

## A Lower Level of Scrutiny?

### New Alternatives for an Effective Restraint on Competitive Activity

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For decades, courts in Illinois and all over the country have struggled with the enforcement of contractual terms that forbid an employee from competing with a former employer. Courts must weigh an employer's right to protect its interests against the employee's ability to earn a livelihood. This analysis often leads to unpredictable results and makes it difficult for employers to predict whether particular contractual restrictions will be enforced by a reviewing court.<sup>1</sup>

Despite this uncertainty, there are measures that employers can take to make results more predictable. For example, several decisions have embraced the idea of "forfeiture-for-competition" clauses that condition an employee's receipt of certain benefits on that employee's promise not to compete with the former employer. If the employee competes, he or she will not be entitled to the benefit. Importantly, these forfeiture-for-competition clauses have been subjected to a lower level of scrutiny than traditional non-competition clauses. Additionally, recent decisions suggest that courts are more likely to enforce a restriction provision where the company alleviates the effect of the former employee's "loss of livelihood" by paying the former employee during the non-compete period.

These developments suggest that courts may be willing to enforce an arrangement that has developed in the United Kingdom, termed "garden

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1. See Greg T. Lembrich, Note, *Garden Leave: A Possible Solution to the Uncertain Enforceability of Restrictive Employment Covenants*, 102 COLUM. L. REV. 2291, 2291 (2002) ("Restrictions such as non-competition and non-solicitation agreements have long been present in many American employment contracts. Courts, however, have historically been skeptical of such provisions and often refused to issue injunctions to enforce them. The resulting uncertainty has proven to be a major problem for employers in many industries, who are left with no reliable means of keeping their key employees from joining a competitor or competing themselves.").

leave.” Garden leave refers to a situation where an employee submits a date certain for resignation in the future and thereafter receives a paycheck while not performing any duties whatsoever for the employer. The notice period under the contract essentially acts as the time period that the employee’s competitive activities will be restrained.

This Article reviews these legal alternatives and ultimately suggests that arrangements requiring payment and retention of employee status during a restricted time period may be subjected to a lower level of scrutiny than traditional non-competition agreements. If this is true, employers would be well-advised to enter into such arrangements with important employees to ensure greater predictability of court review and ultimately greater protection of their valuable business interests.

#### I. TRADITIONAL ANALYSIS OF NON-COMPETITION AGREEMENTS AS “RESTRAINTS OF TRADE”

Under Illinois law, a restrictive covenant will be closely scrutinized and only enforced if the party seeking to enforce the covenant can prove that it has a protectable interest and that the terms of the restrictive covenant are reasonable and necessary to protect that legitimate interest.<sup>2</sup> This rule is well-established, but somewhat unpredictable. As this Article’s focus is not on the traditional non-compete analysis, this section will merely summarize as background the standards typically applied to non-competition agreements under Illinois law.

Because “[c]ovenants not to compete are, in effect, restraints on trade,” they are rigorously scrutinized by Illinois courts “to ensure that their intended effect is not the preclusion of competition *per se*.”<sup>3</sup> Accordingly, in determining the enforceability of a covenant not to compete, the “test applied by Illinois courts is whether the terms of the agreement are reasonable and necessary to protect a legitimate business interest of the employer.”<sup>4</sup> A legitimate business interest exists in two situations:

- (1) where the customer relationships are near permanent and, but for his association with the employer, the former employee would not have had contact with the customers; and
- (2) where the former employee acquired trade secrets or other confidential information through his employment and subsequently tried to use it for his own benefit.<sup>5</sup>

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2. Capsonic Group v. Swick, 537 N.E.2d 1378, 1382 (Ill. App. Ct. 1989).

3. Dam, Snell & Taveirne, Ltd. v. Verchota, 754 N.E.2d 464, 468 (Ill. App. Ct. 2001).

4. *Id.*

5. *Id.* at 469.

Even where a legitimate interest exists, the restriction's reasonableness still must be "measured by its hardship to the employee, its effect upon the general public, and the reasonableness of the time, territory, and activity restrictions."<sup>6</sup>

This is a rather stringent standard and courts have repeatedly stated that non-competition clauses are disfavored under Illinois law.<sup>7</sup> Illinois courts will not enforce a non-competition clause merely because the parties agreed to such an arrangement.<sup>8</sup> Using a complicated framework with multiple factors to weigh, Illinois courts have arrived at different results in seemingly similar cases.<sup>9</sup> As a result, the current state of the law regarding non-competition agreements forces employers to blindly place their faith in a reviewing court's hands to determine whether the business interest is indeed "legitimate" and whether the restrictions contained in the covenant are "reasonable." The level of predictability presents a complicated quandary for employers who have crafted post-employment restrictions to protect what they believe are important business interests.

## II. FORFEITURE-FOR-COMPETITION AGREEMENTS

Because of the high level of scrutiny courts give to post-employment restrictions, employers have begun to seek alternatives to protect their business interests with a greater level of certainty. One alternative method some employers use to attempt to lower the level of scrutiny applied to post-employment restrictions is to insert "forfeiture-for-competition" provisions in stock incentives or other types of compensation arrangements.<sup>10</sup> Essentially, under a forfeiture-for-competition clause, a former employee receives some form of payment (usually stock options or some other form of deferred compensation) in exchange for the employee's agreement not to compete with the former employer for a specified period of time.<sup>11</sup> If the former employee wishes to compete with the former employer during the relevant time

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6. *Lawrence & Allen, Inc. v. Cambridge Human Res. Group, Inc.*, 685 N.E.2d 434, 441 (Ill. App. Ct. 1997).

7. *Sarnoff v. Am. Home Prods. Corp.*, 607 F. Supp. 77, 79 (N.D. Ill. 1985), *aff'd and rev'd in part on other grounds*, 798 F.2d 1075 (7th Cir. 1986).

8. *Advent Elec., Inc. v. Buckman*, 112 F.3d 267, 274 (7th Cir. 1997).

9. *Compare Unisource Worldwide, Inc. v. Carrara*, 244 F. Supp. 2d 977, 982 (C.D. Ill. 2003) (providing that a two-year restriction would be unreasonable), *with Millard Maint. Serv. Co. v. Bernero*, 566 N.E.2d 379, 387-88 (Ill. App. Ct. 1990) (finding a two-year time restriction in a non-competition covenant reasonable).

10. *James V. Garvey & Frederic T. Knape, Employee Stock Forfeiture Provisions—A Different Breed of Restrictive Covenant*, 94 ILL. B.J. 376, 376-77 (2006).

11. *Id.*

period, the employer simply refuses to confer the deferred benefit on the former employee—it is “forfeited” because of the former employee’s competition.<sup>12</sup>

In *Tatom v. Ameritech Corp.*, a leading case in the Seventh Circuit, the court held that a “forfeiture-for-competition” agreement is subject to less scrutiny than a traditional non-compete agreement.<sup>13</sup> *Tatom* involved a former executive of Ameritech who left the company to work for a competitor.<sup>14</sup> The former executive, Tatom, had entered into a forfeiture-for-competition agreement with Ameritech whereby he forfeited his stock options if he competed with Ameritech.<sup>15</sup> Tatom argued that the forfeiture clause was “an unreasonable, anti-competitive restraint on his ability to obtain subsequent employment.”<sup>16</sup>

In analyzing the forfeiture-for-competition clause at issue in *Tatom*, the Seventh Circuit first noted that Illinois disfavors non-compete provisions in employee contracts.<sup>17</sup> The court went on to reason:

This is not a case that involves a facially anti-competitive provision; nothing in the agreements at issue actually restricted Tatom’s ability to work for Ameritech’s competitors. Federal cases draw a distinction between provisions that prevent an employee from working for a competitor and those that call for a forfeiture of certain benefits should he do so . . . .

An anti-competitive clause, if that is what the forfeiture provision here is, may still be enforced in Illinois as long as it is reasonable. A provision that calls for the forfeiture of a bonus in the form of stock options does not strike us as an unreasonable restraint on competition.<sup>18</sup>

The Seventh Circuit in *Tatom* also found relevant that the compensation at issue was stock options.<sup>19</sup> The court reasoned that because stock options allow the employee to acquire an ownership interest in the company, the options may legally be forfeited if the

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12. *Id.* at 377; see also John Fells, *Garden Leave: A New Weapon Against a Departing Employee*, N.Y. L. J., May 29, 1997, at 34 (discussing New York cases “indicative of a judicial willingness to enjoin an employee from working for a competitor when the former employer has agreed to pay the employee for the period she is out of work”).

13. *Tatom v. Ameritech Corp.*, 305 F.3d 737, 744–45 (7th Cir. 2002).

14. *Id.* at 738.

15. *Id.* at 740.

16. *Id.* at 744.

17. *Id.*

18. *Id.* at 744–45 (citations omitted).

19. *Id.* at 745.

holder of the options goes to work for a competitor.<sup>20</sup> The Seventh Circuit did not explicitly consider the impact of the forfeiture-for-competition arrangement on Tatom's ability to make a living, but the court noted that a forfeiture provision that directly affected a person's livelihood would be more strictly scrutinized.<sup>21</sup>

Although *Tatom* is the Seventh Circuit's most recent pronouncement on the subject of forfeiture-for-competition clauses, it is not the first. The seminal Seventh Circuit case addressing such clauses is *Schlumberger Technology Co. v. Blaker*.<sup>22</sup> *Schlumberger* is important because it delves deeply into the subject of forfeiture-for-competition clauses and examines the policy rationales for enforcing them.<sup>23</sup> Judge Easterbrook's insightful opinion endorsing forfeiture-for-compensation clauses explains that the key to a successful provision is that it not threaten an employee's economic livelihood:

Forfeiture contracts leave the ex-employee free to make a living as he chooses. The former employee accepts the money (and refrains from competition) only when the total income from the package plus non-competitive employment exceeds the income he could earn from competitive employment. Having such a choice does not threaten "loss of livelihood," so New York and the majority of other states that have considered the question enforce these agreements.<sup>24</sup>

A subsequent case in the Northern District of Illinois followed this reasoning. In *Spitz v. Berlin Industries, Inc.*, Judge Kocoras properly observed that in *Schlumberger*, the Seventh Circuit simply applied an economic analysis to determine whether the forfeiture-for-competition clause should be enforceable.<sup>25</sup> Further, he noted that "forfeiture provisions, unlike covenants not to compete, do not threaten one's ability to earn a livelihood. For that reason, forfeiture provisions need not be analyzed like covenants not to compete."<sup>26</sup>

*Schlumberger* and *Spitz* provide clear precedent that the most significant factor in favor of enforcing forfeiture-for-competition clauses is that they do not threaten the affected employee's ability to earn a livelihood.<sup>27</sup> This rationale has been accepted in other

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20. *Id.*

21. *Id.* at 744–45.

22. *Schlumberger Tech. Corp. v. Blaker*, 859 F.2d 512, 516 (7th Cir. 1988).

23. *Id.*

24. *Id.*

25. *Spitz v. Berlin Indus., Inc.*, No. 93 C 6355, 1994 WL 194051, at \*3 (N.D. Ill. May 13, 1994).

26. *Id.* (citing *Schlumberger Tech. Corp. v. Blaker*, 859 F.2d 512, 516 (7th Cir. 1988)).

27. *Spitz*, 1994 WL 194051, at \*3; *Schlumberger*, 859 F.2d at 516.

jurisdictions as well.<sup>28</sup> As will be discussed later, this economic rationale for enforcement provides an excellent basis for applying a similar analysis to slightly different restrictions on future employment.<sup>29</sup>

The forfeiture-for-competition line of cases is extraordinarily significant because it allows a post-employment restriction to escape the higher level of scrutiny Illinois courts typically place on restrictive covenants. This lower level of scrutiny allows employers to place broad restrictions on post-employment activity that a reviewing court will only refuse to uphold if the restriction is found “unreasonable.” Prior precedent has somewhat eliminated a portion of the reasonableness analysis, holding that such clauses generally do not have the same hardship to the employee or effect on the general public as restrictive covenants. This is a far cry from the exacting and unpredictable standards found in Illinois precedent that require the covenant to be reasonable and necessary to protect a legitimate business interest of the employer.

Although Seventh Circuit precedent provides an excellent rationale for subjecting a post-employment restriction to a lower level of scrutiny, the forfeiture-for-competition clause still presents problems in terms of employers’ protection of interests. First and foremost, under a forfeiture-for-competition arrangement, the former employer cannot obtain an injunction to prevent the former employee from competing.<sup>30</sup> By its very terms, the only remedy for the employer under the forfeiture-for-competition clause is to stop any payment of the forfeited sums. The former employee could, of course, retaliate by filing a lawsuit challenging the forfeiture clause as unreasonable. This would be the worst result for the employer—it leaves the employer (1) without a contractual remedy against the former employee’s competitive conduct, and (2) facing a potentially expensive lawsuit defending the legal validity of the forfeiture-for-competition clause. Therefore, although an attractive option for employers, forfeiture-for-competition clauses have serious drawbacks.

Wouldn’t it be nice to have all of the benefits of a forfeiture-for-

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28. See *Everett v. Nefco Corp.*, No. 3:06-cv-00047(VLB), 2007 WL 2936210, at \*2 (D. Conn. Oct. 9, 2007) (quoting *Spitz v. Berlin Indus., Inc.*, No. 93 C 6355, 1994 WL 194051, at \*3 (N.D. Ill. May 13, 1994)) (noting that forfeiture provisions are distinct from restrictive covenants in that they do not inhibit a person’s ability to earn a living).

29. See *infra* Part IV.C (examining how courts would interpret a garden leave arrangement).

30. Although the employer would be unable to seek an injunction pursuant to the forfeiture-for-competition clause, there may be other grounds for the employer to seek injunctive relief, including a violation of a contractual confidentiality clause, violation of the Illinois Trade Secrets Act, a breach of the duty of loyalty, or a tortious interference claim.

competition clause without these potential drawbacks? The remainder of this Article tackles this very question.

### III. GARDEN LEAVE

A concept somewhat similar to forfeiture-for-competition clauses is an arrangement commonly used in England called “garden leave.”<sup>31</sup> Although garden leave is a well-established practice in the United Kingdom, it is a concept that is relatively foreign to the U.S. courts. Garden leave refers to the situation where an employee submits a certain date for resignation in the future and, thereafter, receives a paycheck while sitting at home tending to his “garden.”<sup>32</sup> During this period, the person remains an employee collecting a salary, but does not perform any duties whatsoever for the employer. Rather, the employee’s only duty during this time is to remain idle and not compete with the employer. The employer’s interests are protected in that the employee is not competing, and the employee’s interests are protected in that he continues to earn a living by receiving a paycheck from his employer.<sup>33</sup>

Assuming a court would enforce a garden leave provision, the advantages to an employer of using garden leave as a restriction on future employment are enormous. For one, the employee remains employed and, therefore, is subject to all of the duties that apply to a current employee—i.e., the duty of loyalty. Further, should an employee attempt to join a competitor during the garden leave period, the original employer will have many weapons to counter that activity, including seeking an injunction to stop the competing employment. This is different than a forfeiture-for-competition clause, which, as discussed earlier, does not in and of itself permit an injunction as a remedy. Under a forfeiture-for-competition clause, the employer merely quits paying the benefit. Under a garden leave arrangement, the employer can file a lawsuit seeking injunctive relief to stop the competing activity. This is an extremely attractive option for employers because it allows for greater protection of important business interests and can halt the employee’s competitive activities nearly instantaneously through a temporary restraining order and preliminary injunction.

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31. See Lembrich, *supra* note 1, at 2291 (describing England’s solution to non-competition agreements).

32. *Id.*; see also Fellas, *supra* note 12, at 1 (explaining the concept of garden leave and the reasons why it is standard in certain types of English contracts).

33. Lembrich, *supra* note 1, at 2292.

An excellent summary of garden leave and its development in American courts can be found in Greg Lembrich's 2002 Note.<sup>34</sup> As noted by Lembrich, garden leave is a concept that has not received a lot of scholarly attention and has not yet been refined and developed by American courts.<sup>35</sup> There are, however, several key cases applying the general concept of garden leave and suggesting that it may be a viable and enforceable alternative to traditional restrictive covenants under certain circumstances. This Part briefly summarizes the development of this doctrine on the American side of the pond and adds several more recent cases to the developing case law.

Most of the cases addressing compensation arrangements with restrictions similar to garden leave have occurred in New York. For example, in *Maltby v. Harlow Meyer Savage, Inc.*, a New York state court upheld a six-month restriction in part because the affected employees would continue to receive their salary during the six-month period.<sup>36</sup> In finding this restriction reasonable, the court explicitly noted that the payment of base salary "protects the employee's livelihood."<sup>37</sup> Similarly, in *Lumex, Inc. v. Highsmith*, a federal court in New York stated that "the crucial issue" in the case was how to interpret "a special kind of restrictive covenant, one that compensates a former employee who cannot work because of the terms of the agreement."<sup>38</sup> In granting the employer preliminary injunctive relief, the court relied in part on *Maltby*, holding that the restriction was reasonable in light of the fact that the employee would receive his salary "including payment of premiums for health and life insurance" during the restricted period.<sup>39</sup>

The concept of compensating an employee for a period of non-competition was developed further by the Second Circuit, applying New York law, in *Ticor Title Insurance Co. v. Cohen*.<sup>40</sup> *Ticor* involved a title insurance company seeking an injunction against a former title insurance salesman who went to work for a competitor.<sup>41</sup> The salesman had entered into an employment contract with Ticor that included a six-month non-competition provision following the termination of the

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34. *See id.* (comparing restrictive covenants in the United States and garden leave policies in the United Kingdom).

35. *Id.* at 2292-93.

36. *Maltby v. Harlow Meyer Savage, Inc.*, 633 N.Y.S.2d 926, 930 (N.Y. Sup. Ct. 1995).

37. *Id.*

38. *Lumex, Inc. v. Highsmith*, 919 F. Supp. 624, 629 (E.D.N.Y. 1996).

39. *Id.* at 636.

40. *Ticor Title Ins. Co. v. Cohen*, 173 F.3d 63, 71 (2d Cir. 1999).

41. *Id.* at 66-67.

salesman's employment.<sup>42</sup> The contract also included \$600,000 in annual compensation and an express provision that Ticor was only entering into the agreement contingent on the salesman abiding by his contractual post-employment restrictions.<sup>43</sup> The Second Circuit looked to *Maltby* for guidance in analyzing the enforceability of this non-competition provision and held as follows:

Appellant maintains that *Maltby* can be distinguished, because in that case the employees were paid their base salary during the restricted period, while [the salesman] will receive nothing during his six-month hiatus. The significance of the salary paid in *Maltby* was that it helped alleviate the policy concern that non-compete provisions prevent a person from earning a livelihood. Here, by the same token, part of [the salesman's] \$600,000 per year salary was in exchange for his promise not to compete for six months after termination, and since the employer had given [the salesman] sufficient funds to sustain him for six months, the public policy concern regarding impairment of earning a livelihood was assuaged.<sup>44</sup>

*Ticor* is a somewhat surprising decision in that it extends the logic of *Maltby* to situations where certain money is paid in the form of salary even *before* the employee manifests his desire to move to a competitor. The Second Circuit's analysis was likely impacted somewhat by the high salary the salesman received. Nonetheless, *Ticor* indicates that a court will not be greatly concerned about an employee's ability to earn a livelihood if the employer pays a significant amount of money related to a post-employment restriction.

The most recent decision from the Southern District of New York analyzing an arrangement similar to garden leave is *Estee Lauder Cos., Inc. v. Batra*.<sup>45</sup> The defendant Batra, a senior executive for two of Estee Lauder's brands, left to work for a competitor.<sup>46</sup> Batra, however, had previously entered into a restrictive covenant with Estee Lauder that restricted him from working with any of Estee Lauder's competitors for a period of one year upon termination of his employment.<sup>47</sup> Additionally, Batra's employment agreement with Estee Lauder provided that he would receive his full salary during the restricted period.<sup>48</sup> Estee Lauder sued Batra, seeking preliminary injunctive relief

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42. *Id.* at 66.

43. *Id.* at 67.

44. *Id.* at 71.

45. *Estee Lauder Cos., Inc. v. Batra*, 430 F. Supp. 2d 158 (S.D.N.Y. 2006).

46. *Id.* at 164–65.

47. *Id.* at 162.

48. *Id.*

to enjoin Batra from violating the terms of the employment agreement.<sup>49</sup>

The court looked to the reasonableness of the restrictions found in the employment agreement in analyzing whether preliminary injunctive relief should have been granted.<sup>50</sup> In addition to looking at the traditional factors of durational reasonableness and geographic scope, the court reasoned:

An additional factor courts will look to in evaluating the reasonableness of a restrictive covenant is whether an employee receives continued consideration for his loyalty and good will . . . . The desire to avoid “impairing the employee’s ability to earn a living,” is largely mitigated where an individual continues to receive a salary in return for not competing.<sup>51</sup>

Applying this rationale, the court went on to hold that although the geographic scope of the restrictive covenant was “all-encompassing,” the fact that Batra would receive his salary during the period of the prohibition meant that his ability to earn a living would not be jeopardized.<sup>52</sup> Despite finding the compensation element relevant, the court declined to enter an injunction lasting for the contractual twelve-month restriction.<sup>53</sup> The court held that a five-month period was sufficient to protect Estee Lauder’s trade secrets.<sup>54</sup>

#### IV. APPLICATION OF FORFEITURE-FOR-COMPETITION JURISPRUDENCE TO GARDEN LEAVE

As this Article has indicated, the forfeiture-for-competition line of cases in Illinois opens the door for restrictions on employment that are subject to a lower level of scrutiny than traditional non-competition clauses. Furthermore, garden leave provisions may also be subjected to this lower level of scrutiny.

As previously discussed, one of the biggest shortcomings of forfeiture-for-competition clauses is that they do not allow the original employer to seek an injunction prohibiting competition. The employer’s only recourse with respect to a competing former employee is to withhold a particular benefit. This is one of the most important differences between a garden leave arrangement and a forfeiture-for-

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49. *Id.* at 160.

50. *Id.* at 180.

51. *Id.* (internal citations omitted).

52. *Id.* at 181.

53. *Id.*

54. *Id.* at 182.

competition clause. The ability to pursue injunctions based on the lower level of scrutiny applied in forfeiture-for-compensation cases would be a powerful weapon for employers. The argument in favor of allowing employers to use garden leave as a weapon is that, like forfeiture-for-compensation clauses, garden leave does not present a true “restraint of trade.” Thus, by definition, it has no impact on the livelihood of the affected employee.

The questions, therefore, are what such an arrangement may look like and how it would be interpreted under Illinois law. As of the writing of this Article, the answers are not crystal clear, but current case law provides some evidence that arrangements similar to garden leave may be enforced by Illinois courts in the future.

#### A. *The Baxter Problem*

The first reported case applying Illinois law to a provision similar to garden leave is relevant to an analysis of garden leave arrangements in Illinois.<sup>55</sup> Although at first blush it may appear to present an obstacle to the enforcement of such arrangements, a closer analysis reveals that this is not the case. In *Baxter International, Inc. v. Morris*, a former Baxter research scientist, Dr. Roger J. Morris, went to work for a Baxter competitor in the area of developing, manufacturing, and selling diagnostic equipment for use in microbiological laboratories.<sup>56</sup> In connection with his employment at Baxter, Dr. Morris entered into a covenant not to compete with Baxter for one year following the termination of his employment.<sup>57</sup> The agreement apparently provided that Dr. Morris would be compensated during the non-compete period.<sup>58</sup>

The Eighth Circuit reviewed the enforceability of the covenant under Illinois law.<sup>59</sup> In its analysis, the Eighth Circuit deferred to the district court’s holding that Dr. Morris could work for the competitor without divulging Baxter’s trade secrets.<sup>60</sup> It also deferred to the district court’s decision that “even if [the competitor] paid Morris’s salary for the year he would be forbidden to work by the covenant, Morris would suffer

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55. *Baxter Int’l, Inc. v. Morris*, 976 F.2d 1189 (8th Cir. 1992).

56. *Id.* at 1192.

57. *Id.*

58. *Id.* at 1197. In evaluating the reasonableness of the agreement’s restrictions, the court noted the district court’s finding that Microscan paying Morris’s salary was not sufficient to save the agreement.

59. *Id.* The Eighth Circuit noted that the district court had improperly analyzed the restriction under California law.

60. *Id.* at 1197.

undue hardship.”<sup>61</sup>

As the summary above demonstrates, the Eighth Circuit in *Baxter* did little more than defer to the determinations of the district court. This deference was odd given that the Eighth Circuit explicitly held that the district court wrongfully applied California law to the contractual provision.<sup>62</sup> The Eighth Circuit held that Illinois law applied because of a forum selection clause in the agreement and because California did not have a greater interest in the effect of the non-compete covenant than Illinois.<sup>63</sup>

The important issue now, therefore, is to determine *Baxter*'s likely impact on future decisions in Illinois and the Seventh Circuit. The answer: very little. First, *Baxter* was an Eighth Circuit case applying Illinois law that is binding on neither Illinois courts nor the Seventh Circuit. Second, the Eighth Circuit devoted only one sentence to analyzing the impact of compensation during the restricted period.<sup>64</sup> This surface analysis could hardly persuade future courts in light of the strong precedent established by other cases outside of the jurisdiction. Third, and perhaps most importantly, the *Baxter* decision is fifteen years old. The development of case law in this area in the intervening fifteen years suggests that compensation during a restricted period is a very relevant consideration.<sup>65</sup>

### B. Current Developments

Despite the existence of *Baxter*, it remains unclear how a court in Illinois would analyze a provision placing restrictions on employment for a period during which the person remained a paid employee and was forbidden from competing with the employer. Although no Illinois decision has explicitly addressed this issue, a recent but little-noted Northern District of Illinois case confronted a similar situation.

In *Hearns v. Interstate Bank*, the Northern District of Illinois upheld a restriction with important similarities to garden leave.<sup>66</sup> The plaintiff,

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61. *Id.*

62. *Id.* at 1196–97.

63. *Id.*

64. *Id.* at 1197.

65. At least one other commentator agrees. See Lembrich, *supra* note 1, at 2319–20 (“The courts that have dealt with this question, since, however, have refused to follow the *Baxter* court and have found an employer’s willingness to pay the employee during the restraint period persuasive.”).

66. *Hearns v. Interstate Bank*, No. 05 C 175, 2006 WL 862893, at \*1 (N.D. Ill. Mar. 31, 2006).

Hearns, was a director of the defendant Interstate Bank.<sup>67</sup> Hearns had entered into a contract with Interstate Bank that provided that he would receive a salary of \$96,000 per year for ten years, provided that he abided by certain restrictive covenants.<sup>68</sup> In addition to a three-year restrictive covenant following the termination of Hearns' employment, the agreement provided:

[W]hile in the active employ of the Corporation, the Employee will devote such time, skill, diligence and attention to the business of the Corporation as required in order to carry out the duties and obligations of the employee to the Corporation and will not actively engage, either directly or indirectly, in any business or other activity which is or may be deemed to be in any way competitive with or adverse to the best interest of the Corporation.<sup>69</sup>

Hearns became eligible for payments under the agreement in 2002.<sup>70</sup> He continued to serve as the chairman of Interstate Bank's loan committee, the examining audit committee and the assets and liability committee.<sup>71</sup> Simultaneously, Hearns participated integrally in the formation of a competing bank.<sup>72</sup> Upon learning this information, Interstate Bank terminated him as a director and ceased making any payments whatsoever under the contract.<sup>73</sup> Hearns sued Interstate Bank alleging that this discontinuation of payments constituted a breach of contract.<sup>74</sup>

Judge Norgle of the Northern District of Illinois analyzed Hearns' claim as a simple contract matter.<sup>75</sup> The court noted that it was undisputed that Hearns, while serving as a director of Interstate Bank, also served as an organizer for a competing bank.<sup>76</sup> Therefore, if acting as a director of Interstate Bank constituted Hearns' "employment" by Interstate Bank, his activities with a competitor clearly breached the contract.<sup>77</sup> In analyzing the meaning of "employee" in this context, the court held that the contract unambiguously identified Hearns as an employee.<sup>78</sup> In fact, the contract explicitly stated that the term

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67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.* at \*2.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.* at \*3-\*5.

76. *Id.* at \*4.

77. *Id.*

78. *Id.*

“employee” referred to Hearn. <sup>79</sup> In response to Hearn’s argument that he was not in fact an employee, the court stated, “regardless of what the common law definition of the term ‘employee’ may or may not be, it is abundantly clear that the parties have unambiguously provided, throughout the entirety of the Contract, that Hearn was an employee of [Interstate Bank].”<sup>80</sup>

Therefore, the court held that Hearn violated the agreement and was not entitled to the payments.<sup>81</sup> Summary judgment was entered in favor of Interstate Bank.<sup>82</sup> Because the court found that Hearn violated his duties to Interstate Bank as an employee under the agreement, the court reasoned that it was unnecessary to analyze the post-employment restrictive covenant found in the agreement.<sup>83</sup>

There are several notable aspects to the *Hearn* decision. The most important is that the court deferred to the definition of “employee” found in the contract, rather than the common-law definition of the term. This principle is very important for analyzing how a future Illinois court may interpret a garden leave provision. Under a garden leave arrangement, the employee would remain employed by the company during a restricted period. The agreement setting forth that arrangement would explicitly define the employment relationship to include the notice provision and the idle time period of employment during which competition would be forbidden. Under *Hearn*, as long as the definition of employee and employment is set forth unambiguously by the parties, it will be enforced. Presumably, a definition of employment that includes a period of garden leave would therefore be contractually enforceable—regardless of whether the person on garden leave meets the common law definition of “employee.”

Although *Hearn* may mark the beginning of a new line of cases, it is important to note that *Hearn* did not involve a claim for injunctive relief or a notice provision of the sort that is typically found in garden leave arrangements. Because there was no notice period at issue, it is important not to read *Hearn* too broadly. Even so, future cases examining garden leave provisions with a notice period may cite *Hearn* for the proposition that such an arrangement should be subject only to the ordinary contract analysis found in *Hearn*, and not the

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79. *Id.*

80. *Id.*

81. *Id.* at \*5.

82. *Id.*

83. *Id.*

greater level of scrutiny reserved for restrictive covenants.

### C. *Application to Future Cases*

In order to analyze the potential impact of *Hearns*, the following hypothetical is helpful. Assume an employee and employer enter into an employment agreement with the following essential terms:

The employment relationship is at-will;

There is a six-month restriction on employment with a competitor;

The employee will continue to receive his full salary and health benefits during the six-month period of the non-compete;

A six-month notification period is required in order for either party to terminate the employment relationship;

The six-month non-compete period begins upon that notification by either party; and

The employment relationship will be terminated upon the expiration of the six months.

Assume further that the employee resigns and begins working immediately with a competitor. The original employer files a lawsuit seeking to enjoin the employee from violating the employee's obligations under the agreement.

Based upon the decisions discussed in this Article, there is reason to think that a court's analysis of whether to issue an injunction will not subject the employment agreement to the rigorous scrutiny typically applied to restrictive covenants. Like the forfeiture-for-competition cases, enforcement of this contractual provision will not prevent the employee from making a living. As discussed above, this rationale helped justify the lower level of scrutiny in the forfeiture-for-competition cases. Therefore, the lower level of scrutiny should also be applied here.

Further, *Hearns* suggests that the type of employment arrangement involved in the hypothetical posed above would not be invalidated because of the definition of the employment relationship. The definition of "employment" is unambiguous in the contract; thus, there would be no reason to strike it down based on a common law interpretation of the employment relationship. In fact, as discussed above, that argument was explicitly rejected in *Hearns*. Although an Illinois court has not yet encountered this situation, there are good arguments in favor of enforcing the terms of a non-compete provision that provides for continuing employment and continued salary.

Although there are solid arguments supporting the enforceability of garden leave, there are areas where the arrangement could be challenged. For example, an employer seeking to enforce garden leave

with an injunction will face the argument that the injunction is being used as a sword to restrain the employee's mobility. The former employee may also argue that an extended notice period somehow changes the positions of the parties such that an at-will employment relationship no longer exists. Another potential pitfall is an agreement that describes the job duties of the employee but fails to note that those duties may include a period of garden leave.<sup>84</sup> These scenarios are beyond the scope of this Article, but they are potential pitfalls that employers must address in carefully drafting these types of arrangements.

#### CONCLUSION

Although the current state of the law in this area remains underdeveloped, there are good reasons for employers to use a system similar to garden leave to deal with key employees. Garden leave arrangements are expensive in that they require ongoing payments during the restricted period, but these payments dwarf the potential amount the company would spend in ongoing litigation related to the breach of a restricted covenant. Further, employees that continue to receive their salaries will be less likely to compete, given that their livelihood remains intact via the ongoing receipt of salary. Garden leave may not be enforced by every court that reviews the arrangement in the future, but it does provide a useful and powerful tool for employers to use in their efforts to secure and keep safe their most important business interests. Careful, forward thinking and drafting can avoid many of the potential pitfalls and provide the best opportunity for protection of employers against competing employees.

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84. See *Invesco Institutional, Inc. v. Johnson*, 500 F. Supp. 2d 701, 712–13 (W.D. Ky. 2007) (involving an employment agreement that provided specific duties for the employee that could only be changed by mutual agreement, and the dispute that arose after the employer placed the employee on administrative leave without consent in violation of the agreement).