

Compromise Agreements **(All an employer needs to know)**

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1. What is a Compromise Agreement?

The law states that an individual cannot contract out of his employment rights, but there is an exception to this rule where a settlement is reached by way of a Compromise Agreement.

A Compromise Agreement is a legally binding agreement between an employer and employee used to set out the terms and conditions reached when a contract of employment is to be terminated or a dispute is to be resolved. It is essential that you fully understand both your rights as an employer and those of your employees before entering into such an Agreement.

Compromise Agreements can be used in a number of circumstances, including redundancy, dismissal, or the settlement of an Employment Tribunal claim. Perhaps the most common use is in redundancy situations where it minimizes the risk of complications, prevents the possibility of future complaints arising, and concludes the employment contract unequivocally with agreement by both parties.

2. Why is a Compromise Agreement Necessary?

If, when making redundancies, you fail to comply with the relevant laws, it would normally be open to your employees to make a claim to the Employment Tribunal that the redundancy was unfair, potentially resulting in compensation or even reinstatement. As a result, employers are now increasingly using Compromise Agreements to prevent employees making claims after they have been made redundant. Compromise Agreements can also be used in the settlement of an employment related dispute, giving you certainty and closure.

A Compromise Agreement has the effect of your employee signing away their right to make a future claim against you in an Employment Tribunal and thus turning a redundancy package, or claim settlement, into a full and final settlement of any potential claims.

If you are thinking of making staff redundant, we would first of all advise you on the correct procedures to follow in order to comply with the relevant laws and minimise the risk of a claim being made against you by an employee. We would then assist you in drafting a suitable Compromise Agreement that is specifically geared towards the needs and protection of your business. Where necessary, we will negotiate on your behalf and strive to achieve the best settlement terms possible for you.

3. What will a Compromise Agreement contain?

In order to be legally binding, a Compromise Agreement must:

- Be in writing;
- Relate to an employment contract;
- Only be made where the employee has received advice from a relevant independent adviser, such as a solicitor, as to the terms and effect of the proposed agreement. The legal adviser must have professional indemnity insurance;
- Identify and be signed by the independent adviser;
- State that the conditions regulating Compromise Agreements are satisfied;

The Agreement will state the full breakdown of any payments you are making to your employee and the extent to which those sums will be paid free of tax. Usually up to £30,000 compensation can be paid without deduction, but it is usual for the employee to give a tax indemnity to you within the Agreement. We will help you to identify where the risk of future claims may lie and assess your potential liabilities before arriving at an appropriate figure to offer your employee as a settlement figure.

The Agreement will often also provide for confidentiality both in terms of your trade secrets and business affairs and also as to the terms of the Agreement. You will often have to pay the employee a small additional sum for agreeing to this.

The Agreement may contain a long list of Statutes under which the employee will agree not to bring a claim against you. The Agreement is intended to be in full and final settlement of all potential claims but the Agreement must mention the statutes specifically in order to make it enforceable.

The main reason for you to enter into a Compromise Agreement is that it will provide you with complete peace of mind, and remove the risk of a future (potentially costly) Tribunal claim. In redundancy situations, you are free to include reasonable terms for restricting the future employment of the employee, e.g. if working for a competitor could be adverse to your business' interests.

4. Why does my employee need legal advice on a Compromise Agreement?

The law states that a Compromise Agreement is only valid if the employee has obtained legal advice (this requirement cannot be waived in any circumstances). The required advice can only be given by a qualified lawyer, a qualified trade union official, or a qualified advice centre worker, all of whom must be covered by an appropriate certificate of indemnity insurance.

5. Will my employee have to pay tax on the amount received?

Compensation received under a Compromise Agreement can often be paid tax-free up to £30,000.

If the money you are paying is in place of your employee working a notice period, known as a Payment in Lieu of Notice ("PILON"), they may not have to pay tax on it. This will depend on whether there is a clause in their employment contract permitting you to make a PILON. If there is no PILON clause in their contract, any PILON in the Agreement can be paid tax free because it will be classed as compensation rather than a payment under their contract.

If their employment contract does contain a clause allowing you to make a PILON the payment will be subject to tax. Equally, if the contract gives you the discretion to make a PILON but you choose not to do so and pay compensation instead, it may still be deemed to be taxable as a PILON. This is more likely when the "compensation payment" is substantially the same value as a PILON would have been.

The general rule of thumb is that payments due in accordance with their contract of employment are taxable and ex-gratia payments are not. Our solicitors will advise on the tax implications of the figures put forward in the Agreement.

6. Does my employee have to agree to a Compromise Agreement?

There is no legal or other obligation on an employee to sign a Compromise Agreement if they are not happy with it. Their refusal to sign would mean that there is no agreement between you and them and they would maintain the right to pursue an employment related claim in the Employment Tribunal.

However, in many cases their refusal to sign a Compromise Agreement could mean that you refuse to pay the sum originally offered in the Agreement, i.e. the full redundancy package, and instead pay only the minimum state entitlement. The employee will therefore have to consider carefully whether the outcome of a potential claim in the Tribunal is likely to exceed what they would have received under the

Compromise Agreement. This is also something you should consider when putting forward your settlement offer.

If your employee does refuse to sign a Compromise Agreement, and pursues a claim against you in the Employment Tribunal, our solicitors can provide expert advice on defending such claims.

7. What claims will my employee be able to make once an Agreement is signed?

If your employee signs a Compromise Agreement, they will generally only be able to make three types of claim in future:

1. If you breach the Agreement
2. If the claim is in respect of personal injury. However, the Agreement may exclude personal injury claims in respect of injuries of which the employee is already aware at the time that the agreement is signed, e.g. when the reason for termination is due to sickness absence for stress or depression.
3. If the claim relates to accrued pension rights.

Should the situation arise where you find that a claim is made against you in the above terms, we have experience in dealing with such disputes and would be happy to provide advice on your particular situation.

8. Who pays for the legal advice required for a Compromise Agreement?

You will obviously need to pay for the drafting of the Agreement, but the vast majority of employers also offer their employees a contribution to legal fees which is sufficient to cover the costs of the required legal advice. The cost for the employee's legal advisor to review the Agreement is usually between £250 to £750 depending on the nature of the settlement, but this is often a small price to pay for the peace of mind it buys. Obviously, if negotiations become extended, then costs may increase further. The costs also constitute a further 'tax free' benefit for the employee.

This is prepared as general advice and should not be relied on without taking specific advice about your situation. We hope that this information has helped you to understand Compromise Agreements and how they can help you settle disputes in the workplace and resolve potential problems arising out of redundancies. If you have an employment law query relating to a Compromise Agreement or otherwise, please contact us for a consultation in which we will be pleased to provide you with our expert guidance.