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Lock-in period provision in an employment agreement during the term of employment is valid and does not infringe the fundamental rights of an employee; disputes on lock-in period are arbitrable under the Arbitration and Conciliation Act, 1996

In ***Lily Packers Private Limited vs. Vaishnavi Vijay Umak and Ors.***[1] (the "**Lily Case**"), a Single Judge of the Delhi High Court ("**Delhi HC**") adjudicated on (a) the validity of the lock-in period provision in the employment agreement(s) of the respondent employees with the petitioner company; and (b) whether the dispute on lock-in period was arbitrable under the Arbitration and Conciliation Act, 1996 ("**Arbitration Act**"). The Delhi HC held that the lock-in period as a restrictive covenant in the employment agreements was valid, enforceable during the term of employment and did not infringe the fundamental rights of the employees under the Constitution of India ("**Constitution**"). It also held that the dispute on lock-in period was arbitrable.

The Lily Case validates the enforceability of lock-in period and gives employers the legal sanction to incorporate such negative covenants in the employment agreements provided that these covenants are operative during the period of employment.

Brief facts

The petitioner company (Lily Packers Private Limited) (the "**Employer**") was in the business of manufacturing and trading of packaging materials. The employment agreements (the "**Employment Agreement(s)**") of the respondent employees (the "**Employees**") provided for a lock-in period of 3 (three) years (the "**Lock-In Period**") and imposed a restriction on the Employees from terminating their employment during the Lock-In Period. The Employees did not serve the entire Lock-In Period and terminated their employment with the Employer. Thus, the Employer invoked arbitration proceedings against the Employees in accordance with the dispute resolution clause of the Employment Agreements. However, the Employees did not agree to submit the dispute to arbitration. Thereafter, the aggrieved Employer filed a petition under Section 11 (6) of the Arbitration Act before the Delhi HC for the constitution of the arbitral tribunal to resolve the disputes.

The Employees contended that the restrictive covenants bound them to serve the Employer during the Lock-In Period, which violated their fundamental right to life and employment under Article 19 and Article 21 of the Constitution. Since the disputes related to violation of the fundamental rights were not arbitrable, therefore, the present disputes could not be resorted to arbitration. On the other hand, the Employer contended that enormous investments were made to train the Employees. Thus, the Lock-In Period was ought to be honoured by the Employees. Moreover, since

[1] Arbitration Petition 1210/2023 (Decided on July 11, 2024).

the Employment Agreements contained an arbitration clause, disputes arising thereof were ought to be referred to arbitration.

Issues

1. Whether a lock-in period provision in employment agreements was valid under law or does it violate the fundamental rights of employees as enshrined in the Constitution?
2. Whether disputes on the lock-in period of employment agreements were arbitrable in terms of the Arbitration Act?

Findings and opinion

Issue 1

The Delhi HC held that reasonable restrictive covenants that operate during the term of employment were valid in law. Thus, it could not be argued that the Lock-In Period was violative of the fundamental rights as enshrined in the Constitution. The Delhi HC also observed that the disputes related to employment agreements in general were contractual in nature, and not which raised issues of violation of fundamental rights in such fact situations.

The Delhi HC observed that in employment agreements, terms such as lock-in period, pay fixation, emolument benefits, etc., were usually subject matters of negotiation. Typically, such clauses were decided upon voluntarily by the parties as they entered into such agreements on their own individual consent and volition. Covenants such as lock-in periods were especially prevalent at the executive levels of employment in trade and industry and considered necessary for (a) the stability and continuance of the employer organization; and (b) reducing attrition of employees.

Issue 2

While adjudicating on the arbitrability of dispute related to the Lock-In Period, the Delhi HC made a reference to the Delhi HC's ruling in a similar case, i.e., *BLB Institute of Financial Markets Ltd. vs. Ramakar Jha*[2]. In this matter, the Single Judge referred the matter to arbitration and observed that the concerned employee had breached the lock-in period covenant of the employment agreement, which was operative during its subsistence and hence, was not in restraint of trade.

In the present case, the Delhi HC observed that the disputes fell within the ambit of the Employment Agreements as the (a) Employer was not seeking to restrain the Employees from employment with any of its competitors post termination thereof; (b) covenants were only operative during the period of employment; (c) Employer was interested in protecting its confidential information; and (d) Employer wished to seek damages from the Employees. Therefore, the Delhi HC held that the disputes raised in the matter were clearly arbitrable in terms of the Arbitration Act, and thus, appointed an arbitrator to adjudicate the same.

JSA Analysis and Conclusion

The Delhi HC clarifies the legal position on the validity and enforceability of lock-in periods provided in employment agreements during the subsistence of employment, and that it is neither a restraint of trade under the Indian Contract Act, 1872, nor a violation of the fundamental rights enshrined in the Constitution. It also acknowledges that negative covenants such as lock-in period clauses may be necessary for employers as it provides the required stability and strength to their organization and reduces attrition of employees.

Typically, lock-in periods have been enforceable in India, especially in the context of training bonds executed between employers and employees. Broadly speaking, to enforce provisions related to lock-in period, employers need to

[2] (2008) 154 DLT 121.

demonstrate, amongst others, that (a) the concerned employees were beneficiaries of special favour or concession or specialised training at the cost and expense of their employer; (b) there was a contractual breach on the part of employees; and (c) they had incurred loss which was quantifiable. However, the decision of the courts varies based on different fact situations.

In this matter, the Delhi HC gave an overview on the validity of lock-in periods in employment agreements during the subsistence of employment but did not delve into the facts related to the loss incurred by the Employer or whether the Lock-In Period was in the context of specific expenditure undertaken by the Employer in relation to the Employees.

Further, the Delhi HC observed that clauses such as lock-in period were usually voluntarily decided upon by the parties who entered into employment agreements on their own individual consent and volition. However, the disbalance in bargaining power between employers and employees was not addressed in the judgement.

This judgement validates the enforceability of lock-in periods and gives employers the legal sanction to incorporate such negative covenants in their employment agreements provided that these covenants pertain to the period of employment.

Employment Practice

JSA has a team of experienced employment law specialists who work with clients from a wide range of sectors, to tackle local and cross-border, contentious and non-contentious employment law issues. Our key areas of advice include (a) advising on boardroom disputes including issues with directors, both executive and non-executive; (b) providing support for business restructuring and turnaround transactions, addressing employment and labour aspects of a deal, to minimize associated risks and ensure legal compliance; (c) providing transaction support with reference to employment law aspects of all corporate finance transactions, including the transfer of undertakings, transfer of accumulated employee benefits of outgoing employees to a new employer, redundancies, and dismissals; (d) advising on compliance and investigations, including creating compliance programs and policy, compliance evaluation assessment, procedure development and providing support for conducting internal investigations into alleged wrongful conduct; (e) designing, documenting, reviewing, and operating all types of employee benefit plans and arrangements, including incentive, bonus and severance programs; and (f) advising on international employment issues, including immigration, residency, social security benefits, taxation issues, Indian laws applicable to spouses and children of expatriates, and other legal requirements that arise when sending employees to India and recruiting from India, including body shopping situations.

JSA also has significant experience in assisting employers to ensure that they provide focused and proactive counselling to comply with the obligations placed on employees under the prevention of sexual harassment regime in India. We advise and assist clients in cases involving sexual harassment at the workplace, intra-office consensual relationships, including drafting of prevention of sexual harassment (POSH) policies, participating in POSH proceedings, conducting training for employees as well as Internal Complaints Committee members, and acting as external members of POSH Committees.

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