

Supreme Court upholds validity of Employment Bond and liability to pay liquidated damages in the event of its breach

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A two Judge Bench of the Supreme Court in *Vijaya Bank and Another v Prashant B Narnaware*, 2025 SCC OnLine SC 1107 on 14 May 2025, has upheld the validity of a restrictive covenant placed by an employer on its employee prohibiting resignation before the lapse of 3 years from date of appointment and for payment of liquidated damages of INR 2,00,000 as a consequential of breach of such restrictive covenant.

The Supreme Court dealt with Sections 27 and 23 of the Indian Contract Act, 1872 (Contract Act) going into the aspect of restrictive employment covenants and the term "public policy" qua employment contracts and its interpretation over time.

Brief factual background

The employee, Mr Prashant B. Narnaware (Respondent), joined Vijaya Bank (Bank) in 1999. In 2006, the Bank brought out a recruitment notification for certain posts (Notification) containing clauses 9(w) and 11(k) (Restrictive Clauses) which required any employee to sign an indemnity bond for INR 2,00,000 and indemnify the Bank of such amount should such employee resign from the employment before the lapse of 3 years. The Respondent, on his confirmation in 2007 to the post of Senior Manager-Cost Accountant for which he had applied pursuant to the Notification, was bound by Restrictive Clauses in the Notification.

The Respondent resigned from employment in 2009 and paid the sum of INR 2,00,000 under protest and simultaneously, as opposed to a suit, filed a writ petition before the High Court challenging the Restrictive Clauses of the Notification as being violative of Articles 14 and 19 of the Constitution of India, 1950 (Constitution) and Sections 23 and 27 of the Contract Act.

A single judge of the High Court, while relying on the Judgment of a Division Bench of Karnataka High Court in *KY Venkatesh Kumar v BEML Limited*, WA No 2736 of 2009 (BEML Judgment), allowed the writ petition. The judgment of the Single Judge was upheld by the Division Bench of the High Court against which the Bank approached the Supreme Court.

Before the Supreme Court, the arguments centered around whether the Restrictive Clauses were in violation of Section 23 and 27 of the Contract Act.

Key findings of the Supreme Court

Restraint of trade

While dealing with the ambit of Section 27 of the Contract Act, the Supreme Court relied upon its previous judgments in *Niranjan Shankar Golikari v Century Spinning and Manufacturing Co*, 1967 SCC OnLine SC 72 and *Superintendence Company (Private) Limited v Krishan Murgai*, (1981) 2 SCC 246 and drew a distinction between a restrictive covenant which operates during the subsistence of employment and a restrictive covenant which operates post termination. These judgments held that unless there is a negative covenant preventing an employee from working for any other employer, a restrictive covenant during the course of employment would not amount to a restraint of trade under Section 27 of the Contract Act.

In the present case, the court held that the Respondent was not prevented from pursuing further employment. The Restrictive Clauses only sought to impose a condition on the Respondent's resignation to indemnify the Bank. The object of the Restrictive Clauses was in furtherance of the employment contract and not to restrain future employment.

Public policy

The Supreme Court then went into the question of the Restrictive Clauses being opposed to public policy. While doing so, it relied upon its decision in *Central Inland Water Transport Corporation Limited v Brojo Nath Ganguly*, (1986) 3 SCC 156, which laid down the principles to interpret a standard form employment contract. The court stated that:

- (a) there should be *prima facie* evidence of unequal bargaining power;
- (b) if a weaker party pleads undue influence/ coercion, the court ought to keep in mind the position of the parties and context under which such agreement was entered into; and
- (c) the onus to prove that such covenant was not in violation of Sections 23 and 27 of the Contract Act would be on the employer.

The Supreme Court held that "*public policy*" relates to public good and public interest, and the same may change over time. In the context of an employer-employee relationship, technological advancements impacting nature and character of work, re-skilling and preservation of scarce specialized workforce in a free market were emerging heads in the public policy domain which needed to be factored when terms of an employment contract were tested on the anvil of public policy.

The Supreme Court noted that with the advent of globalization and privatisation, the Bank had to compete with private sector banks and ensuring retention of an efficient and experienced staff contributing to managerial skills was one of the tools inalienable to the interest of the Bank which prompted it to put in place a minimum service tenure to reduce attrition and improve efficiency.

The court also observed that the BEML judgment related to a restraint on future employment, whereas in the present case, there was no such restriction placed upon the employee.

The court also held that the imposition of liquidated damages of INR 2,00,000 was just as the Bank had to undertake a longwinded and expensive recruitment process to refill the vacant position caused solely due to the resignation of the Respondent. Therefore, the court set aside the judgment of the Division Bench of the Karnataka High Court. Accordingly, the court found that the Restrictive Covenants did not amount to a restraint of trade and were not against public policy and upheld the validity of the Restrictive Clauses and imposition of liquidated damages.

Comments

This judgment is notable in the context of service bonds as the court reiterated the distinction between a restrictive covenant meant to apply post termination, which amounts to a restraint on employment, and a restrictive covenant which operates during the subsistence of employment, noting that the service bonds fall into the latter category and, therefore, have legal force.

That said, the contours of enforceability of service bonds do not appear to have been discussed in detail by the Supreme Court. For context, the Madras High Court, in the case of *Toshniwal Brothers (Private) Limited v Eswarprasad*, 1997 LLR 500, recognised the enforceability of service bonds but noted that in order to enforce one against an employee, the employer must be able to demonstrate that the management concerned incurred expenditure to give any special training to the employee (which could be specific to the particular position and / or responsibilities taken up by the employee). Further, while enforcing the liquidated damages set out in the service bond clause, a court will examine whether the amount is reasonable in the circumstances. In the case of *Ledella Ravichander and Others v Satyam Computer Services Limited*, 2011 (107) AIC 827, the Andhra Pradesh High Court examined a situation where the employment bond required a minimum service of 2 years, and the concerned employee worked for 14 months and parted ways with the company. The court observed that in such a situation, awarding the liquidated damages of INR 2,00,000 (as mentioned in the employment contract) would be unreasonable, more so when there was no substantial loss or damages proved by the employer on account of the employee's exit. The court accordingly awarded INR 1,00,000 as damages payable by the employee.

The recent pronouncement of the Supreme Court bears noting that the proceedings emanated from a writ petition, which proceedings are summary in nature and not from a suit where any evidence could have been led. What was therefore before the court were only statements on affidavit which were used to interpret the Restrictive Covenants. The court also appeared to place significance on the quantum of bond amount which was INR 2,00,000 in this case. The judgment does not deal with a factual situation where an employee may be bound by onerous bond conditions and consequently restricted from resigning. However, the court has paved way for interpretation of "public policy" in a broader and expansive sense in keeping with modern employment positions.

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