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# Brokerage Windows in Retirement Plans

### *Can Further Guidance Broker Peace?*

**By Andrew L. Oringer, Andrew H. Braid and Aaron S. Cha**

On Aug. 21, 2014, the U.S. Department of Labor (DOL) published a request for information (RFI) regarding the use of so-called "brokerage windows" under retirement plans, such as many "Section 401(k)" plans, that allow participants (and beneficiaries) to direct the investment of their retirement accounts. In general terms, a brokerage window under a participant-directed retirement plan allows a participant to direct trading in a potentially wide variety of investments. While plan fiduciaries frequently craft a list of pre-selected investment options to be offered under the plan, a brokerage window can be designed to allow plan participants to invest in, among other things, individual stocks, bonds, numerous exchange-traded, index and mutual funds, and alternative investments. The RFI is one of the more recent developments surrounding what has become an increasingly controversial topic regarding the investment of Section 401(k) plans and other participant-direct retirement plans.

**Background**

Under Section 404(c) of the Employee Retirement Income Security Act of 1974 (ERISA), plan fiduciaries may be relieved from fiduciary liability associated with poor performance of plan investments if a participant (or beneficiary) exercises control over the assets in his or her account. However, under Section 2550.404c-1(b) of the DOL regulations, Section 404(c) relief only applies if, among other things, "the participant or beneficiary is provided … sufficient information to make informed decisions with regard to investment alternatives under the plan."

In 2010, the DOL issued further regulations clarifying exactly what information is to be provided in order for fiduciaries to be able to avail themselves of the relief from liability granted under Section 404(c) of ERISA (the 404a-5 Rules). The stated purpose of the 404a-5 Rules was "to ensure that all plan participants and beneficiaries in participant-directed individual retirement account plans have the information they need to make informed decisions about the management of their

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# 'Independent Covenant' Language

**By Lyle Shapiro**

It is a defense that has become perfunctory in restrictive covenant litigation — "my former employer is barred from enforcing the restrictive covenant because it committed a prior breach of the agreement!" Most often, the former employee will claim that the former employer breached the employment agreement by failing to pay wages, salary, bonuses or other sums, which renders the entire employment agreement, including the restrictive covenant, unenforceable. When such a defense is raised, an injunction hearing that should focus on the former employee's wrongful post-employment conduct instead often digresses into a hearing at which an argument about what compensation agreement existed and whether the former employer breached that agreement takes place instead.

By the end of injunction hearing, the former employee has often successfully muddied the water enough that the former employer has not established a "substantial likelihood of success on the merits" on its restrictive covenant claim, a showing that is generally required for entry of an injunction.

The above scenario plays out time and again in courts around the country. Yet, by simply incorporating a clear and unambiguous "independent covenant" or "severability" provision in the

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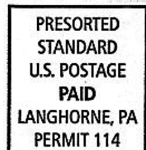

# Brokerage Windows

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individual accounts and the investment of their retirement savings." The 404a-5 Rules require plan administrators to provide to plan participants certain investment-related information, including performance data and benchmarking results, and certain fee disclosures relating to investment alternatives under participant-directed retirement plans. The disclosures required by the 404a-5 Rules apply only to "designated investment alternatives" (DIAs), which generally are investment options selected by plan fiduciaries to comprise the investment options offered to participants under the plan.

## Field Assistance Bulletin 2012-02

On May 7, 2012, in an effort to provide further clarification of the then-recent 404a-5 Rules, the DOL issued Field Assistance Bulletin 2012-02 (the Original FAB), which provided responses to a number of "frequently asked questions" relating to the 404a-5 Rules. Q&A 30 of the Original FAB, relating to brokerage windows, raised particular controversy. (Q&A 19, relating to the manner in which certain performance data for DIAs should be disclosed, also generated some substantial controversy, as outlined, for example, in the May 21, 2012 story by Emile Hallez in *Financial Times' Ignites*, "DOL Rewriting Fee Disclosure Rules on Fly: Lawyers.")

In Q&A 30, the DOL took the position that, if "through a brokerage window or similar arrangement, non-[DIAs] available under [an ERISA] plan are selected by significant numbers of participants and beneficiaries, an affirmative obligation arises on the part of the plan fiduciary to examine these alternatives and determine whether one or more such alternatives should be treated as [DIAs]." The DOL had earlier expressed concern regarding brokerage windows in the preamble to the final version of the 404a-5 Rules, stating that "it is important that participants and beneficiaries understand how brokerage windows operate and the expenses attendant thereto when they are offered as part of the investment platform of a plan."

Under the reasoning of Q&A 30, options offered through a brokerage window could have been considered DIAs and thereby be subject to the disclosure requirements under the 404a-5 Rules. Although Field Assistance Bulletins don't have the force of law, they can indicate the DOL's then-current views of the issues being addressed, and can have the effect of constraining market behavior or otherwise guiding the market regarding attempts to comply with rules that may be unclear.

In the case of Q&A 30, the DOL's position, if followed, could have materially increased the administrative responsibilities of plan administrators, in arguably unworkable ways. For example, the administrative burden of preparing disclosures compliant with the 404a-5 Rules for a potentially wide range of investment options may itself be daunting. In this regard, it is possible that recordkeepers may not have the practical ability to link all possible options a participant may choose (or may have chosen) through a brokerage window, and thus could effectively be incapable of providing required fee disclosure. As another example, it may be difficult to determine what performance and benchmark data should be disclosed with respect to certain investment alternatives, and how that data should be presented.

As addressed further below, a key reason that the DOL has expressed concern with brokerage windows appears to be its perception that, by offering a brokerage window, a plan fiduciary can effectively abrogate its responsibility to contour and otherwise choose an investment menu, by

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# President Obama's Executive Action on Immigration

## *Important Information For Employers*

**By Paul Virtue**

Headlining the Executive Actions announced by President Obama on Nov. 20, 2014, were plans to defer the removal of, and to provide work authorization to, undocumented immigrants who have lived in the United States for more than five years and are parents of U.S. citizens or lawful permanent residents. In addition, the administration will expand the existing Deferred Action for Childhood Arrivals (DACA) initiative.

DACA was implemented in 2012 to provide relief from removal and work authorization to young people who have been in the United States for at least five years, were born after 1981, met certain education and public safety criteria, and who entered the United States as children before June 15, 2007. The Presidential order will revise the DACA guidelines to allow qualified individuals of any age to apply if they were brought to the United States as children before Jan. 1, 2010. Both programs will provide temporary relief for three years.

### Employer Compliance with Employment Verification Requirements

The combined population of undocumented immigrants expected to benefit from the Presidential order is estimated to be approximately five million. By law, employers must have a properly completed Form I-9 (Employment Verification Form) on file for every employee hired after Nov. 6, 1986. As with the initial implementation of DACA, many U.S. employers can expect to be faced with current employees who have been granted deferred action presenting new employment authorization documents and perhaps new identities and Social Security numbers. Under guidelines published by U.S. Citizenship and Immigration Services (USCIS) in 2012, an employer receiving updated documentation from an employee should review the employee's previously completed Form I-9 and determine whether to complete a new Form I-9 or to simply complete Section 3 (reverification) of the previously completed Form I-9.

If any of the following information has changed in Section 1 of the previously completed Form I-9, then an employer should complete a new Form I-9, write the original hire date in Section 2 and attach the new Form I-9 to the previously completed Form I-9: the employee's name, date of birth, attestation or Social Security number. An employer participating in E-Verify should verify the new Form I-9 information through E-Verify.

If, after a review of the previously completed Form I-9, the employer finds that the information in Section 1 has not changed and the employee simply presents a new employment authorization document, then the employer should examine the documentation to determine if it appears to be genuine and related to the employee presenting it, record the document title, document number and expiration date, if any, and sign and date Section 3. Where only Section 3 is completed, the employer should not conduct a new E-Verify check.

### High-Skilled Businesses and Workers

In addition to deferring the removal of five million undocumented immigrants, the President outlined proposed changes to a number of employment-based immigration practices aimed at helping U.S. businesses and foreign workers. In this regard, the President's announcement was followed by a memorandum from Department of Homeland Security Secretary Jeh Johnson directing USCIS and Immigration and Customs Enforcement (ICE) to take action on the following eight areas of interest to high-skilled businesses and workers:

***1. Work Authorization for Spouses***. New rules that give H-4 dependent spouses of H-1B skilled workers authorization to work once the H-1B spouse has an approved employment-based immigrant petition, the penultimate stage of the green card process. This will require USCIS to finalize a proposed rule published earlier this year for public comment. Dependent spouses of intracompany transferees (L-1) and treaty investors and employees (E) are eligible for work authorization under current law.

***2. Exemption from H-1B Cap***. A new definition of "affiliated with an institution of higher education" will allow for broader exemption from the annual cap on H-1B visas. This change is expected to benefit a relatively small number of nonprofit research organizations. Current law requires a showing that the petitioning employer is: 1) connected or associated with an institution of higher education through shared ownership or control by the same board or federation; 2) operated by an institution of higher education; or 3 ) attached to an institution of higher education as a member, branch, cooperative or subsidiary.

***3. Ensuring Use of Employment-Based Visa Numbers***. USCIS to work with the State Department to ensure prospectively that employment-based visa numbers are used each fiscal year and that any unused numbers are preserved for use in subsequent years. Hundreds of thousands of employment-based numbers have gone unused in prior fiscal years because of the way in which the annual allotment of 140,000 employment-based visas is allocated by the State Department. Possible "recapture" of those unused visa numbers from prior fiscal years is likely to be raised in the Presidential Memorandum described below.

***4. Revisions to Monthly Visa Bulletin***. USCIS to work with the State Department to improve the

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## Immigration

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system for determining when immigrant visas are considered "available" to applicants during the fiscal year. This will allow for applications for immigrant visas and adjustment to permanent residence to be filed much earlier for those who have been waiting in the visa queue and will provide relief for dependent children who might otherwise "age out" while waiting in line under the current process. If, as expected, the State Department makes the employment-based visa categories "current," it likely will do so only for a brief period. Employers sponsoring their nonimmigrant employees for green cards will want to follow developments closely to ensure they are ready to assist employees with their applications for adjustment of status and those of family members.

***5. Expanded Green Card Portability***. Regulatory changes would allow workers with approved employment-based immigrant visa petitions (Form I-140) to move or change jobs even while they wait for a visa to become available (which can take years in some cases). Under current interpretation, the worker's green card application must have been pending for six months or more before the worker may change jobs. Also, USCIS will provide guidance for the definition of "same or similar" job for purposes of expanding eligibility for a green card applicant to move to a new job or employer. This will help not only those in the green card process who wish to change employers, but also those employees who move to a different job with the same employer.

***6. STEM Graduates***. Post-graduate (OPT) work training authorization for U.S. college graduates in science, technology, engineering and mathematics (STEM) can last up to 29 months — this would be extended. In addition, USCIS would approve extended OPT for STEM graduates who are pursuing non-STEM advanced degrees, such as an MBA. The Secretary has also directed establishment of stronger ties between OPT and the degree-granting institutions. Finally, labor market protections, which could include a prevailing wage requirement, will be imposed in order to safeguard the interests of US workers in related fields.

***7. Promoting Research and Development in the United States***. Enhanced and expanded options designed to encourage foreign entrepreneurs to invest, create jobs and generate revenue in the United States, including a broader application of the "public interest" parole authority and "national interest" waiver of the labor market test and job offer requirements for green card status.

***8. Bringing Greater Consistency to the L-1B Visa Program***. Noting the "vague guidance and inconsistent interpretation of the term 'specialized knowledge,'" which has created uncertainty for companies managing global workforces as they "choose where to establish new or expanded operations, research centers, or product lines, all of which stand to benefit the U.S. economy," the Secretary has directed USCIS to issue a policy memorandum that provides clear, consolidated guidance on what constitutes specialized knowledge for L-1B visa eligibility. Definitive guidance on this issue is long overdue.

In addition, the Department of Labor announced an effort aimed at streamlining the U.S. labor market test (PERM) required to be conducted by employers sponsoring their workers for green cards. Proposed PERM regulations are expected in FY2016.

### Conclusion

Further reforms may be on the horizon. The President announced plans to issue a Presidential Memorandum on the need for structural reform to the United States immigration system, including proposals for visa modernization, elimination of redundant systems and procedures and better methods to detect visa fraud. This interagency process is expected to be completed within 120-180 days.

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## Brokerage Windows

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making available to plan participants an extremely wide range of unspecified investments. Arguably, the DOL's concerns with the potential appropriateness of brokerage windows generally led to a disclosure-related approach that could have had the effect of making windows costly and difficult to administer and otherwise implement, or even completely unworkable in a number of cases.

One relatively high-profile comment on the Original FAB, submitted by the Securities Industry and Financial Markets Association (SIFMA), took issue not only with the substantive approach taken by the DOL in the original FAB, but also with the process adopted by the DOL. SIFMA made the point that, by not proposing actual regulations, the DOL was avoiding the federal notice-and-comment process applicable where an administrative agency issues regulations. The notice and comments process ordinarily applicable to the issuance of regulations can frequently lead to a more fulsome dialogue between the regulators and members of the public. Reports highlighting the controversy surrounding these developments include the May 18, 2012 story by Emile Hallez in *Financial Times' Ignites*, "DOL's 11th-Hour Fee-Disclosure Provision Sets Off Alarms."

### Field Assistance Bulletin 2012-02R

In response to broad criticism of Q&A 30, the DOL took the unusual step of removing an FAQ in response to objections from the market. On July 30, 2012, the DOL released Field Assistance Bulletin 2012-02R (Revised FAB), in which it deleted Q&A 30 and replaced it with new Q&A 39. In Q&A 39, the DOL reversed its position and expressly adopted an approach contrary to that taken in the Original FAB, stating that "whether an investment alternative is a '[DIA]' for purposes of the [404a-5 Rules] depends on whether it is specifically

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# *EEOC v. Ruby Tuesday*

## *An Off-the-Menu Discrimination Case*

**By Rebekkah Mintzer**

Ruby Tuesday Inc. is a restaurant chain known throughout the U.S. for its burgers and casual family-friendly atmosphere. Unfortunately for the company, the U.S. Equal Employment Opportunity Commission (EEOC) apparently wants to make it known for something less savory: a novel approach to sex discrimination.

*EEOC v. Ruby Tuesday* isn't the typical case on the discrimination menu. The plaintiffs claiming discrimination based on their gender are men, which is still relatively rare. What's even more unusual is that the charges stem not from a direct employment action per se, but from a decision regarding employee housing.

### The Case

In the suit, filed by the commission on Jan. 22 in federal court, Andrew Herrera, a Ruby Tuesday employee in Oregon, claims he was discriminated against because he and other male employees were deprived of the opportunity in the summer of 2013 to apply for temporary server or bartender positions with the company in Park City, UT. The internal job posting for positions in the resort town, which was made available to employees based in Utah, Oregon and seven other states, asked specifically for female applicants only. According to the EEOC's announcement, the company supposedly asked for female applicants because the job also included housing provided by Ruby Tuesday, and the company did not want to house men and women together.

It's easy to guess why Ruby Tuesday may have wanted to avoid putting men and women in the same housing, perhaps because of the increased risk of a sexual harassment suit. Even if this was the case, it didn't matter to Herrera and Joshua Bell, another employee. After failing to resolve the issue with their employer, they are now asking the court to make the restaurant chain stop its allegedly discriminatory practices and compensate them for the opportunities they missed in Utah.

### Commentary

J. Hagood Tighe, a partner at Fisher & Phillips who works on employment discrimination cases, said that most cases alleging sex discrimination under Title VII of the Civil Rights Act deal more with the particulars of the job description, rather than where employees are housed. "Usually when you're talking about an issue like this, you're really focusing on the job itself," he said.

In order to prove that someone's gender is a legally acceptable reason to decline to hire them, companies must prove that for that particular job, gender is a bona-fide occupational qualification (BFOQ). For example, Tighe explained, there have been claims that gender is a BFOQ in prison guard jobs, where guards need to accompany inmates into bathrooms and showers, and sometimes courts have agreed. However, it's usually difficult to prove gender is a BFOQ. "There have been many efforts, but not many successes from an employer's standpoint on BFOQ," Tighe said.

Although he is not working on this case and has no knowledge of the facts beyond publicly available documents, Tighe suspects that perhaps Ruby Tuesday knows some additional information that could bolster its arguments. Or else why not just settle, considering the sum owed to the plaintiffs would be relatively small for a large company? For now, only Ruby Tuesday knows.

### Take-Aways

So how can employers avoid being on the receiving end of the kinds of charges the EEOC cooked up for this restaurant chain? The answer is pretty simple: Don't disallow either gender from applying for a job.

"Employers should really not be making hiring or employment decisions based on gender or any other protected classification," Tighe noted. "Ruby Tuesday may very well have a good defense and may one day win the case. But even if they do, the general rule for 99.9% of the time is that they should not be making decisions based on any protected classification."

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**Rebekah Mintzer** writes for *Corporate Counsel*, an ALM sister publication of this newsletter, in which this article also appeared.

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identified as available [as an investment alternative] under the plan." According to the Revised FAB, because investment options available through brokerage windows are not "specifically identified" as DIAs, they would not be subject to the 404a-5 Rules.

### The Effect of Brokerage Windows on Fiduciary Duties

In the Revised FAB, the DOL foreshadowed that its decision to withdraw Q&A 30 of the Original FAB might not be its last word regarding brokerage windows. In particular, in Q&A 39, the DOL stated that a plan fiduciary's "failure to designate investment alternatives, for example, to avoid investment disclosures under the [404a-5 Rules], raises questions under [ERISA's] general statutory fiduciary duties of prudence and loyalty." While the DOL in the Revised FAB chose not to identify additional requirements regarding brokerage windows, it stated that "plan fiduciaries and service providers may have questions regarding situations in which fiduciaries may have duties under ERISA's general fiduciary standards apart from those in the [404a-5 Rules]."

In addition to expressing concern that plan sponsors might try to avoid certain administrative burdens and fiduciary liability by providing a brokerage window in lieu of DIAs, the DOL also stated in Q&A 39 that a plan fiduciary that provides options under a brokerage window is "still bound by [ERISA's] statutory duties of prudence and loyalty to the participants and beneficiaries, including taking into account the nature and quality of services provided in

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connection with the [brokerage window]." In light of certain judicial developments, the DOL appeared to be concerned with the possibility that a plan sponsor might be able to avoid responsibility for offering suboptimal investment options by simply offering a very large number of options. Notably, in Q&A 30 of the Original FAB, the DOL cited to the case of *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir.), reh'g denied, supplemented by 569 F.3d 708 (2009) (narrowing the earlier decision so as expressly not to rule on whether Section 404(c) of ERISA applies to shield a fiduciary regarding the selection of the investment menu), cert. denied, 558 U.S. 1148 (2010).

In *Hecker*, the Seventh Circuit affirmed the district court's dismissal of the plaintiffs' claim that the plan fiduciaries breached ERISA's fiduciary duty of prudence by offering investment options with "unreasonable and excessive" fees and expenses. The district court had concluded that because a wide selection of investment options was available under the plan, including a brokerage window, any losses must have resulted from the participants' exercise of control over their individual accounts.

The Seventh Circuit in *Hecker*, in affirming the district court, concluded that the plan sponsor did not violate its fiduciary duty because plan participants were offered at least some appropriate investment options. One of the facts identified by the Seventh Circuit as being relevant to its holding was that the plan included a brokerage window that offered over 2,500 funds. The Seventh Circuit reasoned that, because investments offered through the brokerage window are "set against the backdrop of market competition," the *Hecker* plan could not have failed to offer at least some appropriate investment alternatives with appropriate levels of fees. *See also Spano v. Boeing Co.*, 633 F.3d 574, 590 (7th Cir. 2011) (noting that the plan included a brokerage window that offered over 11,000 publicly traded mutual funds); *Renfro v. Unisys Corp.*, 671 F.3d 314, 327 (3rd Cir. 2011) (holding that plan fiduciaries satisfied their obligation to offer "a reasonable range of investment options with a variety of risk profiles and fee rates" when the plan offered 73 different investment options).

The DOL seems to be concerned that the reasoning in cases like *Hecker* could be read to encourage plan fiduciaries to provide an extremely large number of investment alternatives in an attempt to avoid fiduciary responsibility relating to the selection of a more traditional menu of identified funds. (In a later decision (at 569 F.3d 708 (2009)) denying rehearing in *Hecker*, the Seventh Circuit attempted to diffuse such concerns by specifically indicating that there was no intent on its part to approve a strategy whereby a fiduciary would attempt to insulate itself from liability by providing for a very large number of investment alternatives.) In this regard, while it does seem obvious that in the appropriate case the use of a brokerage window under a plan can be both appropriate and advantageous, it can also be argued that a fiduciary of a participant-directed plan should not be discouraged from presenting participants (and beneficiaries) with a more circumscribed universe of investment alternatives from which to choose, if that is the path the fiduciary prefers. Is it necessarily always desirable to have a menu from The Cheesecake Factory, with what seems like boundless dining choices? Or is it the case that, sometimes, depending on the facts, less may really be more?

In light of its concerns regarding brokerage windows, the DOL expressed an intention "to engage in discussions with interested parties." Ultimately, it seems as though the DOL may be struggling to administer ERISA so that ERISA does not inexorably push fiduciaries to provide for an ever-increasing universe of potential investment selections. On the other hand, it would arguably be perverse if the rules under Section 404(a) and (c) of ERISA, which in so many ways encourage flexibility and choice, were to be interpreted in a way that would have the practical effect of unduly constraining the use of brokerage windows, which by their nature offer extensive freedom of choice.

### The Request for Information Relating to Brokerage Windows

The RFI is the latest salvo in the DOL's efforts to address the use of brokerage windows under participant-directed retirement plans. In its Aug. 20, 2014 press release, Release Number 14-1523-NAT, relating to the RFI, the DOL noted that window arrangements "can enable or require individual participants to choose for themselves from a broad range of investments." The release then quotes a senior DOL official as saying, "We promised employers and other plan sponsors and fiduciaries that we would look into the use of brokerage window features. Our goal in issuing this RFI is to determine whether, and to what extent, regulatory standards or other guidance concerning the use of brokerage windows may be necessary to adequately protect participants' retirement savings." The DOL stated in the RFI itself that the purpose of the RFI "is to increase the [DOL's] understanding of the prevalence and role of brokerage windows in participant-directed plans … ; why, under what circumstances and how often these brokerage windows are offered and used; and the legal and policy issues that relate to such usage."

According to the RFI, since the issuance of the Revised FAB, the DOL "has reviewed literature, articles and other commentary available on the use of brokerage windows in 401(k) plans." The DOL has read the arguments favoring brokerage windows by sophisticated investors, who, using their more advanced knowledge of markets and investing, may benefit from the ability to customize their investments through brokerage windows. The DOL, however, indicated its awareness of the contrary argument that brokerage windows may present undue risks for many retirement plan participants. The DOL identified the concern that, because plan fiduciaries do not engage in a deliberative process to

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affirmatively review and select each of the investment options available through brokerage windows, participants may not have adequate or any protections against potentially costly or unsuitable investments made through the brokerage window.

The RFI presented 39 questions organized into 10 categories. The topics covered include, for example, the scope of investment options typically available through a window; demographic and other information about participants who commonly use brokerage windows; the process of selecting a brokerage window and provider for a plan; the costs of brokerage windows; and what kind of information about brokerage windows and underlying investment options typically is available and disclosed to participants. The RFI also solicited views regarding the need for further regulation or other guidance on such matters.

Many interested parties, including industry groups representing the investment industry, submitted comments by the Nov. 19, 2014 comment deadline. A recurring theme in many of these comments was that no further regulation or guidance is necessary regarding the use of brokerage windows in retirement plans. SIFMA, for example, stated in a letter dated Nov. 19, 2014, that "the [DOL] has already addressed any ambiguity surrounding what constitutes a brokerage window or similar arrangement through its clarification of what constitutes a DIA in Q&A 39 of [the Revised FAB]." In response to whether additional guidance is needed in relation to brokerage windows and ERISA's fiduciary provision, SIMFA stated that "the [DOL] adequately addressed most issues in its issuance of [the Revised] FAB … ."

### Conclusion

If the DOL does issue further guidance with respect to brokerage windows, such regulations or guidance could have a wide-ranging effect. Among those potentially affected are: 1) those participants who stand to benefit from the investment flexibility that brokerage windows offer, could be: 2) plan sponsors, 3) brokers who offer or facilitate the use of brokerage windows, 4) recordkeepers that promote or liaise with brokers in making windows available, 5) sponsors of funds offered through brokerage windows, and 6) sponsors of privately offered or other alternative investments that may be offered through a brokerage window. For those who are interested in whether the use of brokerage windows may be constrained or perhaps even shut down as a result of additional guidance, any further progress from the DOL on this issue should be watched carefully.

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## *Restrictive Covenants*

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restrictive covenant agreement, an employer may be able to avoid the "prior breach" defense altogether and be on its way to the injunction to which it is entitled.

### Case Law

It is well settled that under basic principles of contract law a party cannot enforce a restrictive covenant if it is in material breach of other terms of the agreement. However, where the parties clearly intended to make the restrictive covenant "independent" of the other covenants in the agreement, a court may not bar the former employer from enforcing the agreement, even in the face of a prior beach by the former employer, because doing so would be inconsistent with the parties' written agreement.

For example, in the recent case of *Richland Towers, Inc. v. Denton*, 139 So.2d 318 (Fla. 2nd DCA 2014), the trial court denied the former employer's request for a temporary injunction on the grounds that certain bonuses were not paid to the former employees. The appellate court reversed. The appellate court first stated that whenever possible, an agreement should be construed according to its plain language. *Id.* at 321. The court also acknowledged the general proposition that covenants in an agreement are considered dependent unless trumped by a contrary intention expressed in an agreement. *Id.* The court ultimately determined that the parties included such an express intention that the covenants were independent by stating:

> *Covenants Independent.* Each restrictive covenant on the part of the Employee set forth in this Agreement shall be construed as a covenant independent of any other covenant or provisions of this Agreement or any other agreement which the Corporation and the Employee may have, fully performed and not executory, and the existence of any claim or cause of action by the Employee against the Corporation, whether predicated upon another covenant or provision of the Agreement or otherwise, shall not constitute a defense to the enforcement by the Corporation of any other covenant.

Similarly, in another Florida case, *Reliance Wholesale, Inc. v. Godfrey*, 51 So.3d 561 (Fla. 3rd DCA 2010), the appellate court reversed the trial court's denial of a former employer's motion for temporary injunction because notwithstanding evidence that the former employees were not paid earned commissions, the parties' agreement demonstrated that the "non-compete" clause was an independent and not a dependent covenant. *Id.* at 565. The provision at issue in *Godfrey* provided:

> The covenants set forth herein shall be construed as agreements independent of any other provision in any other agreement, by, between, among, or affecting Reliance Medical Wholesale, Inc. and Employee, and the existence of any claim or cause of action of Employee against Reliance Medical Wholesale, Inc., whether predicated on this Agreement or otherwise, **shall not constitute a defense to the enforcement of this agreement**.

*Id.* The court concluded that the former employer's purported "prior

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## *Restrictive Covenants*

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breach" was not a valid or viable defense to the issuance of a temporary injunction. *Id*.

Not surprisingly, the universally accepted concept that courts should enforce, and not rewrite, parties' contract language has resulted in decisions around the country consistent with the Florida decisions discussed above.

***California Law***

The former employer's breach of the employment agreement by wrongfully terminating the employee did not excuse the employee from keeping trade secrets confidential. There was nothing in the record to suggest that the two separate agreements imposed dependent obligations or that the performance of the one was a condition of an obligation to perform the other. If the two agreements "imposed dependent obligations" or provided that "the performance of the one was condition of an obligation to perform the other" a different result may have been required. *Vacco Indus., Inc. v. Van Den Berg*, 5 Cal. App. 4th 34, 49, 6 Cal. Rptr. 2d 602 (1992), modified (Apr. 14, 1992).

***Georgia Law***

An alleged wrongful termination by a former employer was not a bar to enforcement of a restrictive covenant when the parties' agreement provided, "These covenants [restrictive] on the part of the employee shall be construed as an agreement independent of any other provision in this agreement, and the existence of any claim or cause of action of the employee against the company whether predicated on this agreement or otherwise, shall not constitute a defense to the enforcement by the Company of said covenants." *Orkin Exterminating Co. v. Gill*, 222 Ga. 760, 762-63, 152 S.E.2d 411, 413 (1966).

***Mississippi Law***

A clause that stated "[t]his covenant on the part of the Employee shall be construed as an agreement independent of any other provision of this agreement; and the existence of any claim or cause of action of the Employee against the Company, whether predicated on this agreement or otherwise, shall not constitute a defense to the enforcement by the Company of this covenant" may permit the former employer to enforce the restrictive covenant notwithstanding that the former employer's demotion of the employee constituted a material breach of the employment contract. *Hensley v. E. R. Carpenter Co.*, 633 F.2d 1106, 1110 (5th Cir. 1980).

***Indiana Law***

A podiatry clinic's failure to pay a car allowance to a former employee did not preclude enforcement of a restrictive covenant because it contained a provision that the non-competition agreement "shall be construed as independent of any other provision of this Contract and shall survive the termination of this Contract. The existence of any claim or cause of action of Employee against Corporation, whether predicated on this Contract or otherwise, shall not constitute a defense to the enforcement by Corporation of this Restrictive Covenant." *Central Indiana Podiatry, P.C. v. Krueger*, 882 N.E.2d 723 (Ind. 2008).

***Texas Law***

A former employee claimed that the former employer was barred from enforcing the restrictive covenant because the former employer materially breached the contract by failing to pay severance, by failing to provide 90 days' written notice prior to termination, by refusing to buy the former employee's home in accordance with the contract, and by refusing to issue stock. The appellate court disagreed because the agreement provided that, "This covenant on the part of Manager shall be construed as an agreement independent of any other provision of this Contract; and the existence of any claim or cause of action of Manager against Employer, whether predicated on this Contract or otherwise, shall not constitute a defense to the enforcement by Employer of this covenant." *French v. Cmty. Broad. of Coastal Bend, Inc.*, 766 S.W.2d 330, 332-33 (Tex. App. 1989), writ dismissed w.o.j. (Sept. 6, 1989).

### Key Tips

In accordance with the guidance provided by the above legal authority, in order to substantially decrease the likelihood that a "prior breach" defense will defeat a request for a temporary injunction in the restrictive covenant context, it is recommended that an employer:

- Review its restrictive covenant agreement to determine whether it includes an "independent covenant" or "severability" provision that will be enforced under the operative law.
- Review its restrictive covenant agreement to make sure that no other language in the restrictive covenant agreement conflicts with the "independent covenant" or "severability" provision. Loose language in the substance of the restrictive agreement and/or the "recitals" can allow the former employee to argue that the restrictive covenant is ambiguous on the question of whether the covenants are independent or dependent. Moreover, if the employee is requested to simultaneously execute additional agreements, make sure that all of the agreements, read together, unambiguously provide that the restrictive covenant is independent of all of the parties' other obligations.
- If the law of the state that governs its restrictive covenant does not provide clear guidance on whether an "independent covenant" or "severability" provision will be enforced, consider incorporating a choice of law provision in your restrictive covenant in favor of a state law that will enforce such provisions.

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