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EMPLOYMENT UPDATE

Garden Leave Provisions: Can They Help Fight Unfair Competition by Former Employees?

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Employers in the United States frequently utilize non-competition and non-solicitation agreements to try to minimize the business risks that arise when employees depart to join a competitor. However, these agreements sometimes do not have the intended effect, as many employers have learned, because courts are often reluctant to issue injunctions to enforce them due to the potentially detrimental financial impact on the employee and the employee's family. In reaction, American companies have begun weighing the benefits of including "garden leave" provisions as part of written employment agreements.

Garden leave provisions are used by employers in England and elsewhere. Through them, the employer continues to pay the departing employee's salary and contractual benefits in exchange for the employee agreeing to sit "idly" by in the "garden" (or rather, at home) during the notice period provided in the employment contract. This garden leave often lasts up to 180 days, sometimes longer. The departing employee remains a paid employee during the notice period, retaining a duty of loyalty to the employer, and is prevented from working for anyone else.

Of course, the employer must evaluate the nature of its business and the type of job performed by particular employees to determine whether it makes economic sense to place departing employees on garden leave to prohibit potentially competitive behavior in the first place.

Benefits of Garden Leave Provisions

Garden leave benefits an employer by providing an often lengthy notice period in advance of an employee's resignation. During the garden leave period, the employer has the opportunity to prohibit the employee's competitive conduct (including solicitation of existing clients or co-workers) and, perhaps most importantly, build relationships with the departing employee's contacts. A well-drafted provision may also be an effective tool to prevent a departing employee from accessing the employer's records or data during the notice period and to prohibit him from sending confidential materials or information to prospective employers.

Lessons Learned in the Financial Services Industry

Firms in the financial services industry, often maintaining offices in both the United States and England, have been among the first to implement and seek enforcement domestically of garden leave provisions. One company at the helm of litigating these provisions was Bear Stearns & Co. In the spring of 2008, Bear Stearns attempted to enforce its garden leave provisions against some of the more senior of a number of departing brokers; Bear Stearns had not previously been using (or enforcing) these provisions in the United States. Although the results in the cases litigated by Bear Stearns varied by jurisdiction, valuable insight into the potential problems employers may face when seeking to enforce those provisions may be found in two different Massachusetts matters.

In *Bear Stearns & Co. v. McCarron*, filed in Massachusetts state court, Bear Stearns sought to enforce a 90-day mandatory notice provision against three high-producing, departing brokers. The brokers had resigned in February 2008 to work at Morgan Stanley, where they intended to continue providing financial advice to the private clients that they previously serviced at Bear Stearns. The court refused to grant the injunction sought by Bear Stearns to enforce the provision, noting that the brokers never signed any type of non-competition or non-solicitation agreements (nor any documents that promised to give Bear Stearns prior notice of their resignation). Instead, the court found the provision to be "buried" in the company's deferred compensation plan documents, which did not require any signature by the employees.

According to the court, Bear Stearns should have obtained signed employment agreements in which the employees were "fairly told of the restrictions" and given an opportunity to accept them. Furthermore, because the departing brokers would likely be prohibited from serving their clients during the 90-day garden leave, enforcing the notice provision would be "fundamentally unfair to the [brokers'] private clients at Bear Stearns," who would be left with uncertainty as to who would actually be responding to their needs during "turbulent financial times." Ultimately, the court refused to enforce a contract provision "that may deny clients a choice of financial advisors for up to 90 days."

In April 2008, the US District Court for the District of Massachusetts in *Bear Stearns & Co. v. Sharon* found similar problems with another Bear Stearns garden leave provision. In that case, Bear Stearns sought to enforce a garden leave provision against another resigning broker (and managing director of its Boston office) who also left for Morgan Stanley. This time, the provision was included within a memorandum to all Senior Managing Directors entitled "Terms of Employment at Bear Stearns-United States," which was signed by the broker. The garden leave provision required the broker to give 90 days' written notice before resigning, during which time Bear Stearns would pay him his base salary while reserving the right to decide what duties (if any) he would perform. By its own terms, this provision was enforceable through a temporary restraining order.

Although the court initially issued a temporary restraining order, it ultimately refused to issue a preliminary injunction because the effect of such an injunction would require the broker to "continue an at-will employment relationship against his will," and if given its full effect, would have forced the broker to submit to Bear Stearns' "whim regarding his employment activity in the near future." Importantly, the court distinguished the garden leave provision from a traditional non-compete or non-solicitation agreement, concluding that "a different result might be warranted" if the provision was a "simple restrictive covenant against competition or the solicitation of clients." As in the *McCarron* case, the court noted that the provision had the potential for cutting the broker's clients off from their "trusted economic advisor" during financially troubling times.

Finally, although the court refused to grant a preliminary injunction, it did recognize that Bear Stearns had the potential to recover monetary damages from the broker if the arbitration board determined that he acted wrongfully. Monetary damages would force the broker to face the consequences of his actions without disadvantaging innocent clients.

In contrast to these Massachusetts cases, Bear Stearns appeared to have more success with a garden leave provision in New York, where it reportedly filed at least six cases against departing brokers. In *Bear Stearns & Co. v. Arnone*, the New York State Supreme Court in New York County issued a preliminary injunction in March 2008 against a broker seeking to join Lehman Brothers. The departing broker admitted that, during the garden leave period, she contacted her Bear Stearns clients to inform them that she would be on garden leave for 90 days but could thereafter be reached at Lehman Brothers. The court's injunction prohibited the broker from "soliciting, contacting, or communicating" with clients pending a determination by the arbitrator assigned to the case.

Practical Measures to Consider

These seemingly irreconcilable cases suggest that employers may have difficulties and face inconsistent outcomes when trying to enforce garden leave provisions. Thus, employers must be mindful of the jurisdiction in which they seek to enforce garden leave provisions.

Because courts may view garden leave provisions as restrictive covenants, such provisions likely will be subject to heightened scrutiny. In particular, before implementing garden leave provisions, employers must be aware of any specific state law requirements or limitations upon the enforceability of restrictive covenants. According to some commentators, certain states (including California, Georgia, Louisiana and Wisconsin) require special consideration. For example, in California, covenants not to compete are void, subject to several statutory exceptions. Under Georgia law, non-competition agreements that are ancillary to employment and prohibit departing employees from accepting unsolicited business from former clients are unenforceable. Texas, too, has restrictions on the scope of, and consideration required for, restraints to be enforceable. Nationally, however, garden leave provisions may be an effective part of an employer's overall

strategy to minimize the potentially harmful effect of departing employees.

In appropriate jurisdictions, while garden leave provisions standing alone may be insufficient to prevent departing employees from immediately competing with their former employers, such provisions may be coupled with non-competition and non-solicitation agreements to minimize the potential for harm when valuable, senior employees depart to join the competition. As the *Bear Stearns* cases make clear, however, for maximum enforceability, it is important to carefully draft any such agreements to avoid becoming snared or entangled in the "garden" of restrictive covenants.

For more information about garden leave provisions, the cases mentioned in this Update, or employment agreements generally, please contact the Mayer Brown lawyer with whom you regularly communicate, or one of the lawyers listed below.

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