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Enforceability of Non-Competes in Employment Agreements and Its Tussle with Section 27 of the Indian Contract Act

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In the present world, which is a competitive market, the interests of one group of people always overlap with those of the other. Therefore, a non-compete clause acts as a safeguarding option to protect the employer's legitimate interests. A non-compete clause in an employment contract restricts a current or former employee from working for a competitor or starting a similar business or profession.

Here are the elements of a non-compete agreement:

- *Definitions: This section should clearly define the terms used, including competition, confidential information, and trade secrets.*
- *Scope of the Restriction: This part should outline the geographic area and the specific types of businesses in which the employee is prohibited from competing.*
- *Duration of the Restriction: The agreement should state how long the restriction will remain in effect.*
- *Permitted Activities: It should specify the activities that the employee is allowed to engage in, even if they are somewhat competitive.*

However, this non-compete clause is not always enforceable in a court of law; it depends on various other factors, which will be discussed in the research paper along with relevant case laws. Further, the paper discusses the enforceability of non-compete

clauses in employment agreements and presents a unique challenge within Indian law, especially under the stringent framework of Section 27 of the Indian Contract Act, 1872, which declares agreements in restraint of trade as void. Further, the paper delves deeply into the legal, ethical and practical complexities of enforcing non-compete clauses by analysing the evolving trends and judicial interpretations. The paper further suggests potential reforms that could allow the enforceability of the non-compete clause in certain aspects, as the Indian courts uphold a strict interpretation of Section 27 of the Indian Contract Act of 1872. This approach could provide a path that could accommodate and satisfy the interests and freedom of both businesses and employees.

Keywords: *contract, employment, agreement, section 27.*

INTRODUCTION

A non-compete clause is a restriction on the actions of the employees and the senior executives of the company that prevents them from starting a competing business or working for rivals. Basically, a non-compete clause in an employment agreement protects trade secrets, confidential information, client data, goodwill and sale strategies of the employer's legitimate business from potential exploitation by the former employees. These restrictions are usually defined by a specific duration and geographical area, ensuring that individuals cannot engage with competitors for a set period within a designated location(s).[1]

The main objective of the clause is to protect the sensitive information regarding their legitimate business. A person working for a company will surely get introduced to the company's private information, and a non-compete agreement acts as a shield for the industry, as the individual is bound to work for the company's interest. Even after the relationship between the employer and the employee ends, this clause tends to give the employer control over specific actions of the employee. This could further lead to exploiting the employee's right to livelihood and career advancement.

Therefore, the Indian courts have deemed these non-compete clauses illegal in many cases. Section 27 of the Indian Contract Act prohibits agreements that restrain trade, save when the restriction is tied to the sale of goodwill.

[1] Suruchi Kotoky and Pratik Bhat, 'Navigating the Enforceability of Non-Compete Clauses in India' (*BTG Advaya*, 28 November 2023) <https://www.btgadvaya.com/post/navigating-the-enforceability-of-non-compete-clauses-in-india> accessed 25 July 2025

27. Every agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to that extent void.

Exception 1. Saving of agreement not to carry on the business of which the goodwill is sold. One who sells the good-will of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits, so long as the buyer, or any person deriving title to the good-will from him, carries on a like business therein, provided that such limits appear to the Court reasonable, regard being had to the nature of the business.[2]

TUSSLE WITH SECTION 27 OF THE INDIAN CONTRACT ACT OF 1872

The landmark case of Niranjan Shankar Golikari v The Century Spinning Company[3] introduced the rule of reasonableness. As the businesses grew huger and more complex, it was realised that there was a need to introduce a more nuanced approach. This 'rule of reasonableness' had the following factors:

1. The duration of the restriction
2. The geographical scope
3. The nature of the employee's position
4. The availability of alternative employment opportunities[4]

The notion of 'legitimate interest' of the business is contingent upon the facts of the case and is within the discretion of the presiding court. Therefore, the enforceability of the non-compete clause in an employment agreement differs from case to case. Resultantly, after the Niranjan Shankar Golikari v The Century Spinning Company, some courts relied on the rule of reasonableness, while others declared Section 27 of the Indian Contract Act, 1872, to be steadfast in its intent, so any deviation from it will be upheld as void.

That said, the burden of proof lies heavily upon the claimant, and once discharged, the onus of proving otherwise nevertheless shifts to the counterparty.[5] The interpretation of Section 27 of the Indian Contract Act, 1872, is res integra, which means the points which are untouched by the dictum or decision and are not covered by the authority of a decided case, so the judge may decide it upon principle alone. The court's interpretation of the non-

[2] Indian Contract Act 1872, s 27
[3] *Niranjan Shankar Golikari v The Century Spinning and Manufacturing Co Ltd* AIR 1967 SC 1098
[4] Kotoky (n 1)
[5] *Sandhya Organic Chemicals v United Phosphorus Ltd* AIR 1997 Guj 177

compete clause depends upon the facts and circumstances of the case, so it differs in each case.

In view of the judgment of the Delhi High Court in American Express Bank Ltd. v Priya Puri, 2006 LLR 682,[6] wherein the landmark judgment of the Supreme Court of the Superintendence Company of India (P) Ltd. v. Krishan Murgai, the year 1980 was relied upon. The court held that the negative covenant clause in the service and employment contracts cannot be used against an employee.

CONFLICTING INTERESTS OF EMPLOYERS AND EMPLOYEES

A non-compete clause seeks to place restrictions on employees to safeguard the legitimate business interests of employers. These interests may encompass client relationships, proprietary technologies, trade secrets, upcoming projects, or innovative ideas that are critical to maintaining a competitive edge in the market. In an era of intense competition, the protection of such sensitive information becomes imperative for businesses to ensure sustained growth and market dominance.

However, the enforcement of these clauses often leads to a conflict between the employer's right to protect their business interests and the employee's right to livelihood and professional growth. By prohibiting employees from joining competitors or establishing similar businesses within a specified timeframe and geographic area, non-compete agreements can severely restrict an individual's ability to work in their chosen field.

This inherent tension raises questions about fairness and balance. On the one hand, employers argue that without such safeguards, employees could exploit confidential information or goodwill to unfairly compete. On the other hand, employees contend that overly broad restrictions can be oppressive, violating their fundamental right to work under Article 19(1)(g) of the Indian Constitution and Section 27 of the Indian Contract Act, which deems agreements in restraint of trade as void.

19. Protection of certain rights regarding freedom of speech, etc.

(1) All citizens shall have the right

[6] *American Express Bank Ltd. v Ms. Priya Puri* (2006) SCC OnLine Del 638

(g) To practise any profession, or to carry on any occupation, trade or business.[7]

Courts in India have grappled with this delicate balance. While they generally invalidate blanket restraints, courts have upheld non-compete clauses that are reasonable and protect legitimate business interests.

The Delhi High Court declined relief to PepsiCo Food Ltd in the case of PepsiCo Food Ltd. v Bharat Coca-Cola[8] by observing the negative covenant clause that restrained the employees from joining or starting employment for 12 months after they had left the plaintiff's service. The court held that, following the termination of employment, a non-compete clause cannot impose such restrictions on employees, as it would constitute a violation of Section 27 of the Indian Contract Act 1872.

These restraints are deemed void, unenforceable and against public policy. Further, it infringes upon the employee's right in Article 19(1)(g) of the Indian Constitution, which grants every citizen the freedom to pursue any trade or profession. It is further emphasised that the enforceability of the non-compete clause is strictly limited to the duration of the employee's service with the company, not a day further. It serves merely as a tool to ensure the employee works exclusively for the employer, which is permissible during the period of employment. However, this exclusivity ceases to apply once the employee resigns or is terminated.

This notion of a non-compete clause beyond the employment of the person is controversial and violates the right of the employee to earn a livelihood, and establishes stagnancy in the employee's career. Therefore, the Delhi High Court in Affle Holdings Pte Limited v Saurabh Singh[9] held that a negative covenant in the employment contract, prohibiting carrying on a competing business beyond the tenure of the contract, is void and unenforceable.

The Supreme Court of India and various high courts have consistently taken the view that:

(1) Negative covenants can only be enforceable to the extent that they are reasonable[10] and

[7] Constitution of India 1950, art 19(1)(g)
[8] *Pepsico Food Ltd. v Bharat Coca-Cola Holdings Pvt. Ltd* (1999) SCC OnLine Del 530
[9] *Affle holdings Pte Limited v Saurabh Singh* (2015) SCC OnLine Del 6765
[10] *Niranjan Shankar Golikari v Century Spinning & Mfg Co* AIR 1967 SC 1098

2) The purpose of the covenant is to protect the legitimate business interests of the buyer. Even in the aforementioned circumstances, the restraint cannot be greater than necessary to protect the interest concerned.[11]

Interestingly, courts may permit certain non-compete restrictions between buyers and sellers that extend beyond the duration of their engagement, particularly when tied to the transfer of a business's goodwill. However, these restrictions must be limited to specific local areas and deemed reasonable by the court, considering the business's nature. In the case of Ozone Spa Pvt Ltd v Pure Fitness & Ors,[12] the Delhi High Court restrained the defendants from operating or establishing a competing business within the vicinity of the plaintiff's premises. It is unlikely for the courts to permit these restrictions beyond their engagement period unless the sale has been affected along with the associated goodwill.

The Delhi High Court in the case of Le Passage to India Tours & Travels Pvt. Ltd.[13] granted an interim order to restrain the defendant, who was a promoter of a vendor company, from engaging in any action that goes against the non-compete agreement. The court upheld the non-compete clause in the share purchase agreement, which restricted the defendant and their agents from competing with the acquiring company. This was notable as it marked the first instance where the court recognised the transfer of goodwill in such a context.

This uncertainty over the enforcement of the non-compete clause resulted in the insertion of a garden leave clause in acquisition agreements. This clause ensures that the company pays full salaries to their employees during the period in which they are restrained from starting a similar business or joining a competing firm, so that the employee can earn a livelihood without any compromise. The Bombay High Court in VFS Global Services Private Limited v Mr Suprit Roy[14] observed that the payment of compensation during garden leave does not renew the contract of employment; therefore, the garden leave clause is prima facie in restraint of trade and is affected by section 27 of the Contract Act. Nevertheless, the concept of 'garden leave' is popular and widely practised in India.

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[11] *Gujarat Bottling Co Ltd v The Coca Cola Co. & Ors* (1995) 5 SCC 545
[12] *Ozone Spa Pvt Ltd v Pure Fitness & Ors* MANU/DE/2182/2015
[13] *Le Passage to India Tours & Travels Pvt Ltd v Deepak Bhatnagar* (2014) SCC Online Del 259
[14] *VFS Global Services Private Limited v Mr Suprit Roy* (2008) 2 Bom CR 446

The judgment of the Supreme Court in Percept D'Mark (India) Pvt. Ltd. v Zaheer Khan and Anr.[15], the Apex court observed that a restrictive covenant extending beyond the term of the contract is void and not enforceable. The doctrine of restraint of trade does not apply during the continuance of the employment contract and is applied only when the contract comes to an end. As held by this Court in Gujarat Bottling v Coca Cola, this doctrine is not confined to employment contracts but is applicable to other agreements as well.

COMPARATIVE ANALYSIS WITH OTHER JURISDICTIONS

The United Kingdom: In the UK, non-compete clauses are prima facie void and unenforceable unless the employer demonstrates that the restrictions imposed by the clause are reasonable. This approach is similar to that of India, where the concept of 'rule of reasonableness' is followed, as introduced by the case of Niranjan Shankar Golikari v The Century Spinning Company.[16]

In 2023, the maximum duration for the non-compete period was set to three months through legislation by the UK government. This restriction is intended to combat the exploitation of the employees and to ensure they're able to earn a livelihood. However, this legislation has not yet come to fruition. Despite such safeguard measures, non-compete clauses are still widely used in the UK.

Nevertheless, the employer can rebut the unenforceability of the non-compete clause if he can show that the non-compete clause doesn't go any further than just to protect the legitimate business interest of the company.

Further, the reasonableness of the clause has to be assessed between the parties at the time when the clause is agreed upon. And not when the employer is trying to enforce it. The legitimate business interest that is to be protected by this clause has to be expressly mentioned and agreed upon in the agreement. The agreement must include a clearly defined time period as well as the geographical boundaries of the non-compete clause. These restrictions are crucial to determine the genuineness of the non-compete clause. For example, if a former employee has the potential knowledge of the price strategies of the product, then this knowledge tends to have a shelf life, as price strategies are bound to change after a few

[15] *Percept D'Mark (India) Pvt. Ltd. v. Zaheer Khan* (2006) 4 SCC 227
[16] *Niranjan Shankar Golikari v Century Spinning & Mfg. Co* AIR 1967 SC 1098

months. Therefore, a balance has to be struck between the legitimate business interests of the employer and the rights of the employee, to ensure no unfair practices are being followed.

Typically, non-compete clause restraints should be reserved only for senior employees, as they are the ones with the most sensitive and confidential information in the company. The company is at a greater risk if its potential knowledge gets outed. However, this could vary from case to case; there's no steadfast rule that only senior employees have access to sensitive information.

In the view of Boydell v NZP Ltd & Anr[17], a senior employee was prevented from joining a new role at a competitor firm after his resignation. The non-compete clause restricted him from being involved in any activities with the competing businesses for a period of 12 months from his termination. The High Court applied the principle of the blue pencil test to reduce the scope of the non-compete clause. Under the blue pencil test, a court can strike out elements of a contractual clause which would be void or unenforceable, but leave the remainder of the clause intact so long as it does not substantially alter the remaining provisions. Overall, the blue pencil test provides a way for courts to salvage parts of a clause that remain valid and enforceable whilst striking out those that are not.[18] However, it is difficult to enforce non-compete clauses, but they certainly are enforceable when they are being correctly accessed. The enforceability of the clause needs to be assessed on a case-by-case basis.

The United States of America: In April 2024, the US Federal Trade Commission (FTC) proposed a rule to prohibit the use of non-compete provisions in employment agreements at a national level. This rule was set to come into force in September 2024; however, it was struck down by the US courts in that year.

The FTC, in accordance with Section 5 of the Federal Trade Commission Act, declared the non-compete clause an unfair practice to mitigate competition. This new rule rendered the majority of the non-competes unenforceable, and it prohibited the employer from initiating new non-compete agreements after the rule came into force. The US Chamber of Commerce

[17] *Boydell v NZP Ltd & Anor* [2023] EWCA Civ 373
[18] Samuel Gray, 'Case Update – Enforceability Of Non-Compete Clauses' (*Herrington Carmichael*, 03 May 2023) <https://www.herrington-carmichael.com/case-update-enforceability-of-non-compete-clauses/> accessed 25 July 2025

has said that it considers that the FTC did not have the authority to issue its own competition rules and that this new rule sets a dangerous precedent.[19]

In accordance with the landmark case of Edwards v Arthur Andersen LLP (2008)[20], the court ruled that the restrictions imposed by the non-compete clauses are unenforceable under California Business and Professions Code section 16600. This case reinforced strong public policy against such agreements and held that even narrow restraints on trade are also unlawful. California's strict stance against the non-compete agreements got more rock-solid after this case.

Non-compete clauses keep wages low, suppress new ideas, and rob the American economy of dynamism, including from the more than 8,500 new startups that would be created a year once non-competes are banned, said FTC chair Lina M Khan on April 23. The FTC's final rule to ban non-competes will ensure Americans have the freedom to pursue a new job, start a new business, or bring a new idea to market.[21]

The case of Brunswick Floors v Guest[22] also reaffirmed the unenforceability of the non-compete clause under California law. This ruling further emphasised the importance of protecting an employee's right to work in their chosen profession without undue restrictions from former employers.

In the case of Marsh USA Inc. v Cook[23], it was held that the consideration for the non-compete agreement was reasonably related to the employer's interest in protecting its goodwill, which is recognised as a legitimate business interest under Texas law.

Unlike the Federal Trade Commission, which broadly categorised non-competes as unfair methods of competition, the Competition and Markets Authority (CMA) has clarified that non-compete provisions do not violate UK competition law. Instead, such provisions are governed by well-established employment law in the UK. The CMA has further stated that

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[19] Sean Heather and Stephanie Ferguson Melhorn, 'A Significant Win in Fight against FTC Micromanagement' (*U.S. Chamber of Commerce*, 03 July 2024) <https://www.uschamber.com/lawsuits/what-businesses-say-about-noncompetes> accessed 24 July 2024

[20] *Edwards v Arthur Andersen LLP* [2008] 44 Cal. 4th 937

[21] Sreeradha Basu and Maulik Vyas, 'Non-compete Clauses: Unenforceable Under Law, But Companies Love Them' *The Economic Times* (27 April 2024) <https://economictimes.indiatimes.com/jobs/c-suite/non-compete-clauses-unenforceable-under-law-but-companies-love-them/articleshow/109633571.cms?from=mdr> accessed 25 July 2025

[22] *Brunswick Floors, Inc. v. Guest* [1998] 506 S.E.2d 670

[23] *Marsh USA Inc. v. Cook* [2011] Tex. LEXIS 930

its enforcement powers do not cover issues arising from employment contracts or industrial agreements.

BALANCING BUSINESS INTERESTS WITH EMPLOYEE RIGHTS

Duration of Non-Compete Clauses: The introduction of statutory guidelines to govern the enforceability of non-compete clauses in employment agreements is essential to strike a balance between the legitimate business interest of the employer and the rights of the employees. The elements like:

Duration: The time period of a non-compete clause is crucial in determining its reasonableness. Typically, 3 to 12 months is the permissible duration for restricting former employees from starting or joining a competitor firm.

Geographic Scope: The scope of geographical restrictions must be relevant to the employer's business operations. If the restraints are broad, as in nationwide, then that is likely to be unreasonable.

Scope of Activities: Non-compete clauses should be narrowly tailored to restrict only those activities that pose a genuine threat to the employer's business interests.

Additional Safeguards: The protection of the employee's rights is a critical aspect; therefore, certain provisions must also be added for their protection and well-being. Provisions like mandatory compensation, transparency in agreements, and case-by-case reasonableness tests must be provided in the statutory guidelines.

Geographical Scope of Restrictions: The classification must be based on Employee roles, as access to information is primarily based on the role the employee is playing in the company. The non-competes could be more strictly imposed on senior executives, key personnel, or R&D employees, who have access to confidential information, trade secrets or proprietary data. Non-competes for low-level employees with minimal access to confidential information must be prohibited.

Mandatory Compensation for Non-Compete Period: Employers should be required to compensate employees for the duration of the non-compete period, a concept often referred to as garden leave in jurisdictions like the UK. This will ensure that the employees who are restricted from working due to non-competes have financial security and has financial security. In Germany, employers must pay a mandatory 50% compensation during the non-

compete period. Introducing a similar policy in India would align with international standards.

Strengthen Confidentiality and Non-Solicitation Agreements: The use of confidentiality and non-solicitation agreements must be encouraged as an alternative to non-compete clauses. This will protect sensitive business information and will prevent the former employees from poaching the clients or key team members post-resignation.

Public Policy Exceptions: The sectors like healthcare, education, etc, which are critical to societal welfare, should not be subjected to restrictive covenants. These exceptions to the non-compete clause must be codified where restrictions may harm public interest or economic mobility.

Introduce the Test of Reasonableness: For non-compete agreements to be enforceable under the law, they must be fair in both their scope and length. Courts will evaluate the reasonableness of the provision by taking into account elements including the industry, the employee's position, and the possible harm to the employer.

CONCLUSION

The enforceability of non-compete clauses in employment agreements in India remains a contentious legal issue, primarily due to the stringent restrictions imposed by Section 27 of the Indian Contract Act of 1872. While businesses argue that these clauses are essential to protect trade secrets, goodwill, and proprietary interests, employees highlight the oppressive nature of such restraints on their fundamental rights to livelihood and professional mobility.

Indian jurisprudence reflects a growing recognition of the need to balance these conflicting interests. Courts have largely upheld non-competes during the tenure of employment but have been cautious about enforcing such restrictions post-employment, often relying on the principles of reasonableness and proportionality. The case-by-case evaluation of these clauses by courts has provided some clarity but also underscores the need for more definitive statutory guidelines.

This research suggests that reforms such as mandatory compensation during the non-compete period, reliance on confidentiality and non-solicitation agreements, and codification of reasonableness tests could pave the way for a more balanced framework. Moreover,

specific exceptions for critical sectors and low-level employees could ensure that restrictive covenants do not unduly stifle economic mobility or public welfare.

By aligning Indian laws with global best practices while considering the unique socio-economic context, a middle ground can be achieved. This would allow businesses to safeguard their legitimate interests without infringing upon the rights of employees to pursue their professions freely. Such reforms are not only essential for fostering a fair and dynamic labour market but also for ensuring compliance with the constitutional ethos of equality and justice in India.