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Drafting and Negotiating Executive Employment Agreements



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I. Introduction

In the District of Columbia, Maryland, and Virginia, if employers do not offer their employees a definite term of employment, the presumption is that, absent a clear expression of the intent to form a contract of employment for a fixed period of time, “the parties have in mind merely the ordinary business contract for a continuing employment, terminable at the will of ei-

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ther party.”¹ Under the at-will doctrine, an employer can terminate an employee at any time and for any reason or no reason at all, so long as the employee is not terminated for an unlawful reason.²

Although most employers do not negotiate employment agreements with a majority of their employees as a routine practice, such agreements can be beneficial to both employers and employees. Employment agreements can be beneficial for all classes of employees, whether executives, managers, or hourly workers.

Generally, employees can secure a definite term of employment, can negotiate their duties and responsibilities, can negotiate criteria upon which their employers will evaluate their performance and/or grant them bonuses, and can even secure their rights as potential whistle-blowers. Employees can also incorporate aspects of traditional employee manuals by negotiating performance evaluation standards, anti-discrimination and/or anti-retaliation policies and/or reporting procedures. Such clauses would reassure employees that they may rely on these policies and procedures and that their employers are bound to follow these protocols.

Employers can clearly define the manner in which employees shall spend their time at work, can negotiate agreements not to compete, and can negotiate severance payments while they have a positive and functioning working relationship. Employers can also negotiate the rights to employees’ inventions and/or patents that the employees obtain during their employment, and can assure that employees cannot claim that additional

¹ *Bible Way Church of Our Lord Jesus Christ of the Apostolic Faith of Washington, D.C. v. Beards*, 680 A.2d 419, 433 (D.C. 1996) (quoting *Sullivan v. Heritage Found.*, 399 A.2d 856, 860 (D.C. 1979)).

² See *Byrd v. Voca Corp. of Washington, D.C.*, 962 A.2d 927, 931 n. 4 (D.C. 2008); see also *Clampitt v. American Univ.*, 957 A.2d 23, 40 (D.C. 2008).

promises were made to them to induce them to work for the employers.

Employment Agreements Help Avoid Employment Disputes. Further, by entering into employment agreement, both employers and employees eliminate the possibility when disputes arise over promises made or alleged to be made at any point during the employment relationship. Most importantly, an employment agreement prevents the issues that arise when oral agreements or representations govern the parties' relationship.

Oral promises that limit employers' rights to terminate at-will employees must be definitive and limited in duration to be enforced against an employer.³ In *Rinck v. Ass'n of Reserve City Bankers*,⁴ the court upheld an oral agreement, finding that a terminated employee had a valid claim against his employer for breach of contract where the employer terminated him after a merger despite the employer's oral statement that the employee would not be terminated as a result of the merger.

Employment Agreements Help Avoid Invoking Statute of Frauds. Employment agreements also prevent either party from invoking the statute of frauds to defend against a potential or actual claim. In the District of Columbia and in Virginia, the statute of frauds requires that contracts which cannot be performed within one year to be in writing and signed by the party to be charged in order to support a claim for breach of contract.⁵ However, if a party admits that the agreement at issue exists, that party has waived the statute of frauds objection to the enforcement of an oral agreement.⁶ Further, the doctrine of equitable estoppel prevents a defendant from asserting the statute of frauds defense to an alleged breach of contract "if the plaintiff can prove that she reasonably relied on a representation by the defendant to her detriment."⁷

More specifically, executives, by the nature of their employment, are more likely to be bound by employment agreements and/or agreements not to compete with their current and/or former employers. Negotiating employment agreements with executives can assure employers that their executives will work for them for a predetermined amount of time and that their executives will not compete with them after their employment has ended. Executives can negotiate their compensation, criteria for raises, bonus structure, and severance payments and take comfort in the knowledge that they will not have to haggle over these important aspects of their employment in the future.

³ See, e.g., *Beards*, 680 A.2d at 433 (allegation by former employee that "tacit agreement" between former pastor and employee that employee would work for church as long as she desired, even assumed to be true, was insufficient to rebut presumption that employment was at-will).

⁴ 676 A.2d 12, 17-18 (D.C. 1996).

⁵ See D.C. Code Ann. § 28-3502; Va. Code § 11-2(8).

⁶ See, e.g., *Wemhoff v. Investors Mgmt. Corp. of Am.*, 455 A.2d 897, 899 (D.C. 1983); *Kwon v. Lee*, 1993 WL 946217 at *1-2 (Va. Cir. Ct. Sept. 1, 1993) (citing *Harris v. Diamond Constr. Co.*, 184 Va. 711, 722, 36 S.E.2d 573 (Va. 1946)) (admission of existence of contract constitutes waiver of the protections afforded by statute of frauds).

⁷ *Morris v. Buvermo Properties, Inc.*, 510 F. Supp. 2d 112, 116-17 (D.D.C. 2007), citing *T. v. T.*, 216 Va. 867, 873, 224 S.E.2d 148 (Va.1976); *Landow v. Georgetown-Inland West Corp.*, 454 A.2d 310, 313 (D.C.1982).

Employment Agreements Help Avoid FLSA Claims. Managers and hourly employees are less likely to be bound by employment agreements. However, by setting forth employees' duties and responsibilities in employment agreements, employers can use such agreements to avoid claims of misclassification for the purposes of the Fair Labor Standards Act. In drafting these duties and responsibilities, employers should closely examine the regulations surrounding each FLSA exemption and ensure that their internal classifications do not conflict with the law. Employers should then ensure that their employees' job descriptions, as well as the actual duties performed by the employee, fall within the correct classification.

Employment Agreements Help Avoid Discrimination Claims. Employers can also use employment agreements for lower-level employees to protect their employees from discrimination at the hands of poorly trained or maverick managers who disregard the companies' policies. Employment agreements should contain, at a minimum, a term stating the employees' length of employment, as well as terms discussing early termination of the contracts. Should a manager desire to terminate an employee's employment for an improper reason including discrimination or whistleblower retaliation, the lower-level employees would be protected by their employment contract.

Finally, as set forth more fully below, employment agreements can also prevent misunderstandings between the parties as to employees' duties and responsibilities, criteria for earning bonuses, and eligibility for promotions and/or transfers.

II. Key Provisions For Employment Contracts

A. Offer and Acceptance of Employment

To make certain that courts interpret an employment agreement as a contract, at the beginning of the agreement, the employer should include a short section discussing the purpose of the contract (i.e., to offer employment to an individual in a certain position for a certain length of time). The employer should also include a section wherein the employee acknowledges that he or she accepts the employer's offer of employment. Additionally, for the sake of absolute clarity, and as a showing of good faith on the employer's part, the employment agreement should contain a section wherein the parties acknowledge that the agreement binds both the employee and the employer to the terms contained therein.

B. Position For Which Employer Hires Employee

To avoid confusion and contention over an employee's position, duties, and responsibilities, the employer should clearly state the employee's title and should clearly delineate the employee's main responsibilities. However, both the employer's business needs and the employee's skills and knowledge will grow and change over the course of the contract. Accordingly, it is in both the employer's and the employee's interests to leave room for flexibility and change in these descriptions.

When the parties enter into their contractual relationship, neither party can fully anticipate how well that relationship will develop. To allow both the employer and the employee room to grow and the ability to fulfill their needs, employers should also consider developing and

including protocols for executing various personnel actions in the employment agreement. Employees may seek, and employers may desire, transfers or promotions within the company. However, if the parties' employment agreement does not provide for these personnel actions, the parties may be forced to prepare a separate and new employment agreement to cancel or to modify their existing agreement.

C. Length of Contract, Compensation, Benefits, and Bonuses

Other key terms of an employment agreement are provisions that state the length of the contract as well as the employee's compensation and benefits. The parties should evaluate the appropriate length of a contract by analyzing the nature of the position and the skills needed to execute the duties and responsibilities of the position.

The parties should plainly state the amount of compensation to be paid and the time frame in which the employee shall receive his or her compensation. The parties should also be sure to set forth criteria under which the employee's performance may be evaluated and under which the employee will be eligible for raises and/or bonuses throughout the course of his or her employment with the company. In addition to setting forth the criteria for earning bonuses, the parties should also delineate the time frames in which bonuses can be earned and when the bonuses will be paid. Additionally, the parties should state whether a bonus earned while an employee is employed by the company will be paid if the employee is no longer employed by the company on the bonus payment date.

An employer should also set forth the benefits for which the employee will be eligible and should also state which benefits the employee will be eligible to retain should the parties' employment relationship terminate.

D. Noncompete/Nonsolicit Provisions⁽¹⁾*

To prevent employees taking their talents and employer's trade secrets to competitors, a growing number of employers are requiring employees to sign noncompete agreements. While it may seem illogical that an employee cannot use skills learned at one job to advance his career at another job, many companies rely on noncompete clauses to limit just that. In realizing that noncompetes are agreements in restraint of trade, courts critically examine and narrowly construe noncompete agreements. Thus, a broad-form agreement that is not narrowly tailored to serve the employer's business interest is likely unenforceable. In addition, an employer's effort to enforce an invalid noncompete can invite counterclaims and in certain extreme cases, sanctions.

1. Is the noncompetition provision a contract? Ordinary contract principles will guide a District of Columbia/Maryland/Virginia court when ascertaining whether a noncompetition agreement is a contract.⁸

* See *Sample Employment/Severance Agreement Provisions, below*.

⁸ See *Va. Elec. & Power Co. v. Norfolk S. Ry.*, 683 S.E.2d 517, 525 (Va. 2009) (primary focus in considering disputed contractual language is for court to determine parties' intention, which should be ascertained whenever possible from language parties employed in contract) (citing *Flippo v. CSC Assocs. III, L.L.C.*, 547 S.E.2d 216, 226 (Va. 2001); *Langman v.*

2. Is the noncompetition agreement supported by adequate consideration? Under District of Columbia law, an employer seeking to enforce a noncompete must show that the restrictive covenant is supported by consideration i.e., consideration exists when someone gives up a legal right and in return obtains a tangible benefit.⁹ District of Columbia courts have held that adequate consideration exists if an employee agreed to such a provision at the inception of the employment relationship. Continued employment may constitute valid consideration especially where the employee cannot be terminated at-will.¹⁰ However, an employer's statement regarding job security made by the employer to an individual employee who is already working cannot become binding unless the employer gives new consideration in addition to continuing employment.¹¹ Similarly, the general rule in Maryland and Virginia is that if a noncompete agreement or restrictive covenant is supported by adequate consideration and is ancillary to the employment contract, an employee's agreement not to compete with his or her employer will likely be upheld.¹²

3. Is the noncompetition (the "restrictive covenant") enforceable? The enforceability of noncompete agreements differs from state to state. In Virginia, for example, courts enforce noncompete agreements only "if the contract is narrowly drawn to protect the employer's legitimate business interest, is not unduly burdensome on the employee's ability to earn a living, and is not against public policy."¹³ This analysis focuses primarily on the following factors:

- (1) the temporal scope of the noncompete;
- (2) the geographic scope of the noncompete; and
- (3) the clarity and unambiguous nature of the noncompete.

In other words, an employer must narrowly tailor the time, function, and geographic restrictions in a non-

Alumni Ass'n of the Univ. of Va., 442 S.E.2d 669, 674 (1994); *Williamson v. Nat'l Grange Mut. Ins. Co.*, 887 A.2d 665, 670-71 (Md. Ct. Spec. App. 2005) (courts interpreting contracts seek to ascertain intention of parties, as manifested by terms of instrument); *Hill v. Cook*, 156 A.2d 458, 459 (D.C. 1959) (intent of parties governs and instrument and this intent must be received from instrument; however, when words used admit of two meanings, extrinsic evidence may be used, and court will look at subject matter and surrounding circumstances to ascertain correct meaning).

⁹ *Rinck v. Ass'n of Reserve City Bankers*, 676 A.2d 12, 16-17 (D.C. 1996).

¹⁰ See *Ellis v. James V. Hurson Assocs. Inc.*, 565 A.2d 615, 620, 4 IER Cases 1505 (D.C. 1989) (substantial period of employment following signing of covenant does not automatically preclude enforceability of restrictive covenant); *Simko v. Graymar*, 464 A.2d 1104, 1106 (Md. App. 1983) (court held that the employee's continued service was adequate consideration for the restrictive covenant).

¹¹ *Rinck*, 676 A.2d at 17.

¹² *Simmons v. Miller*, 544 S.E.2d 666, 678 (Va. 2001) (holding that analysis of three factors "requires consideration of the restriction in terms of function, geographic scope, and duration"); *Gill v. Computer Equip. Corp.*, 292 A.2d 54, 59 (Md. 1972) (Maryland courts have held that adequate consideration exists if employee began work under contract containing a restrictive covenant).

¹³ *Omniplex World Servs. Corp. v. U.S. Investigations Servs. Inc.*, 618 S.E.2d 340, 342, 23 IER Cases 838 (Va. 2005).

compete agreement to protect nothing more than its legitimate business interest.¹⁴

In the District of Columbia, courts will likely enforce a noncompete agreement that is narrowly tailored to protect an employer's legitimate business interest and is *supported by adequate consideration*.¹⁵ In other words, an employer must prove that:

- the restriction is reasonable in duration and geographic scope;
- the restriction is necessary for the protection of the employer's legitimate business interests; and
- the restriction is intended and agreed upon by the parties.¹⁶

4. Noncompete Must be Reasonable in Duration and Geographic Scope.^[11] To be enforceable in the District of Columbia, a noncompete must be reasonable in duration and geographic scope. District of Columbia courts will not enforce a restrictive covenant that hinders an employee's ability to earn a living, including a noncompete that:

- applies for an unlimited time;
- extends the restrictions to areas where the employer once did business;
- extends the restrictions to locations where the employer only intends to do business; or
- extends the geographic reach of the agreement to an area that is not coterminous with that of the business at the time of the agreement.

There is no hard and fast rule on what restrictive covenants District of Columbia courts will likely consider reasonable. Each case will turn on its own facts and the reasonableness of the restraint will, among other things, be determined by the nature of the business, services that the employee performed, the position of the employee, and whether the employer had a legitimate interest in protecting its business in a particular geo-

¹⁴ *Simmons*, 544 S.E.2d at 678 (holding that analysis of three factors "requires consideration of the restriction in terms of function, geographic scope, and duration"); see also *Mkt. Access Inc., v. KMD Media, LLC*, 72 Va. Cir. 355, 359 (Va. Cir. Ct. 2006) (noncompete agreement that had no geographical limitation was still enforceable because it allowed employee to continue to work in his field); *Motion Control Sys., Inc. v. East*, 546 S.E.2d 424, 426 (Va. 2001) (refusing to enforce restrictive covenant that forbid employee from engaging in business of importing cigars anywhere in world due to unlimited geographic scope of provision); *Advanced Marine Enters., Inc. v. PRC, Inc.*, 501 S.E.2d 148, 156 (Va. 1998) (finding that eight-month duration informed evaluation of both geographic scope and function components of restrictive covenant); *Meissel v. Finley*, 95 S.E.2d 186, 190 (Va. 1956) (affirming noncompete agreement that prohibited former partner from writing insurance or surety bonds for five years within 50-mile radius).

¹⁵ See, e.g., *Deutsch v. Barsky*, 795 A.2d 669, 676-77 (D.C. 2002) (mutual covenant not to compete executed by dentist in connection with purchase of stock in professional corporation, barring a departing dentist for two years following departure, from establishing a dental practice within five mile radius of current office was not facially invalid restraint of trade).

¹⁶ *Hanker*, 309 F. Supp. at 1280.

graphic area.¹⁷ Maryland and Virginia courts have adopted this approach.¹⁸

5. Noncompete Must Serve a Legitimate Business Interest. To enforce a covenant not to compete in the District of Columbia, an employer must demonstrate that it has a legitimate business interest which would be wrongfully injured if the restrictive covenant was not enforced. Protectable interests include: confidential information, trade secrets, customer contacts, and goodwill.¹⁹

A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade if: (1) the restraint is greater than is needed to protect the employer's legitimate interest or (2) the employer's need is outweighed by hardship to the employee and the likely injury to the public.²⁰

6. Blue Pencil Rule. Jurisdictions differ over whether they will rewrite a contract or "blue pencil" to render an otherwise invalid noncompetition agreement enforceable. District of Columbia and Maryland courts reject the view that covenants not to compete must be enforceable in whole or not at all and thus, following the "blue pencil" rule, allow courts to strike objectionable provisions from the restrictive covenant and enforce the remaining valid provisions.²¹ Severance or "blue penciling" is not available however, where an employer has committed serious misconduct in obtaining the covenant.²²

¹⁷ *Chem. Fireproofing Corp. v. Krouse*, 155 F.2d 422, 423 (D.C. Cir. 1946).

¹⁸ See *Deutsch*, 795 A.2d at 676-77 (dentist's covenant not to compete for two years, within five mile radius of current office, was not facially invalid restraint of trade); *Phoenix Renovation Corp. v. Rodriguez*, 439 F. Supp. 2d 510, 521-22 (E.D. Va. 2006) (finding noncompete unenforceable that prohibited former plumber from working in any "household" in 38 states because restriction would unduly hinder plumber's ability to earn living); *Intelus Corp. v. Barton*, 7 F. Supp. 2d 635, 642 (D. Md. 1998) (enforcing covenant not to compete anywhere in United States for period of six months because employee's former employer marketed products nationally, and employee's new employer competed with former employer nationally); *Tawney v. Mut. Sys. of Md.*, 47 A.2d 372, 379 (Md. 1946) (refusing to enforce restrictive covenant in bank manager's employment contract that restricted competition in Baltimore City for period of two years from date of termination of employment, reasoning that "it is sought to enforce a restriction beyond the time when new employees might reasonably be acquainted with existing customers. . .").

¹⁹ *Deutsch*, 795 A.2d at 676-77; *Intelus*, 7 F. Supp. 2d at 638; *Paramount Termite Control v. Rector*, 380 S.E.2d 922, 925 (Va. 1989) (employer protectable interests include trade secrets, customer contacts and other confidential information).

²⁰ *Deutsch*, 795 A.2d at 676.

²¹ *Ellis*, 565 A.2d at 617; see also *Holloway v. Faw, Casson & Co.*, 552 A.2d 1311, 1324 (Md. Ct. Spec. App. 1989) *aff'd in part, rev'd in part*, 572 A.2d 510 (Md. 1990) ("[t]he typical response in the reported appellate decisions in this State, in which the Courts have ruled a portion of an employee noncompetition agreement invalid, has been to "blue pencil" (cross out) the violative portions of the agreement and, if the excised portions of the agreement are severable, to permit the agreement to stand minus the unenforceable wording"); *Tawney*, 47 A.2d at 379 (court severed portion of covenant preventing competition in Baltimore City for two years).

²² See, e.g., *Ellis*, 556 A.2d at 615 (severance available where employer did not engage in serious misconduct).

Virginia law however, prevents courts from revising or “bluepenciling” overly broad portions of a noncompete to sever unenforceable provisions.²³ Thus, if one provision is invalid, the entire noncompete is invalid and unenforceable as a matter of law.²⁴ An employee can move for sanctions against an employer and its attorney for bringing a frivolous suit, where the employer seeks to enforce a noncompete that is obviously void.

E. Confidentiality Provisions

Over the past several years, Congress has strengthened whistle-blower laws to increase protections for employees who report varying forms of fraud or violations of law committed by their employers. Confidentiality provisions in employment agreements should not be used to silence employees or to require that employees report fraud internally prior to going to any outside entity to obtain assistance. In negotiating an employment agreement, the parties should clearly define what information is and is not confidential and should carve out exceptions for the good faith reporting of fraud or violations of law to outside entities. Employees who sign confidentiality agreements or policies should not be forced to forfeit any right to disclose the employer’s unlawful conduct to the appropriate outside entities.

Confidentiality provisions that prohibit employees from disclosing violations of federal or state laws, rules, or regulations are unenforceable. The right to disclose evidence of violations of federal laws has a basis in public policy and the Constitution that supersedes local tort or contract rights.²⁵ Applying that principle to witnesses of illegality, “a citizen may not be denied the right to inform on violation of federal laws.”²⁶ As a district court in the Fourth Circuit explained in *Bondcote Corp. v. Ayers*,²⁷ “whatever ‘tends to injustice or oppression . . . or to the violation of a statute’ is against public policy.”

The *Bondcote* court noted, “[C]ourts of justice will never recognize or uphold any transaction which, in its object, operation or tendency, is calculated to be prejudicial to the public welfare.”²⁸ As succinctly summarized in *Caesar Electronics, Inc. v. Andrews*:²⁹

[H]owever high the duty an agent may owe its principal, society’s interest in preventing the commission of criminal acts overrides that duty, as exemplified by the wealth of state and federal criminal conspiracy statutes in this country.³⁰

²³ *Pais v. Automation Prods. Inc.*, 36 Va. Cir. 230, 239 (Va. Cir. Ct. 1995).

²⁴ *Lanmark Tech. Inc. v. Canales*, 454 F. Supp. 2d 524, 529 (E.D. Va. 2006).

²⁵ See *Maddox v. Williams*, 855 F. Supp. 406, 415 (D.D.C. 1994) (“There is a constitutional right to inform the government of violations of federal laws – a right which under Article VI supersedes local tort or contract rights and protects the ‘informer’ from retaliation.”) (citing *In re Quarles*, 158 U.S. 532, 536-38 (1895)).

²⁶ *United States v. Bailes*, 120 F. Supp. 614, 626 (S.D. W. Va. 1954).

²⁷ 2006 WL 938734 at *4 (W.D. Va. 2006) (citing *Wallihan v. Hughes*, 196 Va. 117, 124 (1954)).

²⁸ *Bondcote*, 2006 WL 938734 at *4 (citing *O’Dell v. Appalachian Hotel Corp.*, 153 Va. 283, 292 (1929)).

²⁹ 905 F.2d 287 (9th Cir. 1990), cert. denied sub nom. *Caesar Electronics, Inc. v. Fairchild Semiconductor Corp.*, 498 U.S. 984 (1991)

³⁰ 905 F.2d at 289.

Confidentiality provisions that effectively require the parties to conceal fraud on the government are also void. In *X Corp. v. Doe*,³¹ a lawyer sought to disclose information about his former corporate client concerning a fraud on the government. The client contended the lawyer could not disclose it due to the corporation’s confidentiality agreement.³² The court held that “[t]o the extent it prevented disclosure of evidence of a fraud on the government, that Agreement would be void as contrary to public policy. In other words, *X. Corp cannot rely on any contract to conceal illegal activity.*”³³ The premise for nonenforcement was “the public interest, which must be considered in every case.”³⁴

As recognized in *McGrane v. Readers Digest Ass’n Inc.*,³⁵ “[C]ourts are increasingly reluctant to enforce secrecy arrangements where matters of substantial concern to the public — as distinct from trade secrets or other legitimately confidential information — may be involved.”³⁶ After thoroughly analyzing the law, the court concluded: “[A]ny arrangement, formal or informal, designed to preclude a former employee from reporting wrongdoing by a former employer to proper authorities would be unenforceable.”³⁷ Addressing trade secrets, it stated, “[D]isclosures of wrongdoing do not constitute revelations of trade secrets which can be prohibited by agreements binding on former employees.”³⁸

F. Lapse of Contract

As the employment agreement should be for a definite term, the parties should also address criteria for extending the period of the contract and what should occur if the contract expires but the employee remains employed with the company. First, the parties must clarify whether an employee is obligated to leave the employment with the employer should the contract end. In cases where the position is dependent upon a certain task, an extension of the contract may not be feasible. However, a majority of workplaces have ongoing relationships with their employees, and would likely desire an employee that is performing well to remain employed with the company. Therefore, the parties should include criteria or circumstances under which an employee may renew or renegotiate his or her employment agreement once the original agreement expires.

Second, the parties should state what should happen if the employment agreement lapses, but the employee continues to work for the employer. In such a situation, the employee may lose the ability to collect a severance payment, and the employer may lose the employee’s agreements relating to confidentiality and to refrain from competing with the employer subsequent to the termination of the employment relationship.

G. Entire Agreement

Finally, both parties must be sure to include a provision stating that the employment agreement represents and contains the entire agreement. Otherwise, the parties could be subject to litigation over whether the parties included or intended to include other provisions in

³¹ 805 F. Supp. 1298, 1310 (E.D. Va. 1992).

³² See *id.*

³³ *Id.* at 1310, n. 24 (emphasis added).

³⁴ *Id.* at 1311.

³⁵ 822 F. Supp. 1044, 1046 (S.D.N.Y. 1993).

³⁶ *Id.*

³⁷ *Id.* at 1052.

³⁸ *Id.* at 1046.

the employment agreement. To further protect themselves, the parties should also ensure that the employment agreement contains a provision requiring that any modifications to the agreement may only be made in writing and must be signed by both parties in order to be valid.

III. Severance Provisions For Employment Contracts

A. Severance Provisions

Including severance provisions in an employment agreement can be an easy way for both the employer and the employee to obtain the severance package that they desire should the employment relationship end *while the parties are on good terms with each other*.

In addition to the amount of the severance payment (or a formula upon which the severance payment will be calculated, the employment agreement should state whether the benefits shall be paid in a lump sum or in installments. If the payments are to be made in installments, the agreement should also contain a defined schedule of payments so that each party understands when each payment is due. An employee should also avoid consenting to payroll or bank account deductions by the employer for any amount equaling a negative vacation balance or an overpayment of expenses.

Both parties should also ensure that the employment agreement's severance provisions contain a statement of whether the employee shall be paid for accrued vacation.^[iii] Indeed, payment for accrued vacation may be considered earned compensation under state law unless otherwise stated in the parties' agreement. Importantly, the parties should also ensure that the severance provisions of their employment agreement address how the severance payments will be taxed, if at all.^[iv]

Next, should the employee hold any stock or other interest in the employer, the parties should also be sure to address how the rights of employee-stockholder will be affected by the employee's departure. The parties should examine the employee's stock options and determine how to dispose of both the employee's vested and nonvested options. Employees should also ensure that there is no immediate loss of their stock grants or vested options and that they have adequate time in which to exercise their options.^[v]

Further, because severance plans are governed by the Employee Retirement Income Security Act, the severance provisions should also include all formalities of an ERISA plan. It should comply with all of the ERISA disclosure and notice provisions, it should include a continuing obligation of the employer and an ongoing administrative framework for administering the plan, and it should include an immediate payment of monies due as wages under applicable wage payment laws.

The parties should also be sure to negotiate what an employer may disclose about an employee's employment after the parties' relationship has ended. Both parties should avoid language that permits the employer to provide information that reflects the employee's work to any potential employers. Such references could reflect poorly upon the employee and later subject the employer to claims of defamation. Instead, the parties should negotiate a neutral reference that confirms nothing more than the employee's position, employment status and or/title, dates of employment, and salary.^[vi]

Finally, the parties should be sure to clearly define when the severance provisions will apply. Neither an employer nor an employee wants to be in a situation where the parties' agreement ends, and so facially, it appears that the employee is entitled benefits under the severance provisions, but the employee is continuing employment, either in the same capacity or in a different capacity. Accordingly, the parties should clearly state whether the severance provisions are only applicable if the contract ends and the employee leaves the company or if the contract ends and the employee remains employed with the company.

B. Breach of Contract

In the event that either party breaches the contract, several provisions are key. First, the parties should state what laws are applicable to a breach of contract. The United States District Court for the District of Columbia has recognized that a "forum selection clause is prima facie valid absent some compelling and countervailing reason for setting it aside."³⁹ Further, although the courts typically give a plaintiff's choice of forum deference, no deference is given "where the plaintiff has agreed to venue elsewhere under a forum selection clause."⁴⁰ Therefore, the parties should be sure to contemplate the jurisdiction in which they would prefer to adjudicate any claims arising out of the employment agreement.^[vii]

Further, the parties should also consider whether to agree to arbitrate or mediate any claims arising out of the employment agreement. These methods can be quicker, less costly, and less hostile than litigation in state or federal courts.

The parties should also consider what damages they would suffer and/or would need to impose on the offending party should a party breach the employment agreement. The damages sought by either party must be reasonable and must reflect the anticipated or actual loss caused by the breach of the agreement. The parties should also consider whether they should include a liquidated damages provision to deter the offending party from breaching the agreement again in the future. The District of Columbia upholds the validity of liquidated damages as long as the amount agreed to by the parties is reasonable.⁴¹

Conclusion

Although this article focuses on the law in the District of Columbia, Maryland, and Virginia, the law varies from state to state and can change over the course of time. In drafting or analyzing an employment agreement, one should seek the advice of an experienced employment attorney.

³⁹ *Cheney v. IPD Analytics, LLC*, 583 F. Supp. 2d 108, 117-18 (D.D.C. 2008) (internal citations omitted).

⁴⁰ *Id.* at 126.

⁴¹ *Ashcraft & Gerel v. Coady*, 244 F.3d 948, 954-56 (D.C. Cir. 2001), citing *Progressive Builders, Inc. v. District of Columbia*, 258 F.2d 431, 433-34 (D.C. Cir. 1958), see, e.g., *Horn & Hardart Co. v. National Rail Passenger Corp.*, 843 F.2d 546, 550 (D.C. Cir. 1988) (citing *Vicki Bagley Realty Inc. v. Laufer*, 482 A.2d 359, 368 (D.C. 1984)); *Burns v. Hanover Ins. Co.*, 454 A.2d 325, 327 (D.C. 1982).

Sample Employment/Severance Agreement Provisions

Noncompete/Nonsolicit Provisions:

ⁱDuring my employment by the Company and for a period of 6 months after I cease to be employed by the Company, I shall not, directly or indirectly, either as an individual, partner, shareholder (other than shares regularly traded in a recognized manner), official employee, agent or otherwise, be employed by, connected with, participate in, consult or otherwise associate with any other business, enterprise or venture that is competitive with Company. By way of example, and not as a limitation, the foregoing shall preclude Employee from soliciting business or sales from, or attempting to covert to other sellers or providers of the same or similar products or services as provided by the Company, a customer, client, or account of Company with which employee has had any contact during the term.

Noncompete Must be Reasonable in Duration and Geographic Scope:

ⁱⁱDuring my employment by the Company and for a period of six (6) months after I cease to be employed by the Company, I shall not, directly or indirectly, either as an individual, partner, shareholder (other than shares regularly traded in a recognized manner), official employee, agent or otherwise, be employed by, connected with, participate in, consult or otherwise associate with any other business, enterprise or venture that is competitive with Company.

Accrued Vacation: Unused but Earned:

ⁱⁱⁱ[Employer] shall, in accordance with its policies and applicable law, provide [Employee] with all base salary and all accrued but unused vacation earned by [Employee] in the normal course of business through

the Employment Termination Date, less all required deductions for federal and state withholdings, other applicable taxes, and any lawfully authorized or required payroll deductions.

Severance Benefits: Taxation:

^{iv}[Employer] will pay [Employee] the [Agreed Severance Benefit], less all required deductions and withholdings.

Severance Benefits: Stock Options:

^vYou will have twelve (12) months from the date of separation to exercise your vested Company stock options. In addition, you will have one additional year during which additional nonvested stock may become vested and exercisable.

Employee References:

^{vi}Should a prospective employer call [Employer] concerning [Employee], provided [Employee] directs such prospective employer to [Human Resources or other designated contact], [Employer's] response will be limited to verification of employment, position as [last position], employment status (full-time), and dates of employment and, if asked for verification of the salary information given by the prospective employer, [Employee's] salary.

Adjudication of Claims: Jurisdiction:

^{vii}Any disputes under or in connection with this Agreement shall, be resolved by the United States District Court for the District of _____, _____ Division, which shall have exclusive jurisdiction thereof. In any action or proceeding brought in connection with this Agreement, the prevailing party or Parties shall be entitled to recover reasonable attorneys' fees in addition to costs and expenses.