

# Judicial perspective of covenants in work contracts

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Companies in India have often relied on employment bonds and post-employment restrictive agreements to safeguard their sensitive data, strategic relations and market positions. Although employment bonds have withstood legal challenges, albeit with considerable scrutiny, post-employment restrictions face far stricter judicial tests. Because employment practices continually change, courts have recently decided a number of cases that affect the enforceability of employment-related restrictions during and after a term of employment.



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The courts have upheld the validity of employment bonds provided they apply only during the term of employment, safeguard the good faith interests of employers and set an amount that is in proportion to actual losses likely to occur. The amount cannot be coercive.

In *Vijaya Bank and Anr v Prashant B Narnaware*, the Supreme Court overturned a Karnataka High Court ruling, relying on its decision in *Niranjan Shankar Golikari v Century Spinning and Manufacturing Company Limited*. It reaffirmed that negative covenants during the existence of the term of employment do not, by themselves, breach section 27 of the Indian Contract Act, 1872 (ICA), provided that they are reasonable. The court, citing its decision in *Central Inland Water Transport Corporation Limited and Anr v Brojo Nath Ganguly and Anr*, also reaffirmed

that bonds, voluntarily accepted, addressing the legitimate needs of the employer to curb losses in a competitive market, are valid contracts under section 23 of the ICA. They do not prevent the carrying on of an occupation, a right enshrined in article 19 of the constitution.

Although employment bonds may be enforced to a degree, post-employment non-compete obligations are treated in a fundamentally different way by the courts. These clauses attempt to prevent former employees from joining competitors or starting similar businesses, thereby interfering with an individual's right to pursue a livelihood. Section 27 of the ICA generally renders such agreements void for being in restraint of trade.



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Delhi High Court's recent decision in *Varun Tyagi v Daffodil Software Private Limited* illustrates the Indian courts' unyielding position on post-employment restrictions. The court unequivocally found the non-compete clause void and held that employees cannot be forced to choose between staying with an employer or being out of work. Even partial restrictions, such as limiting work with specific clients, are unenforceable post-employment because the ICA draws no distinction between complete and partial restrictions. Citing *Superintendence Company of India v Krishan Murgai* and *American Express Bank Limited v Priya Malik*, the court emphasised that the right to seek better employment is fundamental. Post-employment non-compete obligations, even if time-bound or client-specific, are unenforceable unless these restrictions are necessary to protect good faith specific proprietary interests of the employer.

Employers must adopt a pragmatic approach when imposing restrictive covenants on employees. They must balance employees' rights to professional mobility against businesses' need to protect their legitimate interests. The following are factors employers should consider.

Employment bonds should require amounts that are linked to actual and specific expenses incurred by the employer, such as training, onboarding or proprietary knowledge development. Employers should not impose harsh or punitive terms because courts will require proof of actual losses, as in *Kailash Kumar v Syndicate Bank Limited*. Bond conditions should be clearly communicated to ensure informed consent, thereby preventing future claims of coercion. Restrictions should be narrowly drafted and justified by industry-specific business needs.

Precisely worded non-disclosure and intellectual property-related agreements should be used to justify imposing post-employment non-compete restrictions. This should be done to protect proprietary data and intellectual property.

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