efficiency.

The SC set aside the Karnataka High Court's decision and upheld Clause 11(k) ruling that it did not amount to a restraint of trade and was not opposed to public policy. That said, the SC pointed out that its judgement on employment bonds should not be read as definitive law, but that the principles prescribed in the judgement should be carefully applied after considering the factual matrix of each case.

### **Our comments**

The SC's decision reinforces the sanctity of contracts and the principle that parties are bound by the terms they have agreed to, as long as the terms are fair, reasonable, and not contrary to statutory provisions or public policy.

In the past, Indian courts have adopted a nuanced stance when deciding on the validity of employment bonds. In *Kailash Kumar v. M/S Syndicate Bank Limited* (2017 SCC OnLine Del 12532), when ruling on the right of the bank to recover liquidated damages, the Delhi High Court observed that the employer should prove actual loss incurred due to the employee's premature departure from the service of the employer. Additionally, courts have also come down on onerous contractual obligations. The Calcutta High Court, in *Shree Gopal Paper Mills Ltd v. Surendra K Ganesha's Malhotra* (AIR 1962 Cal 61), held a covenant requiring the employee to serve for twenty (20) years as oppressive.

In our view, private employers should apply the SC's ruling with caution. As public policy was a major consideration for the SC in deciding the *Vijaya Bank* case, private sector employers should draft their employment bond clauses with care as public policy concerns may not apply to them.

As highlighted by the SC, validity of employment bonds should be decided on a case-to-case basis depending on the specific facts. Although employee bonds have been upheld, they should be incorporated in agreements with caution and not in a manner unduly onerous to the employee, so as to avoid future litigation with the employee. Any provision of liquidated damages should be a genuine pre-estimate of actual losses that will be incurred by the employer should the employee resign.