

Garden Leave Provisions in Employment Agreements

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A Practice Note discussing garden leave provisions in employment agreements as an alternative or a companion to traditional employee non-compete agreements. This Note addresses the differences between garden leave and non-compete provisions, the benefits and drawbacks of garden leave, and drafting considerations for employers that want to use garden leave provisions. This Note applies to private employers and is jurisdiction neutral.

In recent years, traditional non-compete agreements have come under 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 attitude toward non-compete agreements is unknown, the Obama Administration was disapproving of 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 Department of the Treasury: Non-Compete Contracts: Economic Effects and Policy Considerations (Mar. 2016) and White House Report: Non-Compete Agreements: Analysis of the Usage, Potential Issues, and State Responses (May 2016)). Some states have passed legislation essentially banning non-competes for certain categories of workers, such as low-wage workers in Illinois (820 ILCS 90/1) and technology sector workers in Hawaii (Haw. Rev. Stat. § 480-4(d)). In other states, such as California, almost all post-employment non-competes are unenforceable (Cal. Bus. & Prof. Code § 16600-16602.5).

With this background, employers are seeking alternatives to traditional non-compete agreements to protect their proprietary

information and customer relationships. One alternative gaining rapid favor is the use of garden leave provisions in employment agreements, which extend the employment relationship for a period of time during which the employee continues to receive a salary (and sometimes benefits) but cannot go to work elsewhere. While garden leave clauses are not a panacea, they may serve as a potential tool that employers can use to protect their legitimate business interests and restrain certain employees from going directly to a competitor.

This Practice Note addresses:

- The history and general characteristics of garden leave.
- Comparisons between traditional non-competes and garden leave provisions.
- Advantages and disadvantages of garden leave.
- Drafting considerations for employers that want to use garden leave provisions, including potential issues under:
 - Section 409A of the Internal Revenue Code (Code); and
 - the Consolidated Omnibus Budget Reconciliation Act (COBRA).

GARDEN LEAVE OVERVIEW HISTORY OF GARDEN LEAVE

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). 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 contract that restricts the parties' termination rights.

Garden leave is a variation of a notice provision. Instead of actively working during their notice period, employers place employees on garden leave (to "tend to their gardens"). The employees typically are relieved of their duties and responsibilities during that time, yet remain employed by the employer and therefore cannot go to work for a competitor.

Garden leave was first widely adopted in the US by the financial services industry in New York, presumably 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.

GARDEN LEAVE VERSUS TRADITIONAL NON-COMPETES

Garden leave and non-compete provisions are both tools employers can use when seeking to prevent a departing employee from working for a competitor for a period of time. Traditional non-compete agreements 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 restricted period. This leads to close judicial scrutiny and concerns about fairness to the employee and the adequacy of consideration for the agreement.

In contrast, under typical garden leave provisions, employees must give advance notice of their resignation, typically between 30 and 90 days' notice. During this garden leave period, the employees remain employees of 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. With some garden leave provisions, the employer has a mirror image obligation not to terminate an employee without giving the same advance notice or pay in lieu of the notice.

During the garden leave period, the employer generally can:

- Remove employees from their active duties.
- Exclude them from the workplace.
- Prevent their contact and communications with staff and customers or clients.
- Limit or cut off their access to the employer's computer systems, email, and other documents and information.

However, because they remain employed and continue to draw a salary, they continue to owe a duty of loyalty (and for some employees, a fiduciary duty) 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 less Draconian and more enforceable because:

- Garden leave periods are typically shorter in duration than traditional non-compete periods (six months or less).
- The employee continues to be paid during the garden leave period.

Although paid post-employment non-competes are sometimes also referred to as garden leave, that usage is inaccurate. While paid non-compete periods share some characteristics of garden leave and have some of the same advantages (see *Advantages and Drawbacks of Garden Leave Provisions*), with a non-compete, the employment relationship has terminated, and there is no continuing employee duty of loyalty during the non-compete period. Paid non-competes are therefore subject to the same judicial scrutiny as traditional non-competes and should not be confused with true garden leave provisions.

JUDICIAL TREATMENT OF GARDEN LEAVE PROVISIONS

In most states (with the exception of states like California, North Dakota, and Oklahoma), non-competes are generally enforceable, though subject to rigorous judicial review. Some states regulate non-competes by statute. 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.

However, case law regarding garden leave provisions is not as developed, likely because:

- Garden leave clauses are relatively new in this country.
- They are challenged less often than non-compete periods because they are:
 - shorter than most non-competes;
 - paid; and
 - increasingly common and accepted in the financial services industry where they are most used.
- Many employment disputes in the financial services industry, where garden leave provisions are most common, are subject to mandatory FINRA arbitration (see Practice Note, *FINRA Industry Arbitration: A Step-by-Step Guide*).

In the relatively few published decisions considering "pure" garden leave provisions, the courts have reached conflicting conclusions about their enforceability and been particularly reluctant to specifically enforce them (see *Limitations on Specific Enforcement of Garden Leave Provisions*). For example, in *Bear Stearns & Co., Inc. v. McCarron*, Bear Stearns sought enforcement of a garden leave provision requiring 90 days' advance notice of resignation that was "buried" in various deferred compensation plans that the departing defendants never signed. Bear Stearns agreed to pay the employees' salaries during the garden leave period but reserved the right to terminate their employment or not assign any work during that time. The court refused to enforce these "stealth" garden leave provisions. (2008 WL 2016897 (Mass. Super. Ct. Suffolk Co. Mar. 5, 2008).)

In *Bear, Stearns & Co., Inc. v. Sharon*, the resigning broker had signed a memorandum to all Senior Managing Directors by which he accepted a raise in base salary in exchange for agreeing to a 90-day garden leave provision. Bear Stearns agreed to pay the broker's salary during the garden leave period and reserved the right to decide what, if any, duties the broker would perform during that time. Although the court originally granted a temporary restraining order against the broker going to work for a competing firm, the court refused to grant a preliminary injunction as against public policy (see *Limitations on Specific Enforcement of Garden Leave Provisions*). However, the court did find that there was a likelihood that Bear Stearns would prevail on a breach of contract claim and could be compensated by monetary damages for that breach. (550 F. Supp. 2d 174, 178 (D. Mass. 2008).)

However, in *Bear Stearns & Co. v. Arnone*, a New York state court found that a garden leave clause protected a legitimate business interest and enforced the provision against a departing broker who contacted her clients during the garden leave period, informing them that she could be reached at her new employer following

the garden leave period. The court prohibited her from any further communications with those clients. (Case No. 103187 (Sup. Ct. N.Y. Co. 2008).)

Similarly, in *Natsource LLC v. Paribello*, the court enforced a 30-day notice provision followed by a three-month paid non-compete and enjoined a commodities broker from working for a competitor for the combined four months. The court found it reasonable because the employer continued to pay the employee's full salary during this period. (151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001).)

Many cases conflate their discussion of paid notice (garden leave) and paid non-compete provisions 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 the protection and cementing of customer relationships, keeping proprietary information confidential, or both. For example, courts have:

- Found reasonable a 60-day notice 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 (*Alliance Bernstein, L.P. v. Clements*, 932 N.Y.S.2d 759 (Sup. Ct. N.Y. Co. 2011)).

When analyzing the reasonableness of a garden leave or non-compete provision, 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) (court enforced six-month non-compete where employer agreed to pay employee's salary and benefits if he could not find work because of the non-compete)). Courts have also enforced 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 non-compete where employee received 50% of salary during restricted period)).

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

Limitations on Specific Enforcement of Garden Leave Provisions

Courts have been reluctant to specifically enforce notice or garden leave provisions because doing so requires the court to order employees to continue an at-will employment relationship against their will (see, for example, *Smiths Grp., plc v. Frisbie*, 2013 WL 268988, at *3 (D. Minn. Jan. 24, 2013); *Sharon*, 550 F. Supp.

2d at 178). Courts instead are more likely to issue an injunction prohibiting competition during the notice period of the garden leave (see, for example, *Ayco Co., L.P. v. Feldman*, 2010 WL 4286154, at *10 (N.D.N.Y. Oct. 22, 2010) (issuing preliminary injunction enforcing a combined 90-day notice and non-compete provision but acknowledging that it would not issue injunctive relief forcing the employee to continue working for the plaintiff during the notice provision); *Smiths Grp., plc*, 2013 WL 268988, at *5 (refusing to enforce six-month notice provision but enforcing one-year non-compete provision)).

Another court refused to specifically enforce a 90-day notice of termination (garden leave) provision because it would be "fundamentally unfair" to the employee's private banking clients to deprive them of their choice of financial advisor, especially during the turbulent market times of 2008 (*McCarron*, 2008 WL 2016897).

ADVANTAGES AND DRAWBACKS OF GARDEN LEAVE PROVISIONS

Garden leave clauses have many advantages over traditional non-competes, including:

- Anticipated greater receptivity by courts for enforcement. Although case law remains relatively sparse, courts may be more receptive to garden leave clauses because they have a lower burden on the employee. For example:
 - the employee is paid during the garden leave period; and
 - garden leave is typically much shorter in duration than a non-compete.
- Added protections for the employer during the garden leave period. The employee's common law duty of loyalty continues throughout the period because the employee remains an employee while on garden leave.
- A more orderly transition of client relationships and work responsibilities than the amount of notice typically given when an employee resigns. 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.
- Decreased likelihood of overuse when not necessary to protect legitimate interests. Because of the cost of paying an employee while on garden leave, employers use garden leave provisions more selectively, leading to a greater likelihood of enforcement than when agreements are imposed indiscriminately across an entire workforce.
- Flexibility to release employees from their garden leave obligations if their departure poses no competitive threat (if the agreement specifically allows for this).

Despite the benefits, garden leave is not without its drawbacks. The disadvantages of garden leave clauses include:

- The significant cost of paying an employee during garden leave, even though the employee is performing no work.
- The relatively short duration of a garden leave clause (typically 30 to 90 days) compared with a typical non-compete clause term of six to 18 months. A garden leave clause therefore 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 in many jurisdictions, creating greater uncertainty about enforceability.
- The difficulty of specifically enforcing garden leave provisions because doing so requires that employees remain employed against their will (especially if the employer can require the employee to perform services during that time).

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 (see Practice Note, Stock Options and Other Equity Compensation ([0-501-9297](#))).
- Bonus plans or agreements.
- Equity award agreements.
- Long-term incentive plan (LTIP) agreements.
- Supplemental Executive Retirement Plan (SERP) agreements (see Practice Note, Supplemental Executive Retirement Plans (SERPs) ([w-001-4933](#))).
- Stand-alone non-compete, non-solicit, or confidentiality agreements.
- Severance agreements.

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 time the employee is not expected or permitted to work but will continue to be paid his salary and receive certain benefits. In these circumstances, the garden leave period is often negotiated, which provides an even stronger basis for its enforcement if the employee violates it.

To maximize the employer's protections and increase the likelihood of enforcement, employers must consider several issues when drafting garden leave provisions.

REQUIRE SIGNED AGREEMENTS

Employers should ensure that employees subject to garden leave provisions sign the agreement or plan that contains the restriction. The employee should clearly acknowledge the garden leave terms. Failure to do so creates difficulty in enforcement. (See, for example, *McCarron*, 2008 WL 2016897 (refusing to enforce restrictive covenants "buried" in the terms and conditions of a deferred compensation plan, where former employees did not sign the terms and conditions and may never have seen them).) In some cases, the signature may be electronic (see Standard Clause, General Contract Clauses: Electronic Signatures ([0-529-7779](#))).

IDENTIFY COVERED EMPLOYEES

Employers must determine which employees will be subject to garden leave provisions. Since the garden leave period is paid, often with benefits and sometimes with bonuses, and requires a continuing presence with the employer, employers generally restrict

garden leave to those at its highest level, such as key executives and technical employees. Garden leave 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. A garden leave period may also be useful for other employees with substantial access to trade secrets and other confidential information. Garden leave generally is not used for low-level employees.

DEFINE APPROPRIATE TIME PERIOD

Employers need to select an appropriate time period for garden leave. Periods of 90 days or less are the most common, though some garden leave periods run up to six months. 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.

However, the single most important factor in determining the length of the time 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 persons with greater responsibility, such as:

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

DETERMINE EMPLOYEES' COMPENSATION DURING GARDEN LEAVE

Employers must decide what compensation to provide the employee during the garden leave period. At a minimum, employees continue to receive their regular salary, usually with benefits, but often 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 that the garden leave 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.

The more complicated situations arise for employees paid solely on a commissioned basis. For these employees, employers may want to set a formula to compensate the employees (such as the average of commissions paid over the last several months) that complies with the parties' contract and applicable law but must be mindful that the law is not well-developed on these issues.

CONSIDER LEAVE AND OTHER BENEFITS DURING GARDEN LEAVE

Employers may also choose to limit or decrease certain fringe benefits during the garden leave, such as the accrual of paid time off. This and similar reductions in benefits during the leave will likely have a negligible effect on the potential enforceability of the provision. Employers also may benefit from adding a provision stating that employees must use all unused accrued leave, such as paid time off or vacation, during the notice period.

RESERVE RIGHT TO EXCLUDE FROM WORK

The employer should expressly reserve the right to exclude the employee from performing any work during the garden leave period. It may also want to restrict access to the employer's:

- Workplace.
- Email and other electronic communication systems.
- Clients.
- Confidential or proprietary information.

The employer should also specify that during the garden leave period, the employee will not bind, attempt to bind, or otherwise obligate the employer to any third party and shall not incur business expenses unless preapproved in writing.

CONSIDER RESERVING DISCRETION TO WAIVE OR MODIFY GARDEN LEAVE PERIOD

An employer can decide whether to retain discretion to shorten or waive the garden leave period and whether or not the employee receives pay in lieu of garden leave (notice) for any waived period. If the employer wants to retain these rights, the garden leave provision should explicitly state what discretion it has and how it must notify the employee when exercising that discretion. For example, the employer may include a section reserving its rights to shorten or waive the period and stating it shall notify the employee in writing of any modification or waiver.

A case in Illinois shows the risk of not having this provision in an agreement. 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 six-month 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 signed by both parties, the court held that the payment was due. (65 N.E.3d 904 (Ill. App. Ct. 2016) and Legal Update, Epstein Becker: Illinois Appellate Court Holds Employer's Waiver of Non-Compete Period to Avoid \$1 Million Payment Was Ineffective; see also *Tini v. AllianceBernstein L.P.*, 968 N.Y.S.2d 488, 489 (1st Dep't 2013) (employer had no right to unilaterally reduce notice period).) Although these cases arose in the context of a non-compete provision, they nonetheless serve as a valuable lesson for employers to plan for various contingencies and reserve discretion to modify terms when drafting garden leave provisions.

However, there remains a potential risk in expressly retaining unilateral discretion to waive or modify the leave period without agreeing to pay in lieu of notice. For example, if the threat of enforcing the garden leave clause limits an employee's job mobility, the employer's ability to waive the provision with no notice may still limit the employee's ability to immediately obtain new employment but 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 refuse to enforce the agreement for lack of consideration.

CONSIDER PAIRING GARDEN LEAVE WITH NON-COMPETE AND 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 violate public policy. To increase the likelihood of specific enforcement, employers may want to couple a garden leave provision with a non-compete or non-solicitation period (or both) that runs concurrently with the employee's garden leave. The non-compete period can be paid or unpaid, though if paid, a court may be more likely to enforce it. This way, if the employee starts working for a competitor and the employer cannot enforce the garden leave provision, it has another avenue for enforcement, at least in those jurisdictions that allow post-employment non-competes.

ADDITIONAL DRAFTING CONSIDERATIONS

Other provisions that employers should consider when drafting garden leave provisions include:

- Choice of law and forum selection provisions (see Standard Document, Employee Non-Compete Agreement: Choice of Law and Forum Selection ([7-502-1225](#)) and Practice Note, Choice of Law and Choice of Forum: Key Issues ([7-509-6876](#))). As with non-compete provisions, the jurisdiction and applicable law may be outcome dispositive.
- Jury waiver provisions (see Standard Clause, General Contract Clauses: Waiver of Jury Trial ([9-523-4508](#))).
- Severability and blue pencil provisions (see Standard Document, Employee Non-Compete Agreement: Severability ([7-502-1225](#)) and Standard Clause, General Contract Clauses: Severability ([2-519-1319](#))). However, as with non-compete provisions, the court's ability to blue pencil (or modify) a garden leave provision may depend on applicable state law (see Non-Compete Laws: State Q&A Tool: Question 6).

If employees subject to garden leave participate in any pension, severance, or other benefit plan, the employer should ensure 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 at all ambiguous, terminated employees may have a claim for interference with their right to these benefits under the Employee Retirement Income Security Act (ERISA) (see, for example, *Kirby v. Frontier Medex, Inc.*, 2013 WL 5883811, at *10 (D. Md. Oct. 30, 2013)).

SECTION 409A ISSUES

Although a detailed discussion of this issue is beyond the scope of this Note, when contemplating garden leave, employers also must consider potential issues arising 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. Incentive compensation and severance payments and benefits often fall within its reach. While there are often ways to structure payments to comply

with an exception from Section 409A, it is important to consider the issue before entering into any garden leave arrangement because the rules are complicated and do not specifically contemplate garden leave. Even a minor violation of Section 409A can result in significant adverse tax consequences.

For an overview of Section 409A, see Practice Note, Section 409A: Deferred Compensation Tax Rules: Overview ([6-501-2009](#)). For additional Section 409A resources, see Section 409A Toolkit.

COBRA ISSUES

Although a full discussion of this issue is beyond the scope of this Note, employers that sponsor group health plans also must consider whether placing an employee 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 (see Standard Document, COBRA Election Notice ([7-580-9578](#))).

Placing an employee on garden leave with a reduction 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 the employee for:

- Damages resulting from the coverage loss.
- 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 arrangement (including whether the 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.

For more information on COBRA generally, see Practice Note, COBRA Overview ([3-519-8589](#)) and COBRA Toolkit ([w-001-8389](#)).

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