May 2025

Supreme Court of India affirms validity of employment bond containing restrictive clause and directs payment of penalty for premature resignation

In a recent case of ***Vijaya Bank and Anr. vs. Prashant B Narnaware***[1], a 2 (two) judge bench of the Supreme Court of India ("**Supreme Court**") upheld the validity of a clause which required an employee to serve a minimum tenure of 3 (three) years or pay liquidated damages of INR 2,00,000 (Indian Rupees two lakh) in case of an early exit. The Supreme Court reaffirmed that such provisions were not unconscionable, unfair or unreasonable, do not constitute a restraint of trade under Section 27 of the Indian Contract Act, 1872 ("**Contract Act**") and are not opposed to public policy under Section 23 of the Contract Act.

Brief facts

On September 28, 2007, Mr. Prashant B. Narnaware ("**Employee**") was appointed as senior manager (MMG-III) at Vijaya Bank ("**Employer**"), a public sector Indian bank. Clause 11(k) of the Employee's appointment letter dated August 7, 2007 ("**Appointment Letter**") required him to serve a minimum tenure of 3 (three) years with the Employer from the date of joining the Employer, failing which he was liable to pay liquidated damages of INR 2,00,000 (Indian Rupees two lakh) to the Employer. The Employee also executed an indemnity bond to this effect. Notably, the same condition was also included in clause 9 (w) of the recruitment notification issued by the Employer.

Subsequently, on July 17, 2009, prior to completion of the stipulated 3 (three) year service period, the Employee resigned in order to join another bank. The resignation was accepted by the Employer and on October 16, 2009, the Employee under protest paid INR 2,00,000 (Indian Rupees two lakh) in line with clause 11(k) of his Appointment Letter.

Thereafter, the Employee filed a writ petition before the Karnataka High Court ("**Karnataka HC**") for quashing of clause 9 (w) of the recruitment notification and clause 11 (k) of the Appointment Letter on grounds that it is violative of Articles 14 and 19(1)(g) of the Constitution of India ("**Constitution**") and were unenforceable under Sections 23 and 27 of the Contract Act. The writ petition was allowed by a Single Judge, relying on its decision in K*.Y. Venkatesh Kumar vs. BEML Limited*[2]. On an appeal, the decision was subsequently upheld by the Division Bench of the Karnataka HC.

Aggrieved by the decision, the Employer filed an appeal before the Supreme Court contending that the challenged clauses reflected a reasonable condition to prevent attrition and safeguard recruitment investment, and did not restrain the Employee's right to seek alternative employment.

[1] Civil Appeal No. 11708/2016 (decided on May 14, 2025)
[2] W.A. No. 2736/2009 (decided on December 9, 2009)

Issues

The Supreme Court was presented with the following issues:

1. whether clause 11(k) of the Appointment Letter amounts to a restraint of trade under Section 27 of the Contract Act?
2. whether clause 11(k) of the Appointment Letter was opposed to public policy under Section 23 of the Contract Act, or violative of Articles 14 and 19(1)(g) of the Constitution?
3. whether the quantum of liquidated damages of INR 2,00,000 (Indian Rupees two lakh) is reasonable?

Observations and analysis

The Supreme Court, while examining the facts and deciding upon the matter, laid down the following key observations:

1. on the question of restraint of trade under Section 27 of the Contract Act, the Supreme Court reaffirmed the settled legal distinction between restraints during employment and those post-termination. Relying on its earlier decision in *Niranjan Shankar Golikari vs. The Century Spinning and Mfg Co. Ltd.*[3], the Supreme Court held that negative covenants operating during employment—such as exclusivity of service or minimum tenure—do not fall within the scope of 'restraint of trade' under Section 27 of the Contract Act, unless they are unconscionable or excessively harsh. In this context, clause 11(k) of the Appointment Letter was held to be a valid negative covenant operative during the term of employment, which was in furtherance of the employment contract and not to restrain the future employment. The Supreme Court held that the said clause is not violative of Section 27 of the Contract Act;
2. on the question of whether the above referred clause was opposed to public policy under Section 23 of the Contract Act, the Supreme Court acknowledged that standard-form employment contracts may warrant higher scrutiny due to the unequal bargaining position of employees. However, it clarified that this alone does not render a clause invalid. The Supreme Court also held that the onus is on the Employer to prove that the restrictive clause is not in restraint of trade or opposed to public policy;
3. in the present case, the clause served a legitimate business objective i.e., ensuring staff continuity, and did not preclude the Employee from seeking alternate employment; and the same cannot be said to be unconscionable, unfair or unreasonable. The Supreme Court also observed that, in the context of liberalisation, the Employer faced competition from the private sector banks. The said restrictive clause for minimum service tenure has been introduced by the Employer to reduce Employee attrition and to improve efficiency. The Supreme Court also recognised the operational burden placed on the Employer due to premature exits, especially in public sector recruitments. Accordingly, the clause was not held to be opposed to public policy;
4. while assessing reasonability of the liquidated damages amount of INR 2,00,000 (Indian Rupees two lakh), the Supreme Court held that the sum was neither excessive nor punitive. Taking into consideration the Employee's seniority, the voluntarily executed indemnity bond, and the operational disruption caused by premature exits (particularly in public sector recruitments), the Supreme Court concluded that the clause served a compensatory purpose, was legally enforceable and the liquidated damages of INR 2,00,000 (Indian Rupees two lakh) is reasonable; and
5. lastly, the Supreme Court also clarified that the Karnataka HC had erred in mechanically applying its earlier decision in *K.Y. Venkatesh Kumar vs. BEML Limited.*[4], which was factually distinguishable and did not consider the operational prejudice caused by premature resignations in a public recruitment context.

[3] Civil Appeal No. 2103/1966 (decided on January 16, 1967)
[4] Same as footnote 2

In light of the above, while rejecting the Karnataka HC's finding, the Supreme Court upheld the validity of clause 11(k) of the Appointment Letter and held that the requirement to pay INR 2,00,000 (Indian Rupees two lakh) as damages for premature resignation was legally sustainable.

Conclusion

Very often, employment bonds form part of, or are ancillary to contracts as a means to retain talent and ensure continuity in roles involving specialised training or high onboarding costs. The Supreme Court's ruling in this case provides important direction in this regard. It affirms that employment bonds when clearly drafted, supported by a legitimate objective, and backed by reasonable liquidated damages could be legally enforceable and need not constitute a restraint of trade or violate public policy.

While the decision arose in a public sector context, the Supreme Court's reasoning may hold persuasive value for private employers seeking to implement similar mechanisms to deter premature exits and safeguard recruitment investments.

The ruling adopts a distinctly employer-friendly stance, upholding the enforceability of employment bonds without fully addressing legitimate grounds for early exit such as health concerns, hostile work environments, or family obligations. While the Supreme Court reiterated that such clauses must be proportionate and non-punitive, it offered little guidance on how hardship-driven resignations should be assessed. As a result, the judgment strengthens employers' contractual footing but leaves employees exposed to legal and financial risks even in compelled separations.

This ruling affirms that the quantum of liquidated damages must have a clear nexus with the genuine loss suffered by the employer and the employee's position. This judgment reinforces that the enforceability of restrictive clauses — when voluntarily agreed upon— is contractually binding and enforceable. While this ruling strengthens the employer's ability to recover costs associated with recruitment and training provided to the Employee in the event of premature resignation, it also highlights the importance of ensuring that such provisions remain reasonable and linked to demonstrable loss.

That said, from a general contractual perspective, rigid lock-in periods and significant financial penalties can also result in restricting mobility and reinforcing unequal bargaining dynamics. In practice, employees may exit for *bona fide* reasons, and therefore, the enforceability of employment bonds arguably still remains a fact-specific determination requiring a careful balance between business continuity and employee autonomy.

Judicial position on enforceability and computation of damages for breach of employment bonds in the private sector

Similar to public sector, employment bonds have been generally used in the private sector, with an aim to retain key personnel and protect investments in employee training and onboarding. While Indian courts have recognised their validity, it is emphasised that enforceability and compensation for breach must be evaluated on a case-by-case basis. Against this backdrop, some key aspects emerge:

1. **Employment bonds in the private sector particularly those stipulating minimum service periods or lock-in periods are legally enforceable when they operate during the course of employment and are not excessively restrictive**

   In *Lily Packers Private Limited vs. Vaishnavi Vijay Umak and Ors.*[5], the Delhi High Court ("**Delhi HC**") affirmed the enforceability of a 3 (three) year lock-in period applicable to executive employees, observing that such covenants do not infringe upon constitutional rights under Articles 19 or 21 of the Constitution, especially where they are

[5] Arbitration Petition 1210/2023 (decided on July 11, 2024)

voluntarily agreed to. Furthermore, the Delhi HC emphasised that lock-in periods are essential for maintaining employer stability, particularly at senior levels, and play a key role in reducing employee attrition.

In doing so, the Delhi HC placed reliance on foundational rulings in *Brahmaputra Tea Co. Ltd. vs. E. Scarth*[6] and *Niranjan Shankar Golikari vs. Century Spinning and Mfg. Co.*[7], which affirm that exclusive service obligations during employment are lawful and do not fall foul of Section 27 of the Contract Act.

2. **Employers may *only* recover reasonable compensation, where an employee exits prematurely after receiving specific benefits**

In *Toshniwal Brothers (Pvt.) Ltd. vs. E. Eswarprasad*[8], the Madras High Court ("**Madras HC**") upheld the employer's right to recover compensation where the employee, having received employer-funded training abroad, resigned after 14 (fourteen) months, despite a contractual lock-in of 3 (three) years. The Madras HC held that separate proof of actual loss was not required; the breach itself amounted to a legal injury once it was established that the employee had benefited from a special favour involving financial outlay. The stipulated payback amount of INR 25,000 (Indian Rupees twenty-five thousand) was considered a reasonable and enforceable estimate of the employer's loss.

In M/S. *Sicpa India Ltd. vs. Shri Manas Pratim Deb*[9], the Delhi HC held that enforcement of employment bond obligations must be based on the actual loss suffered by the employer, rather than the full amount stipulated in the bond. In this case, the employee had signed 2 (two) separate bonds, each requiring a payment of INR 2,00,000 (Indian Rupees two lakh) in the event of premature exit. Since the employer incurred INR 67,596 (Indian Rupees sixty-seven thousand five hundred ninety-six) for an overseas trip linked to 1 (one) bond, and the employee had served 2 (two) out of 3 (three) committed years, the Delhi HC allowed proportionate recovery of INR 22,532 (Indian Rupees twenty-two thousand five hundred thirty-two). However, this was adjusted against INR 44,330 (Indian Rupees forty-four thousand three hundred thirty) payable to the employee, resulting in no net recovery.

[6] (1885) ILR 11 CAL545 (Calcutta High Court)
[7] Civil Appeal No. 2103/1966 (decided on January 17, 1967)
[8] 1997 LLR 500 (Madras HC)
[9] RFA No. 596/2002

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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