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Expert Analysis

'Garden Leave' Clauses in Lieu of Non-Competes

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For many years, employers in the United Kingdom have included in their employment agreements so-called "garden leave" clauses. Under a garden leave clause, the employee promises to give a certain amount of notice to the employer in advance of the employee's resignation from employment. In exchange, the employer does not require the employee to work during the period of the garden leave. The term garden leave is based on the quaint idea that the employer pays the employee to stay at home and tend to his or her "garden."

U.S. employers increasingly are including garden leave provisions in their employment agreements. One reason for this is that garden leave clauses have some of the same benefits as non-competition agreements, but perhaps without some of the challenges employers often face in enforcing non-competition agreements. Employers also may realize certain advantages in employee relations as employees may perceive the "optics" of garden leave more favorably than the way in which they perceive the restrictions of non-compete agreements.

Just as with a non-compete agreement, if the employee fails to abide by the garden leave clause, the employer may apply to the appropriate court for an injunction that would enforce the provision. Thus, ideally, the garden leave provision protects the employer against both competition from the employee and/or misappropriation of confidential business information. During the garden leave period, the employee may not work in competition with his or her employer as such conduct would violate the employee's continuing duty of loyalty. Further, because the employee stops reporting to work, the employee no longer can access confidential company records. Finally, any confidential information already in the employee's possession may possibly become stale during the garden leave period.

Garden leaves also provide a measure of protection to the employer against the employee's solicitation of clients and coworkers. During the garden leave period, the employer may seek to transition the departing employee's duties and client relationships over to other employees. At the same time, because garden leave is paid leave, employers are not faced with the prospect of asking a court to enjoin an employee from pursuing his or her chosen field of endeavor or to prevent an employee from earning a living.

What difference, if any, is there between a garden leave clause and a restrictive covenant accompanied by severance? The most obvious difference is that the employee remains an employee of his former employer during the garden leave period. As noted above, the employee still owes a duty of loyalty to the employer. In addition, courts presumptively will be much more willing to allow an employer to dictate the activities of a current employee than they will a former employee. At the same time the employee will typically continue to be covered by the employer's benefit plans, and receive salary continuation during the garden leave.

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In the U.K., courts consistently have enforced garden leave provisions. At the same time, U.K. courts (like U.S. courts) have tended to construe non-competes narrowly and have made enforcement challenging in some jurisdictions. Very few U.S. courts have addressed garden leave clauses. However, those decisions addressing compensation arrangements with restrictions similar to garden leave may provide some guidance. In these cases, courts generally have taken favorable note of the compensation component when conducting the reasonableness analysis that courts must undergo in considering the enforceability of restrictive covenants.

Background

While few reported cases address the enforcement of garden leave clauses, several New York decisions have addressed non-compete agreements containing provisions similar to garden leaves. In considering whether to grant injunctions enforcing non-competes, courts consider the necessity and reasonableness of the covenants. When a non-compete includes a requirement that the employer continue the employee's salary during the period of the non-compete, courts appear to be much more willing to find the reasonableness balance tipping towards the employer.

Courts in New York have upheld non-competes with so-called "safety net" clauses, which provide for payment only in the event that the employee is unable to find alternative employment,[1] as well as non-competes with provisions that are garden leaves in all but name. For example, in *Natsource LLC v. Paribello*, 151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001), the court, in upholding the 30-day notice provision combined with the 90-day non-compete provision, noted the significance of the safety-net payment provision, which made "virtually non-existent [the] concern that Paribello [the former employee] could loose his livelihood."

In Lumex Inc. v. Highsmith and Life Fitness, 919 F. Supp. 624, 629-36 (E.D.N.Y. 1996), the court upheld the six month restrictive covenant, giving great weight to the employee's full compensation of salary and payment of health and life insurance premiums under the safety-net provision: "In this case, there is a special kind of restrictive covenant, one that compensates a former employee who cannot work because of the terms of the agreement." See also *Maltby v. Harlow Meyer Savage Inc.*, 633 N.Y.S. 2d 926, 930 (N.Y. Sup. Ct. 1995) (finding the restrictive covenant reasonable "on condition that plaintiffs continue to receive their salaries for six months while not employed by a competitor").

In *Estee Lauder Companies Inc. v. Batra*, 430 F. Supp. 2d 158, 182 (S.D.N.Y. 2006), the court upheld a restrictive covenant containing a "sitting out" clause. In granting the employer a five month enforcement period (but not the originally requested one year period) of the restrictive covenant, the court found it particularly significant that the former employee-executive was not only

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entitled to his full salary of $375,000 per year during the "sitting out" period but was also permitted to earn additional compensation from non-competitive work during the period. The court found that the risk to the former employee-executive of a loss of livelihood was mitigated by the continual payments.

The Second Circuit, applying New York law, extended the logic even further in *Ticor Title Insurance Co. v. Cohen*, 173 F. 3d 63, 71 (2d Cir. 1999), upholding a six month non-competition agreement even though it did not contain any post-employment payment provision. The circuit found the employee-salesman's annual compensation of $600,000, which had been expressly provided by the employer contingent upon the employee-salesman's agreement to abide by his contractual post-employment restrictions, served the same purpose as the post-employment payments in *Maltby*—to help "alleviate the policy concern that non-compete provisions prevent a person from earning a livelihood." As the former employee-salesman had been provided with "sufficient funds to sustain him for six months," any public policy concern "regarding impairment of earning a livelihood was assuaged."

Involuntary Servitude

A recent garden leave case from Massachusetts raises some issues as to the enforceability of certain types of garden leave clauses in particular circumstances. In *Bear, Stearns & Co v. Sharon*, 550 F. Supp. 2d 174 (D. Mass. 2008), the court denied the employer's motion for a preliminary injunction. The employer based its motion on the former employee-broker's immediate acceptance, upon resignation, of a position with competitor Morgan Stanley, in breach of a garden leave provision with a 90-day notice requirement.[2]

However, the court's analysis reflects that the court focused on the interests of the employee-broker's clients and their need for advise during the economic crisis. The court discussed this concern in connection with its analysis of the "balance of hardships" and the issue of "public policy." The court concluded that monetary damages would be a better alternative if in fact the employee-broker had violated his garden leave clause, as this solution would ensure that the employee-broker's clients would "not be disadvantaged."[3]

The court's analysis also suggests that the result might have been different had the employer drafted the garden leave provision more narrowly. In *Sharon*, the garden leave provision stated: "Bear Stearns will pay your base salary, during which time you may be asked to perform *all, some or none of your work duties* in Bear Stearn's sole discretion."[4] (emphasis added). The court found that this was not a "simple restrictive covenant against competition" but instead a provision that would force the employee-broker into involuntary servitude: "Because the effect of specific performance in this case would be to require the defendant to continue an at-will employment relationship against his will, it is unenforceable in that manner…to give it full effect would be to force Sharon [the employee] to submit to Bear Stearn's whim regarding his employment activity in the near future."[5]

Employers considering garden leave clauses should weigh carefully the issue of remedy as discussed in *Sharon*. If the reasoning in *Sharon* governs, a court will not require specific performance of the employment relationship where that means the employee is being required to perform services for the employer involuntarily.

Query, however, whether the court would have ruled differently if the contract provision at the heart of the injunction focused simply on the requirement that the employee refrain from working for the employer, or for anyone else? One logical approach might be for a court to find that an employee enjoined from performing any services is not engaging in servitude at all, involuntary or otherwise.

Alternatively, employers also may wish to include in the employment agreement ordinary non-competition covenants applicable during the period of employment, including the garden leave period. In that case, if the employee violates the garden leave provision by competing with the employer, the employer may seek to enforce the restrictive covenants against the employee rather than the garden leave provision. In that scenario, the employer also should include a strong severability or "blue pencil" clause in the employment agreement.

Given the costs to the employer of paying salary and benefits during the period of garden leave, the employer must carefully identify the types of employees that warrant a garden leave clause, such as senior executives, key technical employees and employees who have access to confidential information or who control a large book of business.

Practical Considerations

First and foremost, given the costs to the employer of paying salary and benefits during the period of garden leave, the employer must carefully consider and identify the types of employees that warrant a garden leave clause, such as senior executives, key technical employees and employees who have access to confidential information or who control a large book of business. The employer should tailor the garden leave provision to these specific workers.

In determining the proper duration of the garden leave, the employer should consider the individual employee's role and level of knowledge as well as which particular interests the employer wishes to protect. As mentioned earlier, in the U.S., employers thus far have generally favored 30-, 60- or 90-day provisions and generally have not reached beyond a six month limitation period.

Once an employer has made these determinations, the employer should seek to ensure that the employment agreement containing the garden leave provision contains the following: (1) a clause allowing the employer to place the employee on garden leave; (2) a statement of the employer's right to exclude the employee from the office or workplace and preclude the employee from contact with customers, clients and confidential information; and (3) a provision prohibiting the employee from working for another employer during the term of the agreement.

If the employer wishes to reserve the right to require the employee to perform services during the period of garden leave, the employer should be aware that such a clause may make enforcement more difficult, as the *Sharon* case demonstrates. Alternatively, to avoid the result in *Sharon*, employers may wish to make clear in the garden leave provision that the employee will not be required to perform any services during the garden leave period. The employer also may wish to include restrictive covenants applicable during the entirety of the employment period, including the garden leave.

While some plaintiffs have argued that employment exclusion may result in difficulty in resuming work due to the atrophy of skills, New York courts have rejected such arguments. Given the limited guidance on garden leave clauses from U.S. courts, employers may wish to proceed with additional caution and include provisions permitting the employee to practice his or her skills during the garden leave period by engaging in limited work with tasks or clients that would not benefit a future, competitive employer. The employer also may wish to allow for participation in select continuing education opportunities presented by the employer and outside vendors.

1. While at first blush such safety net clauses may seem more appealing to employers, as there is a possibility that the employer will not have to internalize the costs, such safety net provisions often require ongoing monitoring of the former employee, which can end up being time-consuming and expensive.
2. Id. at 176.
3. Id. at 178-79.
4. Id. at 176.
5. Id. at 178-79.