

Steen & Co
Employment Solicitors

SETTLEMENT AGREEMENTS

This is a note about some of the issues involved in Settlement Agreements. It is not a substitute for individual advice that, of course, we will give you, but it is a pre-prepared advice on some of the issues that will arise in your Settlement Agreement. It is designed for us to advise you on these issues economically so that you are prepared for some of the points that may arise.

1. The Tax Indemnity

Nearly all Settlement Agreements rely in some way on the £30,000 tax free allowance for termination of employment or loss of office payments. In theory, this should only benefit companies but it is often used to the employee's advantage to give him or her more money than he or she would otherwise get.

If the £30,000 allowance is used companies invariably want a contractual right to claim back any tax that should have been deducted but because the company got the tax treatment wrong wasn't. This is in case HMRC ever challenge the Settlement Agreement payment's tax treatment. Such a contractual right is called a tax indemnity and you will find such a clause in most Settlement Agreements. An example of such a clause is as follows:-

The payments under Clause 2 ("the Termination Payment") are made in consideration of this agreement. The parties believe that the termination payment and benefits provided to the Employee pursuant to Clause 2 of this Agreement are exempt from tax and national insurance liability. Save for any tax and national insurance contributions deducted by the Company, the Employee undertakes to indemnify and hold the Company harmless against all other taxes and national insurance contributions in

respect of the payments and benefits provided, or to be provided, pursuant to this Agreement, and all costs, claims, expenses or proceedings, penalties and interest incurred by the Company which arise out of or in connection with any liability to pay (or deduct) tax or national insurance contributions in respect of such payments and benefits.

This is an example tax indemnity and in our experience, there is a range of such tax indemnities ranging from favourable to the employee to completely and utterly one-sided and against the employee. This range can be summarised as follows:-

- (a) No tax indemnity;
- (b) Just a requirement to pay back the tax if the Revenue challenge and only after the employee has had an opportunity to take issue with the Revenue;
- (c) Tax and Employee's National Insurance only - no opportunity to take issue with the Revenue;
- (d) Tax, National Insurance, penalties and interest; and
- (e) Tax, National Insurance, possibly including Employer's National Insurance, costs, penalties, interest - no opportunity to take issue with the Revenue and the costs to include all costs of taking issue with the Revenue's investigation, possibly costs of any criminal sanctions and costs of making any of the payments to the Agreement!

When dealing with a Settlement Agreement for the employee we could take the view that we should seek no tax indemnity. However, this is completely unrealistic and such an argument has never been successful. We could try to make the Company's proposed tax indemnity completely useless, which we do occasionally succeed in doing. If there are solicitors on the other side or the Company's advisers are aware of the situation, they won't allow such a ploy. We could accept the Company's tax indemnity but make slight amendments such as removing the requirement to repay penalties, costs and interest. We can also ensure that only Employee's

National Insurance is covered by the indemnity and, finally, we can use our own tax indemnity clause which only relates to tax and Employee's National Insurance and makes it quite clear that the Company will not make any admission as to its liability to pay the tax before the employee has had an opportunity to take issue with the Inland Revenue or other body that is seeking the tax or National Insurance, such as a Court.

If we use our tax indemnity sometimes the Company comes back and requires that any penalties, costs or interest incurred by the employee taking issue with the Revenue or Court etc., as to the Company's liability should also be covered by the indemnity. We will deal with this as appropriate if it arises.

The issue of costs and penalties arise as a result of tax law. A company is required to complete its own tax returns and account properly for tax and national insurance. If it does not, for example, because it has paid money gross that should have been taxed, the Revenue could seek interest on the tax that has not been paid over on time. In addition, it could impose penalties of several times the tax avoided. Costs may arise in dealing with the Inland Revenue's investigation and, in theory, in respect of a prosecution or other court case arising out of the non-payment of tax. Clearly, these are significant liabilities, which it is unacceptable to impose on the employee. As a minimum we will always seek to ensure that no costs, penalties and interest are included within the indemnity. We note that companies sometimes require or purport to require employees to pay Employer's National Insurance. This is wholly unacceptable and is, in fact, a criminal offence and so we are nearly always successful when we point this out.

When negotiating any aspect of the Settlement agreement and in particular the tax indemnity much will depend on your negotiating strength. Sometimes we find that the parties have already negotiated a lot before we get involved. If this is the case and if negotiations have already been exhaustive then there is likely to be little room for further negotiation. Therefore, sometimes, with the best will in the world, we can't get anywhere; other times, when we explain why the proposed tax indemnity is totally one sided, a realistic version is accepted. We also

know that our success in this depends on the other side's solicitor's attitude to sensible negotiation. Our ability to negotiate also depends on a number of other factors, not only your negotiating strength, as mentioned above, but also the amount of costs involved. If we are on a tight budget we may not be able to negotiate for considerable periods. Usually at the first instance we will seek to include our standard tax indemnity (on the basis that removing an indemnity entirely has always proved to be unsuccessful) but if we can't do that we will have to, as lawyers say, "take a view" and discuss the issue with you.

There are some solicitors out there who we consider 'good' in that they draft sensible agreements from the outset. By sensible we mean realistic, fair and sensible. Bird & Bird are an example of this type of solicitor. Other solicitors take a different approach and draft utterly one sided agreements that no sensible solicitor on the other side could ever agree to. What happens in that later case is that no one benefits but the solicitors who record much more chargeable time than they would otherwise have done.

At the same time as looking at the indemnity we will of course be looking at the tax treatment of the payments under the Settlement Agreement. We have great experience in dealing with the tax treatment of Settlement Agreement payments. It is quite often the case that companies are proposing not to tax something that should clearly be taxed. Our view is that it is best to get the tax treatment right than to store up potential problems for the employee under a tax indemnity in the future. Occasionally we are asked by companies to take part in, what is tantamount, to a fraud and, of course, we will not entertain that whatsoever. Sometimes companies can be a little bit upset that we state that the proposed method of payment is actually wrong and, of course, we would discuss with you at the appropriate time.

2. Return of Company Property

We will see such a clause in all Settlement Agreements. It is never normally an issue. We have had one experience however of an ex-employee who signed a Settlement Agreement but did not return some of the Company property. The Company, therefore, refused to make the payment under the Settlement Agreement. As far as we are able, we will try to ensure that

there is no link between payment under the Settlement Agreement and return of Company property. In circumstances where you consider that there might be an issue with the Company's attitude towards return of its property, we advise that you itemise all Company property that you have and on its return take the itemised list and get a receipt for it. We will also try to ensure that the return of Company property clause deals only with property belonging to the Company or associated companies. Quite often we see such clauses that seek the return of all property and documents etc relating to the Company, whereas this of course could be deemed to include your pay slips, contract of employment and other matters.

Another point to note is that often these agreements require you to warrant that you have 'irretrievably deleted' all company information on your home computer. We know that is almost impossible to do without taking an angle grinder to the hard drive. Sometimes we can amend the clause to say 'in a way technically possible' or similar. However, this is a smallish issue!

3. "No Bad Mouthing"

This is a colloquial way of describing a clause that states that the employee will not say or do anything that brings the Company into disrepute. We generally want for such clauses to be mutual i.e., if the employee is agreeing not to "bad mouth" the Company the Company should do the same. Bound up with such a clause are requirements of confidentiality and not referring to the Settlement Agreement and the reference. The reference issue is our next point.

4. References and Reason for Leaving

We have a standard reference clause which provides that the Company will only provide the agreed reference and in so doing will not in any later oral or other communication move away from the spirit and intention of that reference nor make any reference whatsoever to the fact of settlement, the process of settlement, the terms of settlement or the events leading up to settlement. This is to prevent the Company providing the agreed reference to a prospective employer but accompanying it with words to the effect of 'this is the reference we agreed to

provide pursuant to a Settlement Agreement when the employee threatened to sue us' or similar.

If you want an agreed reference, we advise that you start writing it as soon as possible because often the terms of the reference can slow down the completion of the rest of the Agreement. However, we understand that most companies now simply give a standard reference so it might be sensible to only have this.

In respect of the reason for leaving, quite often we see Settlement Agreements that claim the employee cannot say anything about the circumstances of the termination of his employment. In theory, this might prevent the employee not being able to explain why he left. One can see the situation that an employee, in a future job interview, when asked why he left his previous employer, would have to state, "I can't tell you why I left". This could be very damning as it implies that the employee has left under a cloud. Accordingly, we will seek an agreed reason for leaving. This might be resignation for personal reasons, it might be resignation for business reasons or redundancy and we will ensure that the confidentiality requirements exclude the employee explaining the reason and circumstances of the termination of his employment in any later genuine job interview or similar.

5. Restrictive Covenants

Many executives are subject to existing restrictive covenants. These may become unenforceable depending on the circumstances of the termination. In some cases, particularly if the restrictions have become unenforceable, the Company seeks to reinstate those restrictive covenants or indeed to introduce new restrictive covenants within the Settlement Agreement. This has tax implications, as a payment for entering into a restrictive covenant is taxable. If the Company is seeking to introduce new restrictive covenants we will seek a separate payment to protect the tax treatment of the other payments within the Settlement Agreement. You must discuss with us what your views are on those new restrictive covenants. If the circumstances of the Settlement Agreement are such that it is unclear whether any existing restrictive covenants continue after termination, we will need to deal with this and so you must ensure

that we have a copy of your Service Agreement or Contract of Employment so as to be able to deal with this point.

6. Claims by the Company against you

This is an unusual point that shouldn't necessarily arise in a Settlement Agreement. The purpose of a Settlement Agreement is to deal with all of the employee's claims against the Company. It is therefore extremely unusual for it to deal with claims by the Company against the employee. Occasionally, however, we are asked to include within a Settlement Agreement a statement that the Company has no claims against the employee. However the Company will usually say that they will only deal with claims that they know about and, in any event, such a clause will probably not protect you against any claims that the Company later finds out it has. This reflects the general English common law position that claims that are unknown at the time of the settling cannot be settled by either party.

In this regard, you may see in Settlement Agreements statements that the Agreement is in full and final settlement of all claims against the Company 'whether known or unknown'. However, in our opinion this is not likely to be effective to settle unknown claims. We also note that asking a Company to include a claim in a Settlement Agreement that it is in full and final settlement of all claims the Company may have against the employee may hint at some unknown problem. If you have any concerns whatsoever that the Company may have claims against you please raise them with us as soon as possible during the negotiation period.

7. Exclusion of all claims

Earlier in this note we dealt with statements in the agreement that it settled all future claims. This part of the note deals with that part of the agreement that states 'this agreement is in full and final settlement of all claims' etc. Some solicitors see this part of the agreement as a challenge – lets see how many claims we can put it. The worst we have ever seen was a 27 page Settlement agreement! Others take the correct legal approach that Settlement Agreements

can only settle claims that have actually been raised and are therefore in the contemplation of the parties. We take a fairly relaxed view about agreements that list lots of claims that the employee hasn't got anyway but we ensure that personal injury claims and pension claims are not settled. In addition, we try to ensure that the agreement only settles claims arising out of the employment and its termination. In other words if we see the words 'or otherwise' we delete it. If there are claims that you know you have against the company – for example, unpaid bonus, please let us know.

8. Warranty that you haven't got another job

Be aware of this sort of clause. An example would be:

1. The Employee hereby warrants represents and agrees, and further acknowledges that the Company has entered into this Agreement in reliance on her warranties representations and agreement that:

..

1.1 she has not accepted a position with another employer, nor has been offered such a position that she intends to accept; and

1.2 she will upon demand repay immediately any payment made under clause 3 of this Agreement if the Employee breaches any term, condition, warranty or undertaking of this Agreement.

Clearly, the aim is to settle the case and start another job quite quickly so such clauses are difficult to deal with. We can't always get rid of them for you – after all what company wants to pay a lot of money for loss of earnings only to find that the employee has another job to go to immediately.

Please see the paragraph below on the effect of being in breach of a warranty.

9. Warranty that you are not in breach of contract.

This sort of clause is usually quite widely drafted. An example is

1. The Employee warrants that he has disclosed to the Employer any matter or matters that do or may constitute a breach by him of any of his obligations or duties to the Employer, including but not limited to a breach of trust.

Or

2. The Executive warrants that he has informed the Company of any matter which could reasonably have caused the Company to conclude that it could have dismissed him summarily for gross misconduct.

Or

3. Or even: "You warrant as a strict condition of this agreement that as at the date hereof...b) there are no circumstances of which you are aware or of which you ought reasonably to be aware which would constitute a repudiatory breach on your part of your contract of employment which would entitle or have entitled the company to terminate your employment without notice".

Or

4. The Employee warrants and represents to the Employer that up to and as at the date this Agreement becomes binding in accordance with **Clause 19** the Employee:

- 4.1. has not committed any material breach of any duty owed to the Employer or any Group company which in either case would, had the facts of such breach been known to the Company prior to the Termination Date entitle it to terminate the Employee's employment with the Company summarily;
- 4.2. has not done or failed to do anything amounting to a repudiatory breach of the express or implied terms of his employment with the Employer or which, if it had been done or omitted after the execution of this Agreement, would have been in breach of any of its terms;
- 4.3. is not employed or self-employed in any capacity nor is he in discussions which are likely to lead to nor has he received such an offer of employment or self-employment; and
- 4.4. is not aware of any matters relating to any acts or omissions by him or any director, officer, employee or agent of the Employer (or any Group company) which if disclosed to the Employer would or might affect its decision to enter into this Agreement.

All such clauses need to be thought about carefully. If there are any skeletons in the closet we need to know about them. In one case in May 2007 called Sean Mervyn Collidge v Freeport Plc ([2007] EWHC 1216 (QB)) and case number Case No: A2/2007/1280 A2/2007/1280(B) in the Court of Appeal, the ex employee, Sean Collidge, got nothing even though he had signed a Settlement agreement. Following a dispute with the Company terms were agreed for Mr Collidge's departure. These terms were wrapped up in a Settlement agreement which said that the money to be paid was subject to and conditional on terms which included a warranty by Mr Collidge that there were no circumstances of which he was aware or ought to have been aware that might constitute a repudiatory breach on his part of his contract of employment and that

would entitle or would have entitled the Company to terminate his employment summarily: i.e. without notice.

The Company did not pay Mr Collidge the Settlement agreement money but told him it was continuing an investigation of certain matters. These included misuse of a company driver, misuse of a credit card, problems with expense and mileage claims and removal of company equipment. In fact, what happened was that when the Company's Board decided to suspend him for three months while it investigated he said in effect, 'I'm innocent' can't I just sign a Settlement agreement and go'. The Company agreed but said we will still investigate the allegations and it ensured that payment under the Settlement agreement (£445,680) was conditional on Mr Collidge stating that he had not been in breach of his contract of employment. The clause the Company used was number 3 above.

The Court held that the Company's obligation to pay was conditional on the warranty being true; i.e. that Mr Collidge was not aware of such facts. The Court decided that all the matters complained of, including expense fraud, would have justified summary dismissal, that Mr Collidge had been aware that there had been numerous circumstances that would have entitled the Company to terminate his employment without notice and that he was not entitled to payment under the Settlement Agreement. This case is a good reminder of the importance of such a clause. In this particular case Mr Collidge may have thought that by signing the agreement he was home and dry but this was clearly not the case. There is not a lot that even experienced employment lawyers can do about such a clause. However, quite often Company's use Settlement agreements as a way of avoiding having to dismiss someone. In such a case the reason for the proposed termination may, if not disclosed, be a breach of such a warranty. As such, those facts should be disclosed to the company before the agreement is signed so that the company couldn't then use those facts as reason to avoid payment. However, telling the company you have been in breach of contract is a good way of ensuring that you are unlikely to get any money!.

Mr Collidge took his case to the Court of Appeal and on the 5th of March 2008 the Court rejected that appeal. In doing so Lord Justice Sedley said that an ordinary bystander would understand the Settlement agreement to say, if I transpired that Mr Collidge was in breach of contract "In that case he doesn't get paid, and if he has been paid he has to give it back". That was the interpretation he gave to the relevant clause in the Settlement agreement.

Conclusion

The above advice does not deal with all the terms of the Settlement Agreement but deals with some of the issues we regularly see. Please do not hesitate to ask me about any of the points above and of course during the negotiation period and when we discuss the Settlement Agreement with you I will be raising relevant points arising from that Agreement including, if appropriate, the points above.

Simon Steen

Steen & Co Employment Solicitors