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A Guide to Settlement Agreements



Please contact us to discuss your Settlement Agreement in more detail. Whether you are an Employer or an Employee we shall be delighted to help with your Settlement Agreement.



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Settlement Agreements

At mosshaselhurst we have many years experience of drawing up Settlement Agreements (formerly known as Compromise Agreements) on behalf of Employers and advising employees as to their meaning and effect.

What is a Settlement Agreement?

A Settlement Agreement is a document which records an employee's agreement not to pursue a claim after termination of employment, such as unfair dismissal or breach of contract. The agreement provides certainty to both parties and is usually signed in exchange for a sum of money paid by the Employer.

Under the Employment Rights Act 1996 the agreement will only be valid and enforceable if:

- The agreement is in writing.
- The agreement relates to a particular complaint or complaints raised by the employee.
- The employee has received legal advice from a relevant independent advisor, such as a Solicitor, on the terms and effect of the proposed agreement and its effect on the employee's liability to pursue any rights before an Employment Tribunal.
- The advisor has a current contract of insurance, or professional indemnity insurance, covering the risk of a claim by the employee in respect of the advice.
- The agreement identifies the advisor who usually signs to confirm the advice has been given.
- The agreement states that the conditions regulating Settlement Agreements have been satisfied.

A Settlement Agreement should be tailored to the individuals circumstances. However, there are some features that are common to most Settlement Agreements.

The purpose of this leaflet is to explain succinctly some of the more common clauses to be found in Settlement Agreements. It is not a substitute for independent legal advice.

Background

It is often helpful to set out a brief summary of the circumstances which led to the parties entering into the Settlement Agreement, including details of the individuals employment (such as start date, position, any complaints raised, reason for termination).

Parties to the agreement

Usually the only parties to a Settlement Agreement are the Employer and the Employee. If an employee worked for more than one group company, it may be appropriate for all the relevant group companies to be parties to the agreement as well.

Interpretation or Definitions

Many Settlement Agreements begin with a clause explaining or defining terms used in the agreement.

Reason for Termination

A Settlement Agreement does not have to give a reason for the termination of employment. If a

Appendix A

The following is a list of statutory claims that may be settled by way of a Settlement Agreement:

- Claims for equal pay, under section 2 of the Equal Pay Act 1970 (see section 77(4)(aa), Sex Discrimination Act 1975).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of sex or the individuals marital or civil partnership status, under section 63 of the Sex Discrimination Act 1975 (see section 77(4)(aa), Sex Discrimination Act 1975).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of colour, race, nationality or ethnic or national origin, under section 54 of the Race Relations Act 1976 (see section 72(4)(aa), Race Relations Act 1976).
- Claims in relation to obligations under TULCRA that are specified in section 18(1)(b) of the Employment Tribunals Act 1996 (see section 288(2A) of the Trade Union and Labour Relations (Consolidation) Act 1992) but not claims in relation to the actual duty to consult appropriate representatives (see section 288(2C), TULCRA).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of disability under section 17A of the Disability Discrimination Act 1995 (see section 18(1)(c), Employment Tribunals Act 1996).
- Claims under the Employment Rights Act 1996 (ERA 1996) that are specified in section 18(1)(d) of the Employment Tribunals Act 1996 (see section 203, ERA 1996). These include claims for unfair dismissal, a statutory redundancy payment, unauthorized deductions from wages, claims for unlawful detriment (for example as a result of whistleblowing) and in relation to maternity, paternity, adoption and parental leave and flexible working.
- Claims in relation to working time or holiday pay, under regulation 30 of the Working Time Regulations 1998 (see regulation 35(2)(b), Working Time Regulations 1998).
- Claims in relation to the national minimum wage, under sections 11, 18, 20 and 24 of the National Minimum Wage Act 1998 that are specified in section 18(1)(dd) of the Employment Tribunals Act 1996 (see section 49(3)(a), National Minimum Wage Act 1998).
- Claims under regulations 27 and 32 for failure to comply with obligations under the Transnational Information and Consultation of Employees Regulations 1999 (see regulation 41(3), Transnational Information and Consultation of Employees Regulations 1999).
- Claims for less favourable treatment on the grounds of part-time status, under regulation 8 of the Part-Time Workers (Prevention of Less Favourable Treatment) Regulations 2000 (see regulation 9, Part Time Workers (Prevention of Less Favourable Treatment) Regulations 2000).
- Claims for less favourable treatment on the grounds of Fixed-Term Employees (Prevention of Less Favourable Treatment) Regulations 2000 (see regulation 10, Fixed-Term Employees (Prevention of Less Favourable Treatment) Regulations 2000).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of sexual orientation, under regulation 28 of the Employment Equality (Sexual Orientation) Regulations 2003 (see schedule 4, Employment Equality (Sexual Orientation) Regulations 2003).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of religion or belief, under regulation 28 of the Employment Equality (Religion or Belief) Regulations 2003 (see schedule 4, Employment Equality (Religion or Belief) Regulations 2003).
- Claims for failure to comply with obligations under the Information and Consultation of Employees Regulations 2004 (see regulation 40, Information and Consultation of Employees Regulations 2004) which applies in relation to employers with 150 or more employees in the UK from 6 April 2005, to employers with 100 or more employees in the UK from 6 April 2007 and to employers with 50 or more employees in the UK from 6 April 2008.
- Claims for a detriment relating to occupational and personal pension schemes under regulation 17 and paragraph 88 of the Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006 (see paragraph 12, schedule, Occupational and Personal Pension Schemes (Consultation by Employers and Miscellaneous Amendment) Regulations 2006).
- Claims for direct or indirect discrimination, victimization or harassment on the grounds of age, under regulation 36 of the Employment Equality (Age) Regulations 2006 (see schedule 5, Employment Equality (Age) Regulations 2006).
- Claims in relation to the right to be accompanied under section 12 of the Employment Relations Act 1999 and section 48 of the Employment Rights Act 1996.

Only certain claims may be settled by a Settlement Agreement. An example list is set out at Appendix A, which may be added to in the light of current legislation.

It is not possible to waive any accrued pension rights. For example, any such rights are often owed to the employee by the Trustees of a pension scheme, who are not party to the Settlement Agreement.

The Employer may want to obtain a waiver in relation to all existing personal injury claims, and such a waiver may validly exclude claims of which the parties are aware at the time of the agreement, provided the wording is sufficiently clear.

Third party rights

The Contracts (Rights of Third Parties) Act 1999 allows a third party to enforce contractual terms. If it is intended that a third party (for example, the employer's group companies or a buyer on a TUPE transfer) will have rights under the Settlement Agreement then this will be stated in the agreement.

Confidentiality

Employers can protect confidential information while the employee is employed. However, unless there is an express term in the employment contract or Settlement Agreement, protection after termination will only extend to information which is so confidential as to amount to a business secret.

Governing law and jurisdiction

A 'jurisdiction clause' enables the parties to agree which country's courts are to have jurisdiction to hear disputes. This will usually be England and Wales.

Advisors certificate

Although it is not a legal requirement, it is good practice for the employee's legal advisor to sign a certificate confirming that the advice has been given. Often the Employer will want this to be on the headed notepaper of the Solicitors firm. This can be part of the Settlement Agreement but it is good practice to provide this in a separate document.

And finally...

We hope that the information in this leaflet has helped you to understand your Settlement Agreement. However, you will need to obtain formal legal advice for your Settlement Agreement to be valid.

Please note that you must not rely on the information contained in this leaflet as an alternative to seeking specific legal advice from an appropriately qualified legal professional including a Solicitor, Legal Executive or other advisor. To the maximum extent permitted by applicable law we exclude any liability for any information contained in this leaflet which might be regarded as a representation, warranty, undertaking or guarantee relating to its contents.

Without prejudice to the generality of the forgoing paragraph we do not represent, warrant, undertake or guarantee:

- That the information contained in this leaflet is correct, accurate or complete
- That the use of guidance in this leaflet will lead to any particular outcome or result in a particular matter
- In particular that by using the guidance in this leaflet you will enhance or protect your legal position
- We will not be liable to you in respect of any losses arising out of inappropriate reliance on this leaflet.

Call Gerard Rooney on 01606 74301 or e-mail gmr@mosshaselhurst.co.uk to arrange a meeting for detailed advice.

reason is given, it must be consistent with any reference provided.

The reason for termination may be relevant if you have Income Protection Insurance, perhaps as part of a house insurance policy. For example, some such insurance policies only pay out if the reason for termination is redundancy. You should check your policies, and if appropriate, check the cover available with the insurance provider.

Agreements Prior to Termination

Unless your employment has already ended, your Settlement Agreement should deal with the arrangements in the period prior to termination. In particular, it should confirm the payments that will be made to you over that period. These payments usually include salary, holiday pay, and expenses. Since these arise under contract, they will be subject to tax in the usual way.

If you are going to receive any bonus or commission payment then this should be specified in the agreement, and the Employer may also wish to specify what payments you will not receive.

Garden Leave

A Settlement Agreement may provide that you will be on 'garden leave' until the end of your employment.

If you are placed on garden leave, you will not be required to attend work, for example at your office. You are free to stay at home (or in the garden!). You do however, remain an employee and subject to your employers authority. You will not be allowed to go on holiday without properly booking time off work.

Most employees are more than happy to be on garden leave because they continue to get paid without having to attend work.

If the employee is not working any notice period, then a payment in lieu of notice (PILON) may be made. The length of the notice period is usually set out in the employment contract. If not then the law decides how much minimum notice should be given by the employer or the employee.

Payment in Lieu of Notice (PILON)

If you are receiving a PILON, you are not entitled to compensation for the holiday that would have accrued during the notice period. You have the right to a payment in lieu of statutory holiday entitlement that has accrued but not been taken at the date of termination.

Accrued But Untaken Holiday Entitlement

The payment due for accrued but unused holiday pay is usually calculated on the basis of the annual salary divided by the number of working days for each day's holiday entitlement. It should be based on working days and not calendar days. The relevant calculation for a full time worker is 1/260.

The law does not allow employers to deduct money from the employee's final salary where the employee has taken holiday in excess of the entitlement. The employer will only be able to do this, if there is a right to do so in the employment contract.

Termination Payment

Employees usually receive a termination payment by way of compensation for loss of employment. If the termination payment is made after the Employer has issued the employee's P45, the employer may choose to deduct income tax at the basic rate only, in which case the employee will be responsible for any further tax due.

References

There is no legal obligation on an Employer to provide a reference for an employee or ex-employee and Employers are therefore entitled to refuse to provide a reference.

However, it is common to include a term in a Settlement Agreement that provides that the Employer will respond to any request for a reference in accordance with an agreed form annexed to the agreement. If not, employees often insist on having the agreed reference before signing the Settlement Agreement. Often this reference is very basic and provides minimal information such as start date, finish date and job title.

Tax Liability

The first £30,000 of a termination payment is usually exempt from tax and any excess will be subject to income tax in the normal way. Any statutory redundancy payment or ex gratia payment should also be tax free.

Any payments which are allocated to restrictive covenants or confidentiality obligations will be taxable in full.

If the termination date is close to the end of the tax year it may be more tax efficient to move the termination date into the next tax year. The termination payment will then be treated as taxable in that year, which will mean the employee has longer to pay any additional tax due and may be able to make use of lower rate tax bands that would otherwise not have been used.

A Settlement Agreement usually includes a 'tax indemnity' clause. This provides that if additional tax is payable, it will be the liability of the employee rather than the Employer. An Employer can never make guarantees about the tax status of any payments, and will invariably insist on retaining the safety net provided by a tax indemnity clause.

Repayment on Breach

It is common to include in the Settlement Agreement a clause stating that an employee will repay the money if he or she breaches any term of the Settlement Agreement.

There is a danger that such a clause may be unenforceable because 'penalty clauses' are not usually valid. Nevertheless, the Employer often includes the clause, as a deterrent against the employee starting a claim.

Restrictive Covenants and Confidentiality

Restrictive covenants or post-termination restrictions are often included in Settlement Agreements to protect the Employer from harm to its business. They are only enforceable to the extent that they are necessary to protect the legitimate business interests of the Employer.

Typically, restrictive covenants can include restrictions against:

- Dealing with or soliciting customers and suppliers of the Employer
- Poaching employees
- Disclosing confidential information

It is usual for an Employer to state that a specified amount of the termination payment is being paid in consideration for entering into the covenants. This is because payments for restrictive covenants are taxable in full and, if part of the payment is not separated out in this way, the tax authorities may argue that the whole termination payment is payment for the covenants and should be taxable in full.

Employee's Warranty

A Settlement Agreement often includes a warranty that the employee is not aware of any circumstances which would justify their summary dismissal.

The Courts have held that a Settlement Agreement can be conditional upon such a clause. The Employer could withhold the payment if it discovered circumstances that would have justified dismissing the employee without notice.

Legal Fees

Since one of the conditions of a Settlement Agreement is that the employee has received legal advice, it is common for the Employer to make a contribution to the employee's legal fees. However, it is not a legal requirement to do so, and the Employer's contribution is often insufficient to enable the employee to obtain proper detailed and informed legal advice on the Settlement Agreement. Employees should check whether they have legal expense insurance to cover the cost of such legal advice.

Waiver of Claims

The Employer's objective is for the employee to give up any rights to bring a claim against them after the termination of employment.

A Settlement Agreement:

- May cover more than one type of claim and may cover both claims that have been brought in a tribunal and those that have merely been raised by the employee.
- Must clearly identify the claims being settled in order to be a binding waiver of those claims.
- Will be invalid and unenforceable if it purports to simply sign away all an employee's Tribunal rights.

Settlement Agreements should be tailored to the particular circumstances of each case.