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The Basics of Garden Leave — And Why Careful Tilling Is Needed



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When it comes to employee terminations, employers have several alternatives by which to structure any severance-related pay that they desire to provide. A “terminal leave” approach may appeal to employers who want to delay an employee’s termina-

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tion date, perhaps to allow for further vesting of stock awards or retirement benefits — or to extend the period when COBRA¹ health insurance coverage will begin. Terminal leaves come with some baggage, however, because they trigger complex risks under Section 409A of the Internal Revenue Code, and could create disputes with health and welfare insurance providers when policies tie coverage to active employee status. At the other end of the spectrum, an accelerated termination date may be desired in order to assure that an exiting employee’s execution of a claims release does not leave the door open for claims of employment discrimination during a tail-end period of terminal leave or wind-up services.

Garden leave falls somewhere in between by continuing the employment relationship, albeit sometimes inactively, for a transition period, while coincidentally stalling the employee from joining a new employer. The structuring of garden leave severance implicates subtle, yet material, issues that include drafting for maximum enforceability, cost-benefit analyses, and compliance with Section 409A. This last issue has become the latest trap for the unwary.

Q-1: What is “garden leave”? A “garden leave” provision generally takes the form of a “notice” period — designated in weeks or months — during which a terminating employee is paid to remain at home and out of work (tending to the garden), but to be “on call” to his or her former employer for as-needed transitional services. This requirement is ordinarily built into an employment agreement or a severance-related plan or policy. During “garden leave,” an individual’s status as an employee continues (more on that in Q-3, below),

¹ Consolidated Omnibus Budget Reconciliation Act of 1985 (Pub. L. No. 99-272).

thereby preserving the individual's duty of loyalty to his or her employer that precludes the individual from immediately working for competitors of the employer.²

Q-2: How prevalent are garden leave provisions? Garden leave provisions are common in civil law countries (notably in England³ and those in the European Union) where the applicable law requires wage continuation during a notice period that precedes an employee's termination of employment. Other than in the financial services industry, garden leave provisions are less commonly used in the United States but their popularity is gaining slowly, as courts have been willing to enforce them.⁴ However, in the United States, garden leave is more likely to be used for improved enforcement of post-employment loyalty provisions than for transitional services. Therefore, the enforcement of garden leave provisions in the United States typically requires that an employer demonstrate some reasonable justification, such as protecting a legitimate business interest.

One example where U.S. courts looked favorably upon a garden leave provision was in *Credit Suisse First Boston L.L.C. v. Scott Vender*.⁵ There, a garden leave provision was held reasonable to permit the employer to cement client relationships while the terminating individuals were still employed. It was also found reasonable in that situation for the employer to stipulate for an additional 30-day post-termination noncompete provision to facilitate the retention of those client relationships. Significantly, the *Credit Suisse* decision applied traditional noncompetition principles when evaluating the employer's motion for injunctive relief. Likewise, in New York, a court upheld a similar garden leave provision that was coupled with a traditional noncompete provision.⁶

However, in *Bear, Stearns & Co. v. Sharon*,⁷ the court denied a preliminary injunction request to enforce a garden leave provision. Here, the court found that the terminating employee's "loss of professional standing and the inability of the financial advisor to advise his

clients in times of economic turmoil" outweighed protecting the employer via enforcement of the garden leave provision.⁸ Additionally, the court suggested the garden leave provision at issue was too broad and beyond a "simple restrictive covenant" against competition or the solicitation of clients. It found that specific performance of the garden leave provision, stating that "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 Stearns's sole discretion," was unenforceable because it effectively required "the defendant to continue an at-will employment relationship against his will," and "to give it full effect would be to force [the employee] to submit to Bear Stearns's whim regarding his employment activity in the near future."

The fact that the court noted that "Sharon's financial wherewithal and ability to earn a living are not in jeopardy but an injunction will likely result in...[an] inability to advise his clients in times of economic turmoil" demonstrates that the court may have been more concerned with the injunction's effect on the client. The court's acknowledgment that an injunction would not jeopardize Sharon's ability to earn a living possibly suggests a different result if not for the perceived economic and personal financial crisis endured by the clients.

Overall, while garden leave type provisions are generally viable in the United States, and may be used in conjunction with traditional post-termination noncompete provisions, their effectiveness may nevertheless depend on an employer's ability to establish a reasonable business justification for the garden leave protection. Therefore, careful tilling (drafting) of the contractual terms is worth attention because not all courts may agree on what is "reasonable."

Q-3: Why could garden leave help an employer? Aside from positioning for a former employee's availability for as-needed transitional services, an employer may find that a garden leave provision augments its arsenal of arguments on which to seek judicial relief if a former employee commences new employment during the garden leave period. A one-two punch for enforcement could take the following form in an employment agreement or severance plan, for instance:

1. *Garden Leave*: for a fixed number of days (e.g., 30 or 60 days) after an employee gives or receives notice of an employment termination, the employee will be placed on garden leave, during which time the employee will receive salary continuation and continued employee benefits.

2. *Severance Period*: for a designated period after expiration of the garden leave period, the terminated employee will receive severance pay, subject to (i) execution of a claims release when employment terminates, and (ii) honoring any noncompetition, nonsolicitation, confidentiality, nondisparagement, or other "loyalty covenant" upon which the severance is conditioned.

3. *Federal ERISA Relief*: the employer could restructure its executive stock awards, incentive compensation, and/or supplemental retirement benefits into a post-termination package that is both contingent on loyalty covenants, and potentially enforceable under

² See *Duane Jones Co., Inc. v. Burke*, 306 N.Y.2d 172, 178 (1953).

³ The seminal U.K. case is *Evening Standard Co. v. Henderson*, I.C.R. 588594 (1987); see generally, Lembrich, "Note: Garden Leave: A possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants," 102 COLUM. L. REV. 2291, 2308 (2002).

⁴ See *Maltby v. Harlow Meyer Savage Inc.*, 633 N.Y.S.2d 926, 930 (Sup. Ct. 1995) (enforcing a six-month noncompete agreement on condition that employer paid individual's base salary for period that individual is unemployable because of the restrictive covenant). See also *Lumex, Inc. v. Highsmith*, 919 F. Supp. 624, 629-36 (E.D.N.Y. 1996) (finding "special kind of restrictive covenant" reasonable because employer would pay employee's full salary and premiums on health and life insurance during noncompete period).

⁵ 2004 U.S. Dist. Lexis 24525 (N.D. Ill. Dec. 3, 2004).

⁶ *Natsource L.L.C. v. Paribello*, 151 F. Supp. 2d 465, 472 (S.D.N.Y. 2001) (upholding bifurcated noncompete provisions consisting of a pre-termination 30-day notice period and a post-termination provision as reasonable as employer continued to pay individuals' salary during these times. See also *Deutsche Bank Sec. v. Zelnick*, Index no. 10/600986 (N.Y. Sup. Ct. April 2010) (Fried, J.) (granting temporary restraining order preventing employees from working for a competitor during a "notice period" and requiring former employer to allow the employees back during the notice period to service clients if they chose to return).

⁷ 550 F. Supp. 2d 174 (Mass. 2008).

⁸ See also *Bear, Stearns & Co. Inc. v. McCarron*, Civ. Action No. 08-0979-BLS-1 (Mass. Super. Ct. Suffolk County March 5, 2008) (finding garden leave provision not enforceable because it denied clients access to their financial adviser).

federal Employee Retirement Income Security Act laws that preempt state noncompetition laws.⁹

If structured in the above manner, the employer may, if needed, seek to enforce its garden leave provision without regard to state noncompetition laws on the premise that the short duration and wholesale prohibition of employment serves a bargained-for, and fully paid-for, employer protection. If enforcement of the garden leave provision fails, the employer could seek enforcement of its loyalty covenants or other noncompetition protections. For one more layer of enforcement potential, the employer could pursue an aggressive ERISA “top hat” plan design.

With respect to the garden leave provision, courts may view arrangements with continuing employees more favorably to employers than may be the case with ex-employees. Nevertheless, an effective garden leave provision may be viewed as producing the same result as noncompete clauses, albeit generally for a shorter period (with 30 to 180 days being about the range), in that garden leave:

- prevents an employee from unexpectedly going to work for a competitor;
- restricts the employee from access to confidential information;
- may, through sidelining the ex-employee for up to a few months, provide the most critical protection against post-exit competition, solicitations, and disclosures of confidential information; and
- helps employers transition client connections from the terminating employee back to the employer.

⁹ Contact the authors for more information about this strategy.

Q-4: Why not use a garden leave provision? Garden leave is not cost-free or risk-free. It generally involves an advance contractual commitment by the employer to continue an employee’s salary and benefits for a period of weeks or months after the employee’s active services have effectively ended. Employers may hedge this cost by merely reserving the right to pay for garden leave, although this could undercut an argument that transitional services are critical, especially if the employer develops a history of triggering garden leave only for those who leave to join competitors. Effectively, such a practice could indicate that the garden leave provision is a disguised noncompete, and that could jeopardize enforcement efforts.

Courts across the globe have limited the enforcement notice periods to key employees who possess the types of confidential information or unique skills that require time to be preserved by the employer. An overly broad use of garden leave could undercut an employer’s credibility even when only asserting its rights against key employees.

Conclusion

Unlike in the United Kingdom, the judicial enforcement of garden leave provisions in the United States continues to depend on the application of state law principles relating to legitimate business protections. Nevertheless, garden leave has the potential to serve as a healthy complement to a well-coordinated program by which an employer is best positioned to enforce covenants relating to employee loyalty.