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Will Garden Leaves Blossom in the States?

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The authors believe that the trend toward incorporating garden leave provisions in policies and agreements will likely continue as employers seek to protect their confidential information, customer relationships, and other valuable assets. Moreover, they suggest, it is likely that employers—and employees—will begin to test them in the courts in the near future.

The use of "garden leave" provisions—a fixture in the United Kingdom—has been gaining momentum on this side of the Atlantic in recent years, but whether they will yield the benefits that employers want remains to be seen. Under a garden leave provision, employees are required to provide a certain amount of notice before terminating their employment. During that notice period, the employee continues to receive full salary and benefits, but does not work. Because the employment relationship technically continues, employees on garden leave arguably cannot work for others during the garden leave period.

Now that these provisions have been planted for some time, and movement by employees with garden leave provisions is becoming more common, courts are expected to pass on their enforceability in the near future. For example, in late 2005, Morgan Stanley reportedly entered into new agreements with its directors and managing directors, extending the notice period from 30 days to 90 days. Executives and managing directors who did not sign the new agreements reportedly forfeited the stock element of their bonuses.[1] Similarly, in early 2006, Citigroup Inc. reportedly implemented a garden leave policy in its employment manual whereby directors are required to give 50-days' notice, and managing

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directors are required to give 75 days' notice. Adding a twist to their garden leave, Citigroup directors who do not abide by the policy may forfeit bonuses received during the leave period. Citigroup reportedly stated that the garden leave policy was to "ensure minimal disruption" to clients and business, and to allow "ample time to plan the transition of client coverage, work responsibilities and any other outstanding matters."[2] Financial disincentives to violations of garden leave are apparently becoming more commonplace on Wall Street.

GARDEN LEAVE'S ROOTS

The notion of "garden leave" arose among English employers and courts amidst a judicial landscape that left significant uncertainty as to the enforceability of post-employment restrictive covenants. Garden leave is an attempt to avoid the question of *post*-employment restrictions by imposing a mandatory notice period before the employee can resign. (Of course, the employer usually agrees to give the same amount of notice to employees it wants to terminate.) During the notice period, the employer requires an employee not to work, but rather to stay at home "tend the garden"—*i.e.*, not compete—while still receiving full salary and benefits. The theory behind garden leave is that the employment relationship continues to exist during the leave period, so contractual and common law duties prohibit the employee from actively competing. The goal is to keep the employee out of commission long enough for any confidential information they had to become stale, and for the employer to shore up client relationships without interference from the former employee. In effect, a garden leave is another way to obtain a period of non-competition from a departing employee who may have key client relationships, confidential information, or other valuable assets.

The 1986 decision in *Evening Standard Co. v. Henderson*, has been credited with originating the garden leave concept in England.[3] Henderson was a production manager for the *Evening Standard*, which at the time was the only major evening newspaper in London. However, Henderson was recruited to leave the *Evening Standard* and become the production manager of a new, rival publication. He provided the *Evening Standard* with only two months' notice, but his contract provided that "he could not work for any other employer during the term of the contract and that the contract could only be terminated by one year's notice on either side."[4] Pursuant to its contract with Henderson, the *Evening Standard* sought an injunction to prevent him from working for a competitor for a full year. Despite Henderson's letter of resignation, which he believed terminated his contract, the *Evening Standard* still regarded him as an employee and intended "to pay Henderson his full salary and benefits under the contract for the remainder of the required notice period, whether he actually worked for them or not."[5] The court held that Henderson "ought not, pending trial, to be allowed to do the

very thing which his contract was intended to stop him doing, namely working for somebody else during the period of his contract."[6]

Since *Henderson*, garden leave provisions have become recognized among English courts as a legitimate means to protect an employer's business, but they are not without their own limitations. Among other things, the agreement must be explicit with respect to the obligation not to compete during employment and the right to prevent the employee from working during the garden leave.[7] English courts have, in some cases, also limited the context in which it would prevent an employee from working during a garden leave to work that is competitive and similar to that which the employee did for the employer seeking to enforce the leave. In another early garden leave case, *Provident Financial Group v. Hayward*, the employee had agreed to a one year notice requirement that expressly provided for non-competition during employment and garden leave.[8] After Hayward resigned, he negotiated the notice period down to six months. With ten weeks left in the six-month period, Hayward informed Provident that he intended to start working for a competitor, and Provident asked a court to stop him. The court refused Provident's request, finding that there would be no damage to Provident because, although he was working for a competitor, his position there was not similar to his position at Provident. The court still found that the notice provision could give rise to damages, but refused to grant an injunction against Hayward's work for a competitor in a different capacity. The court noted, however that " 'in appropriate circumstances' an employee could be restrained 'under a clause in the contract like those in the defendant's contract.' "[9] Thus, while garden leave is apparently widely recognized in England, it may not be blindly enforced by injunction.

SEEDS OF GARDEN LEAVE IN US LAW

In the United States, published decisions have yet to directly address the enforceability of a garden leave provision. However, some of the concepts behind the enforceability of garden leave have been addressed in the context of post-employment restrictive covenants. For example, it is well settled that, after giving notice of an intent to leave, employees continue to owe their employers a duty of loyalty, and may not engage in active competition. This was made clear in 1953 by the seminal New York decision in *Duane Jones Co., Inc. v. Burke*.[10] That case involved extreme circumstances where a group of directors and officers of the company were found to have informed the principal of the company that if he did not sell them ownership of the company they would form a competing agency and "resign *en masse* within forty-eight hours."[11] After negotiations over such a sale terminated without agreement, the defendants resigned from their roles as officers and directors of the company, but explained in each of their notices that they "would

continue his duties as an employee of the . . . agency, and stated [that] '[a]s an employee, I will continue to service those accounts now assigned to me, to the best of my ability.' "[12] The court found that defendants had conspired to effectively destroy their employer's business, and began doing so by soliciting customers and employees while still employed. They had therefore breached their duties to their employer, albeit after having given notice of their intent to leave and after having strongly indicated their hostility to their employer.

American courts have also recognized that, although a term employment contract cannot be specifically enforced to require an employee to involuntarily provide services (due to the Thirteenth Amendment), "in certain narrowly tailored situations," a term employment contract can be "negatively" enforced to prevent an employee from working for others during the remainder of the term.[13] In 1981, in *American Broadcasting Company v. Warner Wolf*, the New York Court of Appeals explained that,

> where an employee refuses to render services to an employer in violation of an existing contract, and the services are unique or extraordinary, an injunction may issue to prevent the employee from furnishing those services to another person for the duration of the contract.[14]

The court suggested that, for unique employees, a restriction against competing during the term of employment could be implied if the employee had expressly "or by clear implication" agreed not to compete during the term of employment.[15] But for periods after the term of a personal services contract, post-employment restrictions would not be implied. Thus, because ABC was seeking to enjoin Warner Wolf—a sportscaster who was likely a "unique" employee—from "going to the videotape" for a competitor after the term of his employment had ended, and there was no express post-employment restriction on doing so, the court refused to enjoin him from working for a competitor.[16]

Furthermore, in the post-employment context, courts have upheld, under certain circumstances, post-employment non-compete provisions where the employer continued to pay the former employee during the non-compete period. In 1995, for example, a New York court enjoined former employees from working for a competitor under a six-month, paid non-compete provision in *Maltby v. Harlow Meyer Savage Inc.*[17] In *Maltby*, the employees' agreements stated that "[u]pon any breach by the Employee during the Restriction Period of his obligations . . . the Corporation's obligation to pay the Base Salary shall immediately cease."[18] The employees resigned to work with a direct competitor, and the employer sought to enjoin them from doing so under their agreements.[19] The court found that the

> restrictive covenants are reasonable in that each protects the employer from severe economic injury while—at the same time—it protects the

> employee's livelihood, by requiring that he be paid his base salary. [Additionally], [t]he duration of six months is reasonable because that is the amount of time [Harlow Meyer Savage] needs to recover from plaintiff's departure; it is not unduly long so as to cause permanent injury or loss of ability to earn a livelihood.[20]

The court therefore enforced a six-month non-compete, in large part because the former employees continued to be paid to stay out of the business.[21]

A year later, in *Lumex Inc. v. Highsmith*,[22] a federal district court in New York enforced a slightly more limited non-compete provision. In *Lumex*, the employee agreed that, for a period of six months after termination of his employment, he would not work on a "competitive product" for another company.[23] The agreement specifically provided that if the employee is unable to obtain employment due to the non-competition agreement, the employer would continue to pay his base salary and health and life insurance premiums during the restricted period.[24] The court found that the six-month restriction was both reasonable and enforceable, since the former employee could still "work for a competitor, but not on a 'competitive product.'"[25] Also, the court reasoned that six months was a relatively short time period for a non-compete to be imposed, especially considering that the former employee would be fully compensated by receiving his full salary and payment of premiums for health and life insurance.[26]

Coming closer to the point, two more recent decisions indirectly indicated that a non-compete restriction that applied during a notice period and for a period thereafter could be enforced through an injunction, although the decisions did not directly discuss the notice issue. In *Natsource LLC v. Paribello*,[27] a restrictive covenant providing for a 30 day notice period and a 90 day, post-employment non-compete was deemed reasonable by the court. The employment agreement provided that Paribello would provide 30 days' notice of terminating his employment, and that he would not compete with Natsource during his employment or for three months thereafter. During his employment and the three month restricted period, he would be paid his base salary. But if he accepted employment with another employer during that period, such payments would cease. Subsequently, Natsource received a letter by Paribello providing the required 30 days' notice of his intention to terminate his employment agreement. In consideration of giving the required notice, Paribello requested that he receive his bonus as he and Natsource had agreed. However, Natsource claimed that Paribello had breached his obligations by encouraging Natsource employees to work for a competitor and by soliciting Natsource's customers. Natsource therefore refused to pay his bonus, instructed him to stop reporting to work, and demanded that he cease all conduct that was in breach of his obligations to Natsource. Finding that there was no

contractual provision for the bonus, the court enforced the restriction against competition during the notice period and thereafter through an injunction. The court adopted the reasoning in *Maltby* to find that, in light of the provision of payment, the 120-day non-compete period (which therefore included the 30-day notice) was reasonable and enforceable. The court noted that Paribello would not be economically harmed, and that

> a 'trader's absence from trading for [several] months does not render him unemployable within the industry or substantially impair his ability to earn a living. The relationships previously developed with customers can be renewed after that time.'[28]

In contrast, if Paribello were allowed to work for a competitor or solicit Natsource customers within the 120 day period, the court reasoned that Natsource would be irreparably harmed.[29]

Likewise, in *Credit Suisse First Boston LLC v. Scott Vender*,[30] defendant security brokers had signed an agreement to provide 30 days' notice of their intent to terminate their employment, and prohibited them from engaging in any competitive activity or solicitation for an additional 30-day period following their termination. However, defendants terminated their employment with Credit Suisse First Boston without providing the 30 day required notice. They immediately commenced employment with a competing firm, and began soliciting Credit Suisse First Boston clients with whom they had a relationship, in breach of the terms of their employment agreements. While defendants claimed that the 60-day time period of restrictions in the agreement was unduly burdensome, the court held otherwise, finding that the 60-day restricted period provided Credit Suisse First Boston with "an opportunity to cement its relationships with the customers formerly serviced by defendants while defendants are still employed . . . and to continue to work with the clients for an additional 30 days after the defendants' departure without having to deal with competition from their former employees."[31]

While the above decisions may suggest that American courts could enforce a garden leave under certain circumstances, there remain significant questions as to whether the pure non-competition aspect of a garden leave will bear fruit. In most states, before a court will prevent an employee from working for a competitor, the employer is required to demonstrate that doing so is necessary to protect a legitimate business interest, and is not simply sought to prevent otherwise lawful competition. In recent years, such legitimate interests have included client goodwill and relationships, confidential information and trade secrets, and unique services. But some courts have explained that they will not enforce a broad non-compete when a narrower restriction—such as a non-solicitation and non-service provision—will protect those interests.

For example, in *BDO Seidman v. Hirshberg*, the New York Court of Appeals ruled that an employer has a legitimate interest in protecting against a former employee's "competitive use of client relationships which [the employer] enabled him to acquire . . . during the course of his employment."[32] However, the court also explained that, although the employer claimed to want to protect its client base,

> [T]he only justification for imposing an employee agreement not to compete is to forestall unfair competition. . . . If the employee abstains from unfair means in competing for those clients, the employer's interest in preserving its client base against the competition of the former employer is no more legitimate and worthy of contractual protection than when it vies with unrelated competitors for those clients.[33]

There also remain questions as to whether there are valid justifications for treating garden leave more favorably than post-employment non-competition agreements. Among other things, in the financial community where employees are compensated primarily through bonuses or commissions, there is an issue whether continued payment of salary would suffice to protect the employee from (relative) economic hardship during a garden leave period. It remains to be seen, then, how courts will respond when directly confronted with the types of garden leave provisions that are becoming commonplace in the United States.

VARYING APPROACHES TO GARDEN LEAVES

There are many ways for employers to incorporate the garden leave concept into their agreements and policies. Perhaps the most obvious way of implementing garden leave is to include a notice period with an explicit non-competition provision in an employment agreement. An employer could also adopt garden leave by incorporating it in their employee policies. For example, an employer could issue a policy requiring 90 days' notice and providing that employees cannot compete during the notice period. Such a practice, however, could face questions about whether a handbook policy can constitute an enforceable garden leave contract. In the context of handbooks that mandate that all disputes are submitted to arbitration, some courts have held that continued employment by an employee after the promulgation of an arbitration policy sufficed as consideration and acceptance of an arbitration requirement.[34] But courts have relied on the strong public policy favoring arbitration in so holding. In contrast, courts consistently make clear that there is strong public policy against restrictive covenants for employees. As the New York Court of Appeals has explained, "[r]outinely issued employee manuals, handbooks and policy statements should not

lightly be converted into binding employment agreements."[35] The more certain route for employers, then, is to obtain affirmative agreement to garden leave provisions from their employees.

The garden leave concept may also be tied to financial incentives. Employers may consider conditioning the receipt and/or retention of bonuses, stock options, and other forms of executive compensation to compliance with a garden leave provision. Citigroup reportedly did just that by requiring that a director return any bonus received during the 50-day or 75-day period prior to resigning without notice. Thus, if a director gave only two weeks' notice, and received a bonus a month before resigning, the director would have forfeited the right to retain that bonus under the terms of the garden leave provision. When doing so, however, employers should keep in mind that there may be a significant legal distinction between imposing the garden leave as a condition of earning and retaining compensation that has not yet been earned, and imposing the garden leave as a condition of retaining compensation that has already been earned. Some states prohibit the forfeiture of certain types of compensation, even by agreement, and an attempt to claw back what has already been earned may run afoul of such laws. Even without those laws, there may be significant questions about whether conditions can be added to compensation that may not have been paid but has already been earned. Employers who are considering tying compensation to garden leave provisions should also consider whether doing so might reduce their odds of obtaining an injunction that prevents the employee from working during the leave period. A court could potentially deem the forfeiture or loss of entitlement to compensation to constitute liquidated damages or the sole remedy intended for the failure to provide notice. Employers should expressly provide for injunctive relief in the garden leave provision to help avoid such a result.

CLICKING ONTO GARDEN LEAVE

While "garden leave" may sound like a Victorian-era concept, employers should keep in mind that incorporating that concept does not necessarily have to involve paper and ink. Email and the Internet make it possible for employers to promulgate notice and garden leave policies to large groups of employees in the blink of an eye. And just as garden leave agreements have become more commonplace, so has the use of electronic signatures for employees to execute them. An electronic signature can take many forms, from typing the signer's name into the signature area, to pasting in a scanned version of the signer's signature, to signatures secured by cryptographic technology, to the simple click of an "I Agree" button on a page containing the terms of the agreement. Most states have adopted the Uniform Electronic Transactions

Act (UETA), which establishes the legal validity of electronic signatures, stating that "when an electronic signature is used, contracts created online are now as legal as those on paper."[36] According to the National Conference of Commissioners on Uniform State Laws, only Georgia, Illinois, New York, and Washington have not enacted UETA. However, these states have their own laws recognizing electronic signatures. For example, New York's Technology Law Section 304 (2006) states that "an electronic signature may be used by a person in lieu of a signature affixed by hand. The use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand."

Moreover, the Electronic Signatures in Global and National Commerce Act, otherwise known as E-SIGN, removed much of the uncertainty that used to surround e-contracts. Under E-SIGN, electronic signatures are deemed as legal and enforceable as a traditional ink signature. E-SIGN defines an electronic signature as "an electronic sound, symbol, or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record," and states that "a contract relating to such transaction may not be denied legal effect, validity, or enforceability solely because an electronic signature or electronic record was used in its formation."[37] To additionally protect consumers, E-SIGN provides that

> (i) prior to consenting, [consumers are] provided with a statement of the hardware and software requirements for access to and retention of the electronic records; and (ii) consents electronically, or confirms his or her consent electronically, in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is subject to the consent.[38]

Employers may therefore be able to promulgate garden leave provisions *en masse* through their networks, and have employees sign on to them with the simple click of a button.

CONCLUSION

Following Wall Street's lead, the trend toward incorporating garden leave provisions in policies and agreements will likely continue as employers seek to protect their confidential information, customer relationships, and other valuable assets. Since garden leave provisions have been in place for a few years in the United States, one can expect that employers—and employees—will begin to test them in the courts in the near future. Until then, whether, and in what form, garden leave will take root and bloom in the United States will remain an open question.

NOTES

1. Shanny Basar, "Mack and Cruz Sign Revised Morgan Stanley Contracts," Nov. 29, 2005, *http://news.efinancialcareers.com/NEWS_ITEM/newsItemId-5137.*

2. George Stein, "Citigroup Requires Bankers to Give 50-Day Notice of Lose Bonus," Jan. 17, 2006, *http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aFn4oFviDblk.*

3. Greg T. Lembrich, "Note: Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants," 102 *Colum. L. Rev.* 2291, 2308 (citing [1987] I.C.R. 588 (C.A. 1986).

4. *Id.*

5. *Id.* at 2309.

6. *Id.*

7. *Id.* at 2311–2313.

8. *Id.* at 2309–2310 (citing [1989] 3 AII E.R. 298 (C.A. 1988)).

9. *Id* at 2311 (citing [1989] 3 AII E.R. at 302).

10. 306 N.Y. 172, 178 (1953).

11. *Id.* at 181.

12. *Id.* at 182.

13. 52 N.Y. 2d 394, 402 (1981).

14. *Id.*

15. *Id.*

16. *Id.* at 406.

17. 166 Misc. 2d 481, 482 (Sup. Ct. N.Y. Co. 1995).

18. *Id.* at 484.

19. *Id.*

20. *Id.* at 486.

21. *Id.* at 487.

22. 919 F. Supp. 624 (E.D.N.Y. 1996).

23. *Id.* at 626.

24. *Id.*

25. *Id.* at 636.

26. *Id.*

27. 151 F. Supp. 2d 465 (S.D.N.Y. 2001).

28. *Id.* at 472.

29. *Id.*

30. 2004 U.S. Dist. LEXIS 24525 (N.D. Ill. Dec. 3, 2004).

31. *Id.* at *6.

32. 93 N.Y.2d 382 , 392 (1999).

33. *Id.* at 391.

34. *See, e.g.,* Gonzalez v. Toscorp Inc., 1999 U.S. Dist. LEXIS 12109, at *6 (S.D.N.Y. Aug. 5, 1999).

35. Lobosco v. N.Y. Tel. Co., 96 N.Y.2d 312, 317 (2001).

36. Unif. Elec. Transactions Act 7, 7A U.L.A. 21, 43 (Supp. 2001).

37. 15 U.S.C.S. § 7001 (a) (1)- (2) (2007).

38. *Id.* at (c)(1)(C)(i)-(ii).

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