USING LIQUIDATED DAMAGES CLAUSES IN EMPLOYMENT CONTRACTS

An increasing number of contracts are incorporating liquidated damages clauses. In these clauses, the parties to a contract designate a fixed or "liquidated" amount of damages for the non-breaching party to collect upon a specified breach. A recent federal court decision highlights an increased willingness by courts to enforce these provisions in employment agreements, including those containing restrictive covenants. The reasoning of the decision has application for a host of other corporate and commercial agreements as well.

Courts will enforce liquidated damages provisions only if actual damages from a breach are difficult to determine and the sum fixed as damages bears a reasonable relationship to the loss foreseeable (at the time the parties sign the contract) from a party's breach. In contrast, courts will not enforce these provisions if the amount of damages is easy to compute or the estimate provided is grossly disproportionate to the anticipated harm. One familiar example of a liquidated damages clause comes from real estate contracts where buyers often forfeit their deposits for failing to complete their planned purchases.

In the recent case of *GFI Brokers, LLC v. Santana*, a currency option broker had agreed to post-employment restrictive covenants limiting his ability to work for a competitor and solicit his former customers for four months after the end of his employment with GFI. The agreement fixed damages for breach of the non-compete and non-solicit covenants as the product of his average monthly commissions and the number of months remaining on the covenants. The broker resigned and began work for a competitor during the restricted four-month period, causing the employer to sue and seek enforcement of the liquidated damages provision.

The federal court in New York upheld the covenants on several grounds:

- >> First, the court agreed that efforts to fix the amount of damages made sense in this competitive industry, as the damage from the loss of a successful broker and his clients was difficult to compute.
- >> Second, the court looked favorably on the particular method of fixing damages, which used a proportion

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THE BOTTOM LINE

Employers should consider using liquidated damages clauses in employment agreements to fix the sum of damages from breaches of restrictive covenants, and should carefully consider the anticipated harm to ensure that the fixed sums are reasonable. Companies should also examine other forms of agreements in which they enter into to consider whether a liquidated damages provision will provide it with greater leverage if and when the other party to the agreement breaches the contract.

tied to the time remaining on the covenants. The court reasoned that the use of proportion helped avoid the risk that a specific sum fixed for damages would be disproportionate if the employee violated a non-compete provision that had only a short time left on the restricted period. Thus, the court found that the employer did not have a one-size-fits-all fixed sum that would apply whether there were just a few weeks or many months remaining on the restriction period, which could be considered an unreasonable forecast in some situations.

>> Third, the court rejected the broker's argument that the liquidated damages provision should not be enforced because the fixed amount of damages considered the brokerage's revenues on essentially a gross basis. The court held that it would not invalidate a liquidated damages formula merely because some other measure might better correlate to actual damages. The court also rebuffed the broker's argument that the provision deterred him from leaving, finding that liquidated damages provisions are always designed to encourage compliance with contractual duties because they fix an amount of damages for non-compliance.

GFI Brokers demonstrates that courts are willing to enforce liquidated damages provisions that use a reasonable formula to estimate harm even if the estimate was not calculated using the best possible forecast available. While these provisions are becoming an increasingly useful tool in employment agreements, including those with restrictive covenants, they must be tailored to particular circumstances to avoid the risk that a court will not enforce them.

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