

Resignation at a price: Supreme Court endorses lock-in clauses for PSUs

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- The SC's decision in the *Vijaya Bank* case serves as a landmark precedent for assessing the validity of lock-in clauses and liquidated damages provisions in employment contracts, particularly in the public sector context.
- This judgment confirms that lock-in clauses imposing a minimum service period, coupled with a reasonable financial consequence for premature exit, are enforceable.
- The SC clarified that such negative covenants are not violative of Section 27 of the Contract Act or the fundamental rights under Articles 14 and 19 of the Constitution, as the objective is in furtherance of the employment contract and not to restrain future employment.

I. INTRODUCTION

With Public sector undertakings (“**PSUs**”) increasingly facing stiff competition from its private counterparts, incorporating clauses mandating minimum service tenures and stipulating damages has been a step to retain talent and reduce attrition. These lock-in clauses restrict employees’ ability to leave the organization within a specified period, otherwise requiring them to pay damages in case of early departures from the employers’ organizations.

Recently, in a matter questioning the enforceability of lock-in and damages clauses, the Supreme Court’s (“**SC**”) decision in **Vijaya Bank & Anr. v. Prashant B Narnaware/I/** (“**Vijaya Bank Case**”) reaffirmed the enforceability of such clauses, highlighting their significance for PSUs seeking to protect their legitimate business interests.

II. VIJAYA BANK CASE

a. Factual Background

The case pertained to Vijaya Bank (“**Bank**”), a public sector undertaking, which engaged Mr. Prashant B Narnaware (“**Employee**”) as a Probationary Assistant Manager in 1999 and upon his probation being confirmed and subsequent promotions, he held the position of Middle Management Grade-II.

Thereafter, in 2006, the Bank issued a recruitment notification (“**Notification**”) for appointment of officers in various grades. Clause 9(w) of the Notification stipulated a lock-in period of 3 years from the date of joining, along with a requirement to execute an indemnity bond for INR 2,00,000 in the event the employee left the service prior to completing the said period. Pursuant to this, the Employee applied for the post of Senior Manager – Cost Accountant and was appointed to the post by an appointment letter (“**Letter**”) dated August 07, 2007. Clause 11(k) of the Letter reiterated the lock-in requirement and mandated execution of the bond on stamp paper.

Subsequently, on July 17, 2009, the Employee resigned from the said post before completing the 3-year lock-in period. The resignation was accepted by the Bank, and the Employee, under protest, remitted a sum of INR 2,00,000 in compliance with the bond condition.

Thereafter, the Employee filed a writ petition before the Bombay High Court (“**HC**”) seeking quashing of clause 9(w) of the Notification and clause 11(k) of the Letter claiming that these conditions were violative of Articles 14 and 19(1)(g) of the Constitution of India (“**Constitution**”) and Sections 23 and 27 of the Indian Contract Act, 1872 (“**Contract Act**”).

The writ petition was allowed by the Single Judge and upheld by the Division Bench of the HC. Aggrieved by the decision, the Bank filed an appeal before the Supreme Court (“SC”).

b. Issues raised

In view of the aforementioned facts, the following issues were framed by the SC; whether clause 11(k) of the Letter: (i) amounts to restraint of trade under Section 27 of the Contract Act and/or (ii) is opposed to public policy and thereby contrary to Section 23 of the Contract Act and in violation of Articles 14 and 19 of the Constitution?

c. Arguments advanced

- The Bank argued that in a deregulated and competitive market, it was essential to implement a minimum service tenure to curb attrition and maintain efficiency. It justified the INR 2,00,000 liquidated damages as a reasonable measure to recoup the financial and administrative losses incurred due to premature resignations and repeated recruitment efforts.
- The Employee contended that the Letter was a standard form agreement, leaving him with no real choice but to accept the terms in order to secure the job and advance in his career.
- The Employee further argued that the terms of the Letter were unreasonable, onerous and ex-proportionate measure resulting in unjust enrichment for the Bank which is violative of his fundamental rights and opposed to public policy.

d. Findings of the Court

The SC upheld the validity and enforceability of clause 11(k) of the Letter, which required the Employee to serve the Bank for a minimum period of 3 years and, in the event of failure to do so, to pay liquidated damages of INR 2,00,000. The SC observed that a plain reading of clause 11(k) made it evident that the restriction imposed on the Employee was limited to the subsistence of the employment relationship and did not in any manner seek to restrain him from engaging in any profession, trade, or employment after cessation of service. Accordingly, the clause did not fall within the ambit of Section 27 of the Contract Act.

In relying on the seminal judgment in *Niranjan Shankar Golikari v. Century Spinning and Manufacturing Co. Ltd.*, [2] wherein it was held that negative covenants operative during the term of employment are not per se violative of Section 27 of the Contract Act, the SC reiterated that the law draws a distinction between restraints during the term of employment which are permissible and those that extend beyond the term of service, which may be void unless reasonable.

Applying these principles, the SC held that the impugned clause, which required the Employee to serve for a fixed tenure or pay liquidated damages, did not restrain him from taking up future employment after his resignation. In fact, the Employee did resign from service and paid the specified amount of INR 2,00,000 under protest, which further indicated that the clause did not operate as a prohibitive deterrent. Rather, it was a reasonable restriction that sought to secure the Bank’s legitimate interest in service continuity and in recouping the investment made in recruitment of employees.

In conclusion, the SC found that the lock-in clause did not constitute a restraint of trade or was opposed to public policy under Section 27 and Section 23 of the Contract Act respectively, and there was no violation of the Employee’s fundamental rights under Articles 14 and 19 of the Constitution.

Accordingly, the SC set aside the HC’s decision and upheld the validity of clause 11(k) of the Letter, thereby attesting to the enforceability of reasonable lock-in provisions in employment contracts where they serve a legitimate business purpose and do not restrain post-employment liberty.

III. ANALYSIS AND CONCLUSION

The SC's decision serves as a landmark affirmation of the enforceability of lock-in and liquidated damages clauses in employment contracts, particularly in the context of PSUs. In noting the broader institutional context of public sector banks, where recruitment processes are lengthy, competitive, and governed by constitutional standards of fairness and transparency, the SC found that the Bank had a legitimate expectation of service continuity, and premature resignations could disrupt institutional efficiency and impose administrative and financial costs.

By upholding the lock-in clause for the period of employment, which required the Employee to either complete a 3 year tenure or compensate the employer with pre-agreed damages, the SC clarified that such conditions do not restrain post-employment liberty. The key determinant was that the restriction applied only during the subsistence of the employment relationship and did not create a barrier to future employment opportunities.

In its adjudication of the matter, the SC's application of principles from *Niranjan Shankar Golikari and Superintendence Company of India case* demonstrates the judiciary's consistent stance that negative covenants operative during employment are valid, provided they are not oppressive or overly broad.

As also discussed in our *HR Law Hotline* titled Lock-in period in employment contracts: Need for a more nuanced view, the enforceability of such clauses hinges on the reasonableness of the restriction and the proportionality of the liquidated damages. The *Vijaya Bank* judgment confirms this position and provides a persuasive precedent for employers across sectors who seek to implement similar mechanisms to protect their commercial interests.

Ultimately, this decision represents a calibrated judicial approach that courts will respect contractual freedom where the terms are transparent, proportionate, and not in derogation of fundamental rights. Going forward, employers would do well to ensure that lock-in provisions are backed by demonstrable business rationale and are not excessive in either their duration or financial consequence. For employees, the ruling serves as a reminder that contractual obligations entered into freely and fairly might be upheld, even if they impose certain exit conditions.