

## HR Law Hotline

November 19, 2024

### LOCK-IN PERIOD IN EMPLOYMENT CONTRACTS: NEED FOR A MORE NUANCED VIEW

- The Delhi High Court's decision in Lily Packers case serves as a critical reference point for future cases involving validity of lock-in clauses in employment contracts.
- This judgement validates the enforceability of lock-in periods during the period of employment.
- Such negative covenants should be incorporated with the need to balance lock-in clauses in employment contracts and right to livelihood of employees.

#### I. INTRODUCTION

In today's competitive landscape, characterized by high attrition rates and the rise of gig economies, provisions such as "lock-in" clauses are increasingly necessary for businesses to maintain continuity and protect proprietary knowledge. These clauses restrict an employee's ability to leave the company for a specified period, thereby ensuring that employers can recoup their investment in training and skill development. The Delhi High Court's recent validation of the lock-in clause in the case of **Lily Packers Private Limited vs. Vaishnavi Vijay Umak and Ors<sup>1</sup>** ("Lily Packers Case") underscores the same. However, on the flip side, lock-in clauses in employment contracts can be argued to be detrimental to employees, as they impose significant restrictions on their freedom to seek better opportunities and can lead to an imbalance of power between employers and employees. These clauses often prevent individuals from resigning or changing jobs for a specified period, which can be particularly problematic in a dynamic job market where career growth and adaptability are essential.

#### II. LILY PACKER CASE

##### a. Factual background

The case pertained to Lily Packers Private Limited ("Company"), a manufacturing company which engaged an employee, Ms. Vaishnavi Umak ("Employee") as a fashion designer by way of an employment agreement dated 16<sup>th</sup> April 2022. The agreement recorded clauses such as protection of company confidentiality, a lock-in period of 3 years (*from the start of the employment*) and further, compliance and adherence towards company policies.

The lock-in clause in particular, provided that, after successful completion of the probation period, the Employee would be bound by a lock-in period, to be counted from 3 years of the date of joining and that the Employee would not terminate the employment agreement before the completion of the lock-in period agreed upon. The lock-in clause however, on the contrary, provided that the employment agreement could be terminated during the subsistence of the lock-in period at the sole discretion of the Company without providing any notice or assigning any reason thereof.

The employment agreement also contained a separate confidentiality clause, whereby, the Employee had agreed to not dissipate confidential information of the Company, further, an intellectual property protection clause which provided for the obligation of the Employee towards protecting the intellectual property of the Company, and a data protection clause which placed certain obligations on the Employee towards protection of data of the Company.

The Employee had agreed to continue for 3 years from the date of joining as per the employment agreement, however, during the subsistence of the lock-in clause, the Employee went on leave and never came back and sent a resignation email wherein the Employee stated that his mental health was deteriorating due to stress caused by work, thereby working for a period of one year and two months instead of the agreed lock-in period of 3 years. The Company, apprehending a violation of the; (a) lock-in clause, (b) intellectual property clause, and (c) data protection clause and in view of the disputes that had arisen between the two parties, issued a notice of demand to the Employee. Further, the arbitration clause in the employment agreement was invoked by the Company. The Employee responded to the notice of arbitration and denied all the allegations made by the Company and refused to arbitration as per the Arbitration and Conciliation Act, 1996 ("A&C Act").

##### b. Issues raised

In view of the aforementioned facts, the following issues were framed by the Delhi High Court; (a) whether a lock-in period in employment contracts is valid in law, or does it violate the fundamental rights enshrined in the Constitution of India? (b) whether disputes relating to a lock-in period in employment contracts are arbitrable in terms of the A&C Act?

##### c. Arguments advanced

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- It was argued by the Company that it had made an enormous investment in training the Employee during the employment, therefore, the lock-in clause was required to be honoured.
- In contrast, it was contended by the Employee that the Employee was employed at one of the divisions of the Company and not at the Company itself, therefore, no privity of contract existed between the Company and the Employee.
- It was further argued by the Employee that lock-in clauses are violative of Article 19 and Article 21 of the Indian Constitution, and Section 27 of the Indian Contract Act, 1872 and that disputes in relation to the same are not arbitrable.

#### d. Findings of the Court

- In relation to arguments raised, the Delhi High Court held that *“the fixation or prescription of a lock-in period in employment contracts, merely means that the employee would serve the employer for a certain period. In employment contracts, the terms which the employees agree to, such as, the lock-in period provided herein, pay fixation, emolument benefits, etc. are usually the subject matter of negotiation.*

*Such clauses in an agreement are usually decided upon voluntarily, as also such employment contracts are entered into by the parties by their own individual consent and volition. It was also noted that such clauses in employment contracts may in fact be necessary for the health of the employer institution as it provides the required stability and strength to the employer institution and its framework.*

*Lock-in periods in employment contracts are especially prevalent at the executive levels in the trade and industry and are considered necessary for the purpose of stability and continuance of the employer organization. It also reduces the employee attrition levels”.*

- The Delhi High Court also relied on the dicta of the Apex Court in cases such as ***Brahmaputra Tea Co. Ltd. vs. E. Scarth<sup>2</sup>*** and ***Niranjan Shankar Golikari vs. The Century Spinning and Mfg. Co. Ltd<sup>8</sup>*** to say that the principles with regard to the validity of covenants in employment contracts are well settled. In this regard, the Delhi High Court clarified that *“Any reasonable covenant operating during the term of the employment agreement would be valid and lawful. It cannot, therefore, be argued that in the present cases there is a violation of any fundamental right as enshrined in the Constitution of India. It was further observed that employment contracts in general are contractual disputes and not disputes which raise issues of violation of fundamental rights, in such fact situations. There may be certain employment conditions which could be considered unreasonable curtailment of the employee's right to employment but a 3-year period of lock-in cannot be held to be such a condition”.*
- In relation to arbitrability of disputes arising out of the employment agreement herein, it was held that reasonable lock-in periods in employment contracts that apply during the term of employment are valid in law and do not violate fundamental rights as enshrined in the Constitution of India. Hence, disputes relating to lock-in periods that apply during the subsistence of employment contracts, are arbitrable in terms of the A&C Act.

### III. ANALYSIS AND CONCLUSION

While the concept of 'lock-in' is fairly uncommon, this judgement validates the enforceability of lock-in periods and gives employers levy to incorporate such negative covenants in their employment agreements provided that these covenants operate during the period of employment.

However, one of the key premise basis which the Delhi High Court has arrived at the conclusion of aforementioned of validity of lock in clauses in employment contract, is the fact that lock-in clauses which are usually the subject matter of negotiation, are agreed upon by the parties out of their own will and volition. Further, such lock-in period should typically kick in post completion of probation period. However, it is critical to understand that employment contracts are often marred with bargaining power disparity between the employer and the employee and in such a circumstance, taking into consideration the underlying assumption of equality in bargaining power during negotiation of such lock-in clauses may disproportionately favour employers, especially when employees may not fully understand the implications of long-term commitments due to inherent bargaining power disparity. Therefore, it is crucial for employers to ensure that these clauses are reasonable in time period and are clearly communicated at the time of recruitment.

The enforceability of employment bond agreements has also been tested in Indian courts. For example, in the case of ***Desiccant Rotors International (P) Ltd v Bappaditya Sarkar<sup>4</sup>***, the Delhi High Court had observed that in cases of inconsistency between employers' attempts to protect themselves from competition and the right of employees to seek employment wherever they choose, the right of livelihood of the latter must prevail.

Though, ruling in the Lily Packers case serves as a critical reference point for future cases involving validity of lock-in clauses in employment contracts. Balancing lock-in clauses in employment agreements with employees' right to livelihood is a nuanced challenge that requires careful consideration of both employer interests and employee rights.

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<sup>1</sup>ARB.P. 1210, 1212 and 1213/2023

<sup>2</sup>(1885) ILR 11CAL545

<sup>3</sup>1967 AIR 1098

<sup>4</sup>CS(OS) No.337/2008, Decision dated 14th July, 2009

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