Garden Leave Provisions in Employment Agreements

As traditional non-compete agreements face increasing scrutiny, employers are using garden leave provisions as an alternative to protect their proprietary information and customer relationships. This article discusses the legal issues surrounding the enforcement of garden leave provisions and provides best practices for employers when drafting these provisions.

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In recent years, traditional non-compete agreements have faced increasing judicial scrutiny, with courts focusing on issues such as the adequacy of consideration, the propriety of non-competes for lower-level employees, and whether the restrictions of a non-compete are justified by a legitimate business interest or are merely a tool used to suppress competition.

Although the Trump Administration's view on non-competes is unknown, the Obama Administration took issue with them. Both the US Department of Treasury and the White House issued reports in 2016 that questioned the widespread use of non-competes and suggested that they hampered labor mobility and ultimately restrained economic growth (see US Dep't of the Treasury, *Non-Compete Contracts: Economic Effects and Policy Implications* (Mar. 2016), available at *treasury.gov*; White House, *Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses* (May 2016), available at *obamawhitehouse.archives.gov*).

Some states have passed legislation essentially banning non-competes for certain categories of workers, such as low-wage workers in Illinois (820 ILCS 90/10) and technology-sector workers in Hawaii (Haw. Rev. Stat. § 480-4(d)). Other states, such as California, have passed legislation making almost all post-employment non-competes unenforceable (Cal. Bus. & Prof. Code § 16600).

Against this background, employers are seeking alternatives to traditional non-competes to protect their proprietary information and customer relationships. One alternative gaining traction is the use of garden leave provisions in employment agreements. These provisions extend the employment relationship for a period of time past the notice of an employee's termination or resignation, during which the employee remains employed and continues to receive a salary (and sometimes benefits) and therefore cannot work elsewhere.

As a practical matter, garden leave provisions are not as often challenged in court or violated by employees as traditional non-competes. This may be explained in part because garden leave provisions:

- Are paid.
- Are typically between 30 and 90 days, which are shorter periods than non-compete periods.
- Are mutually respected by employers and employees, especially in the industries where they are commonplace.
- Allow for continuous employment and therefore create no resume gaps.

While garden leave provisions are not a panacea, they may serve as a helpful tool that employers can use to protect their legitimate business interests and prevent certain employees from immediately working for a competitor.

This article addresses:

- The general characteristics of garden leave provisions, including:
  - a comparison of garden leave provisions and non-competes; and
  - developments in the judicial treatment of garden leave provisions.
- Best practices for employers when drafting garden leave provisions, including tips for increasing the likelihood of enforcement.

Search Garden Leave Provision for a model provision providing for a garden leave period when terminating an employment relationship, with explanatory notes and drafting tips.

GARDEN LEAVE PROVISIONS: OVERVIEW

Garden leave provisions are a variation of notice provisions. Instead of requiring that employees actively work during their notice period, garden leave provisions reserve the employer's right to place employees on "garden leave," during which time employees are typically relieved of most or all of their duties and responsibilities.

GARDEN LEAVE VERSUS NON-COMPETES

Garden leave provisions and non-competes are both tools employers can use to prevent a departing employee from working for a competitor for a period of time. Non-competes directly prohibit employees from working in certain capacities for the employer's competitors (or certain defined competitors) for a limited time after their employment relationship ends. Employees generally are not paid during the non-compete period. This leads to close judicial scrutiny and concerns about fairness to the employee and the adequacy of consideration for the agreement.

Under typical garden leave provisions, employees must give advance notice of their resignation, usually between 30 days' and 90 days' notice. Unlike during the non-compete period, during the garden leave period employees remain employed by the company and continue to receive their salary (and often benefits), but generally are relieved of some or all of their duties and responsibilities. In some cases, employers also pay a pro rata share of the employee's bonus, especially where the bonus constitutes a significant portion of the employee's total compensation. Under some garden leave provisions, the employer has a mirror-image obligation not to terminate the employment relationship without giving the employee the same advance notice or pay in lieu of notice.

During the garden leave period, the employer generally can:

- Remove employees from their active duties.
- Exclude employees from the workplace.
- Prevent employees from contacting and communicating with staff and customers or clients.
- Limit or cut off employees from accessing the employer's computer systems, email, and other documents and information.

However, because employees on garden leave remain employed and draw a salary, they owe a continuing duty of loyalty to their employer and therefore cannot join or assist a competitor or

any other employer during the garden leave period. The garden leave period therefore functions as a traditional non-compete period by keeping the employee out of the competitive market, but may be perceived as more enforceable because:

- Garden leave periods are typically shorter in duration than non-compete periods.
- The employee continues to be paid during the garden leave period.

Although paid post-employment non-compete periods are sometimes also referred to as garden leave periods, that usage is inaccurate. While paid non-compete periods have some of the same characteristics as garden leave periods, and share some of the same advantages, there is an important distinction between the two. Under a non-compete, the employment relationship has terminated, and employees have no continuing duty of loyalty during the non-compete period. Paid non-competes are therefore scrutinized under similar judicial analysis as traditional non-competes (though they are more likely to be enforced), but should not be confused with true garden leave provisions.

Search Non-Compete Agreements with Employees for an overview of non-competes between employers and employees, including the benefits and limitations of non-competes and key issues to assess when drafting a non-compete.

JUDICIAL TREATMENT OF GARDEN LEAVE PROVISIONS

In most states (with the exception of states such as California, North Dakota, and Oklahoma), non-competes are generally enforceable, but are subject to rigorous judicial review. Some states regulate non-competes by statute, while other states evaluate them under common law contract principles. Although the specific iterations vary, most common law jurisdictions disfavor non-competes, but enforce them to the extent reasonably necessary to protect legitimate business interests.

Case law regarding garden leave provisions is not well developed. This is likely because:

- Garden leave provisions are relatively new in the US.
- Garden leave provisions are challenged less often than non-competes (generally because garden leave periods are shorter than most non-compete periods and are paid).
- Many employment disputes in the financial services industry, where garden leave provisions are most common, are subject to mandatory Financial Industry Regulatory Authority (FINRA) arbitration.

Search FINRA Industry Arbitration: A Step-by-Step Guide for more on the steps necessary to initiate and conduct an arbitration of an industry dispute before FINRA.

In the relatively few published decisions considering pure garden leave provisions, courts have reached conflicting conclusions about their enforceability. Courts have also been particularly reluctant to specifically enforce these provisions, at least to the extent that doing so would require the court to order employees to continue an at-will employment relationship against their will.

Courts are instead more likely to issue an injunction prohibiting competition during the garden leave period (see, for example, *Ayco Co., L.P. v. Feldman*, 2010 WL 4286154, at *10 (N.D.N.Y. Oct. 22, 2010) (issuing a preliminary injunction to enforce a combined 90-day notice and non-compete period, but acknowledging that the court would not issue injunctive relief forcing the employee to continue working for the employer); *Smiths Grp., plc v. Frisbie*, 2013 WL 268988, at *5 (D. Minn. Jan. 24, 2013) (refusing to enforce a six-month notice provision, but enforcing a one-year non-compete)).

Many cases conflate their discussion of paid notice provisions, such as garden leave provisions, and paid non-competes, and often use these terms interchangeably. Courts generally find that reasonable notice or garden leave provisions and other restrictions are enforceable when supported by a legitimate business interest, such as protecting and cementing customer relationships, maintaining the confidentiality of proprietary information, or both. For example, courts have:

- Found reasonable a 60-day notice provision and two-year non-solicitation and non-service of clients provision (*Chernoff Diamond & Co. v. Fitzmaurice, Inc.*, 651 N.Y.S.2d 504, 505-06 (1st Dep't 1996)).
- Enforced a 60-day notice provision (*AllianceBernstein, L.P. v. Clements*, 932 N.Y.S.2d 759 (Sup. Ct. N.Y. Co. 2011)).

Garden Leave in the US

Garden leave is a relatively new concept in the US, but well established in the UK and elsewhere in Europe. In those jurisdictions, most employment relationships are governed by contract and can only be terminated by notice to the other party (and often only for cause by the employer). In contrast, because most US workers are at-will employees, the notice concept is relatively rare except for more senior executives and certain other unique personnel who are employed under an employment agreement that restricts the parties' termination rights. A garden leave provision is a variation of a notice provision. Instead of actively working during their notice period, employees are placed on garden leave (to "tend to their gardens").

Garden leave was first widely adopted in the US by the financial services industry in New York, after these firms became familiar with the concept in London financial circles. In recent years, it has gained some traction as another way for employers to restrict competition by departing employees, either as an independent tool or combined with non-compete or non-solicitation provisions.

- Enforced a 30-day notice provision followed by a three-month paid non-compete, where the employer continued to pay the employee's full salary (*Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001)).

When analyzing the reasonableness of a garden leave provision or a non-compete, courts generally find that an employer's willingness to pay an employee during the restricted period weighs in favor of enforcing the restriction (see, for example, *Maltby v. Harlow Meyer Savage Inc.*, 633 N.Y.S.2d 926, 930 (Sup. Ct. N.Y. Co. 1995) (finding the restrictive covenant reasonable "on condition that plaintiffs continue to receive their salaries for six months while not employed by a competitor"); *Lumex, Inc. v. Highsmith*, 919 F. Supp. 624, 629-36 (E.D.N.Y. 1996) (enforcing a six-month non-compete where the employer agreed to pay the employee's salary and benefits if he could not find work because of the non-compete)).

Courts have also enforced these provisions where employees only receive their base salary and no bonus, even if this results in a substantial reduction in pay for the period (see, for example, *Hekimian Labs., Inc. v. Domain Sys., Inc.*, 664 F. Supp. 493, 498 (S.D. Fla. 1987) (enforcing a non-compete where the employee received 50% of his salary during the restricted period)).

However, even paid non-competes that extend for a time period that is too long or that cover a geographic area that is too broad may be deemed unreasonable in scope or not necessary to protect an employer's legitimate business interests (see, for example, *Estee Lauder Co., Inc. v. Batra*, 430 F. Supp. 2d 158, 180-82 (S.D.N.Y. 2006) (reducing a 12-month paid non-compete period to five months); *Baxter Int'l, Inc. v. Morris*, 976 F.2d 1189, 1197 (8th Cir. 1992) (refusing to enjoin a research scientist from working for a competitor during a one-year paid non-compete period, where the company's legitimate interests in protecting its trade secrets were already covered by an injunction against disclosing confidential information)).

Garden leave provisions may help bridge the gap for employers seeking to prevent unfair competition and protect their legitimate business interests. Given their shorter duration, both new employers and departing employees are more likely to abide by their terms. Because they can be costly to employers, employers are less likely to use them in circumstances where they are not necessary to protect the employers' legitimate business interests.

Search Garden Leave Provisions in Employment Agreements for the complete, online version of this article, which includes additional information on the judicial treatment of garden leave provisions.

DRAFTING GARDEN LEAVE PROVISIONS

Garden leave provisions may be included in various agreements between employers and employees, such as:

- Offer letters.
- Employment agreements.
- Stock option plans.
- Bonus plans or agreements.
- Equity award agreements.
- Long-term incentive plan agreements.
- Supplemental Executive Retirement Plan (SERP) agreements.
- Stand-alone non-compete, non-solicitation, or confidentiality agreements.
- Severance agreements.

Search Stock Options and Other Equity Compensation for information on the different types of equity compensation available to employers.

Search Supplemental Executive Retirement Plans (SERPs) for an overview of SERPs and key legal issues that companies must consider when designing SERPs.

Garden leave provisions can also be found in separation agreements. It is not uncommon for employers terminating employees, especially high-level employees, to provide for a transitional period during which the employees are not expected or permitted to work, but continue to be paid their salaries and receive certain benefits. In these circumstances, garden leave periods are often negotiated, which provides an even stronger basis for their enforcement.

A carefully drafted garden leave provision can maximize the employer's protections and increase the likelihood of enforcement. When drafting garden leave provisions, employers should:

- Require signed agreements.
- Identify covered employees.
- Define the length of the garden leave period.
- Determine the employees' compensation during the garden leave period.
- Determine the employees' eligibility for leave and other fringe benefits during the garden leave period.
- Consider the impact of garden leave on benefit plans.
- Reserve the right to exclude employees from work.
- Reserve discretion to waive or modify the garden leave period.
- Consider pairing garden leave provisions with non-compete and non-solicitation provisions.
- Consider including related provisions.

SIGNED AGREEMENTS

Employers should ensure that employees subject to garden leave provisions sign the agreements or plans that contain the restriction. Employees should clearly acknowledge the garden leave provisions. Failure to do so creates difficulty in enforcement. (See, for example, *Bear Stearns & Co., Inc. v. McCarron*, 2008 WL 2016897 (Mass. Super. Ct. Suffolk Co. Mar. 5, 2008) (refusing to enforce restrictive covenants "buried" in the terms and conditions of a deferred compensation plan, where the former employees did not sign the terms and conditions and may never have seen them).) In some cases, the signature may be electronic.

Search General Contract Clauses: Electronic Signatures for a model provision providing that contract parties may authenticate their agreement with an electronic signature, with explanatory notes and drafting tips.

COVERED EMPLOYEES

Employers must determine which employees will be subject to garden leave provisions. Since garden leave periods are paid, often with benefits and sometimes with bonuses, and require a continuing relationship with employers, employers generally restrict garden leave to those employees at a higher level, such as key executives and technical employees.

Garden leave provisions may also be useful for:

- Sales or other employees responsible for developing relationships with clients, to provide a period in which the employer can work to transition their client relationships without direct competition.
- Employees with substantial access to trade secrets and other confidential information.

Garden leave provisions are generally not used for low-level employees.

LENGTH OF THE GARDEN LEAVE PERIOD

Employers must determine the appropriate length of the garden leave period. Periods of 90 days or less are the most common, though some garden leave periods can be up to six months long. Garden leave periods for much longer than this run the risk of being challenged, especially in non-negotiated agreements, as a form of involuntary servitude because the employee must remain employed.

The single most important factor in determining the length of the garden leave period is the protectable interests at stake. Employers should consider the nature of the employee's position, as well as particular concerns associated with that position. For example, employers may have incrementally longer garden leave periods for employees with greater responsibility, such as:

- 30 days for a vice president.
- 60 days for a director.
- 90 days for a managing director.

EMPLOYEE COMPENSATION

Employers must decide how to compensate employees during the garden leave period. At a minimum, employees should continue to receive their regular salary, usually with benefits, but may forfeit eligibility for bonuses or other incentive pay. This may be problematic for employees who receive a substantial portion of their compensation through bonuses, because they may claim that they are not receiving adequate consideration and therefore the garden leave provision should not be enforced. Although not always stated in these terms, courts are reluctant to enforce non-competes and, by extension, garden leave provisions, that are perceived as fundamentally unfair to the employee. However, this argument may not be persuasive in jurisdictions where continued at-will employment is sufficient consideration for enforcing even an unpaid non-compete period.

More complicated situations arise when employees are paid solely on a commission basis. Employers may want to compensate these employees based on a set formula (such as the average of commissions paid over the last several months) that complies with the parties' contract and applicable law. Employers should be mindful that the law is not well developed on these issues.

LEAVE AND OTHER FRINGE BENEFITS

Employers may choose to limit or decrease certain fringe benefits during the garden leave period, such as the accrual of paid time off. This and other similar reductions in benefits during the garden leave period will likely have a negligible effect on the potential enforceability of the garden leave provision. It may also be helpful for employers to add language to the garden leave provision stating that employees must use all unused accrued leave, such as paid time off or vacation, during the garden leave period, especially in jurisdictions that require employers to pay out unused accrued leave when the relationship terminates.

BENEFIT PLANS

If employees subject to garden leave provisions participate in any pension, severance, or other benefit plans, employers should ensure that the plan documents clearly define whether the employees vest in their benefits based on a notice of termination (that is, by placing employees on garden leave) or on the final employment termination (the end of the garden leave period). If this is ambiguous, terminated employees may have a claim for interference with their rights to these benefits under the Employee Retirement Income Security Act of 1974 (ERISA) (see, for example, *Kirby v. Frontier Medex, Inc.*, 2013 WL 5883811, at *10 (D. Md. Oct. 30, 2013)).

Tax Issues Under Section 409A

Incentive compensation and severance payments and benefits often fall under Section 409A of the Internal Revenue Code, which creates a complex and comprehensive set of rules regarding nonqualified deferred compensation. Section 409A defines deferred compensation broadly as any form of compensation that is or may be paid in a year following the year in which the legal right to the payment arises, unless an exception applies.

When drafting garden leave provisions, employers must consider potential issues arising under Section 409A. While there are often ways to structure payments to comply with an exception to Section 409A, it is important to consider the Section 409A issues before entering into any garden leave arrangement because the rules are complicated and do not specifically contemplate garden leave. Employers should consult with counsel, because even a minor violation of Section 409A can result in significant adverse tax consequences.

Search Section 409A: Deferred Compensation Tax Rules: Overview for more on Section 409A's requirements, and the various exceptions from Section 409A, including the short-term deferral exception and the severance pay exception.

Search Section 409A Toolkit for resources to assist employers in complying with Section 409A.

Advantages and Disadvantages of Garden Leave Provisions

Advantages of garden leave provisions include:

- Greater likelihood that employees and their new employers will respect the garden leave provision without legal challenge.
- Increased likelihood of enforcement. Courts may be more receptive to garden leave provisions because:
  - the employee is paid during the garden leave period; and
  - the garden leave period is typically much shorter than a non-compete period.
- Added protection for the employer. The employee's common law duty of loyalty continues throughout the garden leave period because the employee remains an employee while on garden leave.
- A more orderly transition of client relationships and work responsibilities. When an employee leaves, the most crucial period for an employer is the immediate 30- to 90-day period after the resignation notice. That period is typically covered by garden leave and is longer than the amount of notice typically given when an employee resigns.
- Decreased likelihood of overuse when not necessary to protect legitimate business interests. Because of the cost of paying an employee while on garden leave, employers use garden leave provisions more selectively.
- Flexibility to release employees from their garden leave obligations if their departure poses no competitive threat (if the garden leave provision specifically allows for this).

Disadvantages of garden leave provisions include:

- The significant cost of paying an employee who does not perform any work during the garden leave period.
- The relatively short duration of a garden leave period compared with a typical non-compete period. A garden leave provision may provide less protection to an employer than a reasonable non-compete.
- Logistical issues regarding electronic access during the garden leave period if the employee is needed for transitional duties during that time, especially if the employee is prohibited from working or contacting clients or coworkers.
- The lack of case law regarding garden leave provisions, which creates uncertainty surrounding enforceability.
- Difficulty in specifically enforcing garden leave provisions. Specific enforcement of garden leave provisions would require that employees remain employed against their will (especially if an employer can require an employee to perform services during that time).

COBRA Issues

Employers that sponsor group health plans must consider whether placing employees on garden leave triggers any rights or obligations under the Consolidated Omnibus Budget Reconciliation Act (COBRA). COBRA requires most employer-sponsored group health plans to offer covered employees and dependents (known as qualified beneficiaries) the opportunity to continue their health coverage in situations where the coverage would otherwise end because of certain life events (known as qualifying events). Among other compliance obligations, plans must provide COBRA-qualified beneficiaries an election notice when certain COBRA qualifying events occur.

Placing an employee on garden leave with a reduction in, or total elimination of, work hours may:

- Constitute a qualifying event under COBRA.
- Result in a loss of coverage under a plan, depending on the plan terms (including governing eligibility provisions).

Failure to comply with COBRA's specified notice obligations may result in:

- Claims by employees for damages resulting from the loss of coverage.
- Penalties and fines.

Employers that place employees on garden leave should:

- Consult the governing plan terms and, if applicable, the plan's insurer or stop-loss carrier.
- Address how COBRA will be handled under the garden leave provision (including whether garden leave constitutes a COBRA qualifying event), so that the commencement and duration of any COBRA coverage period is clear.
- Coordinate with any third-party COBRA administrators to ensure that required COBRA notices are timely provided and premium payments are handled properly.

Search COBRA Overview for more on group health plan compliance with continuation coverage requirements under COBRA.

Search COBRA Toolkit for resources to help employers and their advisors understand and comply with COBRA.

EXCLUDING EMPLOYEES FROM WORK

Employers should expressly reserve the right to exclude employees from performing any work during the garden leave period. Employers may also want to restrict employees on garden leave from accessing:

- The physical workplace.
- The employers' email and other electronic communication systems.

Employers should be aware that there is a potential risk in expressly retaining unilateral discretion to waive or modify the garden leave period without agreeing to pay in lieu of notice.

- Clients and prospects.
- The employers' confidential or proprietary information.

Employers should specify that during the garden leave period, employees will not bind, attempt to bind, or otherwise obligate the employer to any third party and shall not incur business expenses unless pre-approved in writing.

WAIVING OR MODIFYING GARDEN LEAVE RESTRICTIONS

Employers can decide whether to retain discretion to shorten or waive the garden leave period and whether the employees receive pay in lieu of garden leave for any waived period. If employers want to retain these rights, the garden leave provisions should explicitly state what discretion the employers have and how they must notify employees when exercising that discretion. For example, employers may include a section reserving their rights to shorten the garden leave period or waive their right to enforce it and stating they will notify the employees in writing of any modification or waiver.

In *Reed v. Getco, LLC*, an employer had to pay an employee $1 million in exchange for a six-month non-compete. Shortly after the employee resigned, the employer notified the employee it was waiving the non-compete restriction and therefore not paying the $1 million. The employee nonetheless complied with his end of the bargain and refrained from competing with the employer for six months. Because the agreement provided that there could be no waiver of the agreement unless it was signed by both parties, the court held that the payment was due. (65 N.E.3d 904 (Ill. App. Ct. 2016); see also *Tini v. AllianceBernstein L.P.*, 968 N.Y.S.2d 488, 489 (1st Dep't 2013) (finding that the employer had no right to unilaterally reduce the notice period).) Although these cases arose in the context of non-competes, they nonetheless highlight the importance of planning for contingencies and reserving discretion to modify terms when drafting garden leave provisions.

Search Epstein Becker: Illinois Appellate Court Holds Employer's Waiver of Non-Compete Period to Avoid $1 Million Payment was Ineffective for more on *Reed v. Getco*.

Employers should be aware that there is a potential risk in expressly retaining unilateral discretion to waive or modify the garden leave period without agreeing to pay in lieu of notice. For example, if the threat of enforcing the garden leave provision limits an employee's job mobility, the employer's ability to waive the garden leave period with no notice may still limit the employee's ability to immediately obtain new employment (without the employer obligating itself to do or pay the employee anything in return). A court may find that the employer's promise in this situation is illusory and therefore may refuse to enforce the garden leave provision for lack of consideration.

PAIRING GARDEN LEAVE PROVISIONS WITH NON-COMPETES AND NON-SOLICITATION PROVISIONS

Another option employers can consider is pairing garden leave provisions with non-competes or non-solicitation provisions. Some courts may be reluctant to specifically enforce garden leave provisions because they compel an employee to remain employed against their will and therefore specific enforcement would violate public policy.

To increase the likelihood of specific enforcement, employers may seek to contract for a non-compete or non-solicitation period (or both) that runs concurrently with the employee's garden leave period. The non-compete period can be paid or unpaid, though if it is paid, a court may be more likely to enforce it. The employer will then have another avenue for enforcement if the employee starts working for a competitor and the employer cannot enforce the garden leave provision.

RELATED PROVISIONS

Employers should consider including the following provisions when drafting garden leave provisions:

- Choice of law and forum selection provisions. As with non-competes, the jurisdiction and applicable law may be outcome dispositive.
- Jury waiver provisions.
- Severability and blue pencil provisions. As with non-competes, the court's ability to blue pencil (or modify) a garden leave provision may depend on applicable state law (for more information, search State Q&A Tool: Non-Compete Laws).