KRIEG DEVAULT

Insights

Non-Compete A Non-Option? Consider Garden Leave

March 25, 2024

By: Nancy J. Townsend

Effective post-employment restrictions have fallen into limbo. Several states have banned such restrictions outright, and the FTC has taken steps to eradicate them.[1] Most states disfavor noncompete agreements and many impose unpredictable and shifting tests of validity. Court decisions provide no bright-line rules. What is currently an enforceable noncompete agreement might not hold up in court in a few years, leaving employers with little assurance of protection. This vulnerability only stands to increase as employees become more mobile and gain greater access to an employer's electronic information. Indeed, if the sea change continues, what prevents an employee from absconding with the company's "crown jewels" – a veritable treasure trove of customers, trade secrets, and proprietary information – and delivering them to a competitor?

Perhaps one solution lies where the Crown Jewels reside.[2] Employers in England long ago developed a concept known as "garden leave," in which departing employees stay on the payroll during the period they are restrained from competing. Under this concept, an employer can restrict a departing employee's competitive activities by keeping the employee in the proverbial "garden" – retained with pay but held inactive from any work responsibilities and denied access to the workplace itself. English courts now widely accept garden leave, as it discourages employer overreach and alleviates restrictions on the departing employee's ability to earn a living.

Given garden leave's unique advantages, American employers have begun using similar provisions to prevent unfair competition by key employees. Garden leave has three common components: (1) continued employment, (2) with no ability to work for another employer, and (3) no access to company property, customers, or employees. Departing employees remain on the payroll, often at their regular rate but sometimes less and sometimes up to 150% more. Importantly, employees in the garden remain bound by conventional duties of loyalty and confidentiality, which restrict employees' from competing with their employer or working for a competitor without permission. The employer reserves the right to reassign or restrict the employee's activities, exclude the employee from the workplace entirely, and prevent contacts with customers, clients, co-workers, and contractors – anyone the employee might solicit or collaborate with to harm the employer competitively. The employee's duties and access to trade secrets, customers, and suppliers cease, allowing any replacement employees adequate time to train, build relationships, and ramp up to compete while the departing employee lingers innocuously in the garden.

Because they continue to receive pay, departing employees may be less prone to challenge the restraints of garden leave. Employees who accept other employment during a garden leave period certainly risk forfeiting their garden leave pay. But there could be significant legal consequences as well – including claims for breach of fiduciary duty by an employee and breach of contract under state law. Sometimes the contract will include a liquidated damages provision or specify other consequences of a breach by the employee. Moreover, those who flee the garden and engage in competitive activity likely will not evoke the same sympathy in court as workers whose noncompete agreements left them with no job and no income for the restricted term.

Not For Everyone?

Employers must weigh the cost of garden leave and decide which employees are appropriate for garden leave provisions. Not every employer can afford to pay its high earners' salaries while also paying high-cost replacements. Companies with financial capital will have a hefty hiring advantage over small businesses and "start-up" competitors that cannot provide these incentives.

Because the garden leave period is paid – often with benefits and sometimes even with bonuses – and requires a continuing relationship with the employer, employers generally restrict garden leave to those employees at its highest level, such as key executives and information technology (IT) employees. These employees generally pose the greatest competitive threat to the employer, which justifies the expense.

Garden leave provisions may also be useful for sales or other employees who work directly with clients, to allow a transition period for the employer to solidify or rescue client relationships without direct competition. A garden leave period may also be useful for employees with access to sensitive trade secrets and other confidential information. Lower-level employees, who present less risk of competitive harm, generally will not justify the cost of garden leave.

Garden leave carries inherent checks and balances. The high cost of garden leave should curb employers from creating unreasonably long restriction periods. A rational employer will weigh the cost of garden leave against the threat of competitive harm, with that threat waning as every month of garden leave passes. This analysis mimics the framework courts typically apply in scrutinizing the validity of noncompetes: is the restriction essential to protect an employer's legitimate business interests and is it narrowly drawn to protect those interest without forcing the employees out of their profession? As an added failsafe, the current tight labor market should deter employer overreach. Valuable candidates may reject lengthy or onerous garden leave terms that threaten their career trajectory by keeping them out of the market for longer periods of time. New recruits may be reluctant to join a team that imposes significant limitations on their mobility.

States Weigh In

Given the states' distaste for competitive restrictions, employers must draft garden leave policies carefully to avoid having them nullified as unlawful noncompete agreements. Indeed, many states – whether through their legislatures or courts – are starting to address the garden leave trend. At least initially, garden leave provisions have found favor with state legislatures and courts, perhaps in part because employers pay dearly for the competitive restrictions imposed.

Massachusetts statutes, for example, only allow employee noncompete agreements that include payment of garden leave or "other mutually agreed upon consideration." Gen. Laws Ann. ch. 149, § 24L (West 2018). To be enforceable, a garden leave provision must guarantee payment of at least 50 percent of the employee's salary during the entire restrictive period, with some exceptions for employees who breach a fiduciary duty or unlawfully take the employer's property. *Id.*

Illinois has enacted legislation that expressly recognizes garden leave by excluding garden leave clauses from the definition of covenants not to compete. *See* 820 ILCS 90/5 ("'Covenant not to compete' does not include … (6) clauses or an agreement between an employer and an employee requiring advance notice of termination of employment, during which notice period the employee remains employed by the employer and receives compensation"). Notably, unlike Massachusetts, the Illinois statute does not impose any minimum compensation required for a garden leave provision to exclude the agreement from the definition of a noncompete.

New York's governor recently vetoed proposed legislation broadly banning nearly all noncompetition agreements, noting that while she supported legislation to protect middle class and low-wage workers, she rejected the legislature's "one-size-fits-all approach." As drafted, the New York legislation would have implicitly allowed garden leave arrangements, as it only prohibited noncompete agreements "after the conclusion of employment." (A01278B). Because garden leave occurs *during employment*, rather than after the conclusion of employment, the proposed legislation would not have prohibited noncompete restrictions during garden leave.

In the same vein, courts addressing garden leave provisions have tended to look favorably on them. New York courts had previously telegraphed that "garden leave" might boost the enforceability of an otherwise reasonable restrictive covenant.[3] In a case decided under Maryland law, a federal court in Florida similarly found that paying the employee during a noncompete period (even half the regular salary) significantly improves the reasonableness of a noncompete.[4]

These and similar cases aside, there is still reason for caution. At least one court has determined that garden leave mandates may clash with public policy favoring at-will employment. In a recent case decided under Oregon law, a federal court upheld the right of an employer to impose garden leave by requiring 60 days' notice of termination but also acknowledged the *employee's* power to terminate employment at any time.[5] The court found that the resignation took effect when the employee specified that the employment terminated (without the 60 days' advance notice) and that his duty of loyalty ended there too.[6] While reserving the possibility of consequences stemming from the employee's breach of the 60-day notice requirement, the court refused to impose a duty of loyalty on the employee after the date he quit, effectively nullifying the garden leave provision. This case suggests that employer-imposed garden leave has little efficacy in Oregon if the employee chooses to terminate and work for a competitor before the end of the garden leave.[7]

An Option When Hiring

While garden leave benefits employers by restricting the competitive activities of departing employees, it can have benefits on the hiring front too. Some employers have imposed paid garden leave terms on new hires – initially preventing them from working in order to avoid claims of interfering with a noncompete agreement of a former employer. One New York employer, for example, immediately placed certain new hires on a "Sabbatical Year," during which they would receive signing bonuses between $1,200,000 and $1,400,000, but would provide no work,

information, or services to the new employer.[8] The new employer also agreed to indemnify the new employees' attorney fees and damages from the employment transition, but only if they did not engage in conduct that violated their noncompete agreements with the prior employer.[9] A court upheld this contractual arrangement (including the indemnity provision), concluding that it encouraged employees to honor, rather than breach, their noncompete agreements because the employees would forfeit their right to indemnification by engaging in competitive conduct.[10]

Drafting Garden Leave Agreements

Garden leave provisions may be included in a variety of written agreements: offer letters, employment agreements, stock option plans, bonus agreements, equity award agreements, long-term incentive plan agreements, stand-alone non-compete, non-solicit, or confidentiality agreements, or severance agreements negotiated at the time of separation. At a minimum, the garden leave agreement should:

- Be part of a *signed* writing (not just an unsigned employment policy or handbook provision).
- Specify the length of the garden leave period – typically three to six months, although higher level employees may warrant longer time.
- Detail employee compensation during the garden leave.
  - Specify whether bonuses and other non-salary compensation will be paid.
  - The amount of pay may depend on employees' positions within the company, the confidential and proprietary information they hold, their other employment opportunities, and their potential for competitive harm, along with any state law constraints.
  - Highly marketable employees – with greater potential for competitive harm – will require more.
  - Retiring or unproductive workers, on the other hand, could demand far less.
- Define allowable activities during the garden leave period.
  - Reserve the employer's right to restrict access to company property, information, customers, clients, and employees during garden leave.
  - Decide whether the employee must remain entirely idle, refrain from specified competitive work, or obtain employer's permission before seeking or securing any outside employment.
  - Reserve the employer's right to waive or modify the garden leave period.
- Address accrual of leave and other benefits during the garden leave.
- Address COBRA issues, including whether the garden leave is a COBRA qualifying event under the company's plan.
- Consider a liquidated damages provision or other specific consequences of breach by the employee, in addition to state law remedies for breach of fiduciary duty and breach of contract.

For further questions about whether your company might benefit from a garden leave contract and how your employment practices may be impacted, please contact Nancy J. Townsend, Matthew C. Branic, or another member of our Labor and Employment Practice.

Disclaimer. The contents of this article should not be construed as legal advice or a legal opinion on any specific facts or circumstances. The contents are intended for general informational purposes only, and you are urged to consult with counsel concerning your situation and any specific legal questions you may have.

[1] Non-Compete Clause Rule, 88 Fed. Reg. 3482 (proposed Jan. 19, 2023) (to be codified at 16 C.F.R. pt. 910).

[2] Housed at the Tower of London, The Crown Jewels are a collection of treasures comprising more than 100 objects and over 23,000 gemstones. They include the English Coronation Regalia, a set of sacred objects used in the coronation ceremony of English monarchs. https://www.hrp.org.uk/tower-of-london/crown-jewels/#gs.354mfu

[3] *See, e.g., Pontone v. York Grp., Inc.*, No. 08 Civ. 6314(WHP), 2008 WL 4539488, at *4 (S.D.N.Y. Oct. 8, 2008) (applying New York law; stating that "[a] factor weighing in favor of reasonableness is whether the individual received compensation during the time he was restrained from competing"). *See also Bradford v. N.Y. Times Co.*, 501 F.2d 51, 58 (2d Cir. 1974) (noting that payments during the restricted period support the reasonableness of a noncompetition agreement).

[4] *Hekimian Labs., Inc. v. Domain Sys., Inc.*, 664 F. Supp. 493, 499 (S.D. Fla. 1987).

[5] *Aitkin v. USI Insurance Services, LLC*, 607 F.Supp.3d 1126, 1151 (D. Or. 2022).

[6] *Id.*

[7] *Id.*

[8] *See In re Document Techs. Litig.*, 275 F. Supp. 3d 454, 458–59 (S.D.N.Y. 2017).

[9] *Id.*

[10] *Id.*