

NON -COMPETE AGREEMENTS

Sleeping with the corporate enemy.

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As you walk into your office one morning, you notice a letter on your desk. One of your key sales employees has just announced that she is resigning and is going to work for one of your fiercest competitors. As you reread the letter, you realize that she knows some of the most confidential information about your business.

To promote her sales efforts, you gave her vital information about your customers, pricing structure, marketing plans and development strategy. You also encouraged her to build close relations with many of your key contacts. In most likelihood, she will reveal your confidential information and solicit your customers and key contacts to the new employer.

Many companies view their key executives as assets to be preserved and maintained, recognizing that these individuals add value to the organization. In an attempt to keep those assets out of the hands of competitors, companies often turn to 'non-compete' agreements, implying those that do not restrain her from working for a competitor. These ballooned in popularity in the nineties when the tech boom sparked poaching of employees. If a former employee moves to a competitor, there is inevitably a transfer of knowledge. To prevent this, many companies routinely ask new employees to sign statements that they won't work for a competitor for a certain period of time after leaving the employer. From the employer's perspective, this is a reasonable solution to a real problem. Employers often try to make the agreement as broad as possible in terms of length of time and geographic area, and other restrictive clauses.

From the employee's perspective, however, the broader the non-compete agreement, the harder it will become to earn a living.

LAW VERSUS COURTS

Despite such agreements, business houses are often surprised to learn that a court of law will not enforce most of these agreements that they were counting upon for protection. In a society that promotes freedom of trade, it is no wonder that the law, as regards restraint of trade agreements, provides only limited protection.

The courts do not generally and historically favour non-compete agreements or clauses because they are viewed as restraint on trade. In a recent judgment, a Division Bench of the Madras High Court vacated the injunction order issued by the learned Single Judge, whereby an employee, after tendering his resignation, joined another company despite signing an agreement with his former employer.

that upon cessation of his employment, he would not seek any employment in any establishment of similar nature for a period of five years. The court held that such negative covenants restraining the employee from taking an employment with the third party after he ceases to be an employee is violative of public policy under Section 27 of the Indian Contract Act, 1872 (Act). Which basically means “what is prohibited by law cannot be permitted by the Court’s injunction” (Pepsi Foods Ltd and Others Vs Bharat Coca-Cola Holdings Pvt. Ltd & Others).

As per Section 27 of the Act, any agreement by which anyone is restrained from exercising a lawful profession, trade or business of any kind, is to extent void. There is, however, one exception: that in which goodwill is at stake. ‘One who sells the goodwill of a business may agree with the buyer to refrain from carrying on a similar business, within specified local limits.’

BASIS FOR BREACH

Ultimately, the restraint in the agreement must not result in the employee being unable to exercise his vocation or to earn a living. Notwithstanding the above, the former employer can claim damages based on wrongful acts of the employee. For example, unauthorized use of confidential and copyrighted information in which the employer alone has a right.

The courts may also restrain former employees from utilizing and disseminating such data for their own benefit, if it is proved that misuse of such material could expose the employer to liability and loss of face. Or that there is a clear interest of the employer, which deserves protection.

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