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## Employment Spotlight: Confidentiality Clauses in Settlement Agreements

### Introduction

A settlement agreement (also known as a separation agreement) is a legally binding contractual document which sets out the employer's and employee's agreed terms of the termination of the employee's employment. There is no statutory requirement to enter into a settlement agreement upon termination, however, where separation terms can be agreed, it is often helpful to confirm those terms in writing. Typically, a term of the settlement agreement will be to keep the terms and the fact of the agreement confidential. In this note, we consider the effect of a breach of a confidentiality clause in a settlement agreement and discuss factors that may be useful for drafting a confidentiality clause.

### Duchy Farm Kennels

In the recent English case of *Duchy Farm Kennels v Steels*, [2020] EWHC 1208 (QB), the Court considered the effect of the breach of the confidentiality clause in a settlement agreement. In particular, the Court gave guidance as to the construction of a confidentiality clause and the circumstances in which a breach of a confidentiality clause would give rise to the innocent party being freed from the remaining obligations of the settlement agreement.

### Facts

This case involves a former employee, Mr Steels and his former employer, Duchy Farms Kennels Ltd ("DFK"), who entered into a settlement agreement on termination of Mr Steels' employment. The settlement agreement provided that DFK would pay Mr Steels a sum of £15,500 in 47 weekly instalments in full and final settlement of the employee's claims. The settlement agreement contained a term which obliged Mr Steels to keep the fact and terms of the settlement confidential. Mr Steels had allegedly breached the confidentiality clause by

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disclosing the fact of the settlement and the amount of the settlement to a third party. Upon discovering the alleged breach of the confidentiality obligation, DFK discontinued the payments and claimed to be released from the settlement agreement. DFK sought a declaration to the effect that as a consequence of Mr Steels' breach of his confidentiality obligation, the outstanding instalments were no longer payable.

## Legal principles

1. The Court distinguished between the three types of terms:

- a) a **condition**, the breach of which entitles the innocent party to bring the settlement agreement to an end;
- b) a **warranty**, the breach of which only entitles the innocent party to the remedy of damages; and
- c) an **intermediate or innominate term**, where depending upon the circumstances and the nature of the breach and whether it amounts to a repudiatory breach, the innocent party may be entitled to terminate the settlement agreement.

2. The question of whether the term is a condition of the settlement agreement is determined by reference to the language of the clause in the context of the agreement at the time the parties entered into the settlement agreement.

## Analysis

Cavanagh J. opined that:

1. When drafting a settlement agreement, parties may wish to expressly state whether a particular term is a "condition" of the settlement agreement and whether or not a breach of the term would absolve the innocent party from further obligations. In the absence of an express provision to that effect, the Court would consider the surrounding circumstances to decide whether the confidentiality obligation is at "the core of agreement". In this case, the term was found to be ancillary to the main settlement agreement rather than it being a condition, as such it was held that the confidentiality clause was not a condition of the settlement agreement. Since it was an innominate or intermediate term, DFK remained obliged to continue the payments to Mr Steels notwithstanding the breach of the settlement agreement.

2. Cavanagh J. went on to highlight the issues of enforceability of confidentiality clauses in settlement agreements. It was acknowledged that breaches of confidentiality often occur after the termination payments have been made. This effectively leaves the innocent party without recourse to damages as it may be difficult to quantify the loss caused by the breach of confidentiality. Cavanagh J. suggested two ways to deal with this issue when drafting a settlement agreement: -

- a) Clearly set out the remedies an innocent party would be entitled to in the event of breach of the confidentiality clause. This could include terms that require the party in breach to repay all or part of the sum

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paid by the innocent party; and/or

b) Specify that the confidentiality clause is a condition.

## Key takeaways for employers when drafting confidentiality clauses

When an employer enters into a settlement agreement with an employee, particular attention should be paid to the following:

1. **Simple and clear terms:** A confidentiality clause should be drafted clearly and unambiguously by avoiding the use of legal jargon. Any legal terms used should be carefully defined. The meaning, effect, and limits on the operation of the clause should be clear so that the parties to whom it applies are able to understand the scope and effect of the clause.

2. **Compliance with laws:** The confidentiality clause should not (a) seek to limit or restrict the legal rights of employees, (b) give the impression that the confidentiality obligation would prevent the employee from fulfilling his/her legal or regulatory obligations, or (c) purport to limit an employee's rights to report a crime or an offence that has occurred. Any such term is unlikely to be enforceable and should not be included in a settlement agreement.

3. **Express stipulation of confidentiality as a condition:** Depending upon the particular circumstances of the termination, an employer may wish to consider expressly stating that the confidentiality clause is a condition of the settlement agreement if it wishes to be released from further obligations in the settlement agreement in the event of a breach of the confidentiality clause.

4. **Agreed remedies for breach:** Depending upon the particular circumstances, it may be helpful to set out the remedies in the event of a breach of the confidentiality provisions of a settlement agreement. For example, the settlement agreement may contain a term that enables the employer to claw back all or some of the payments made to the employee (such as ex-gratia payments) in the event of such a breach. In this regard, employers should seek legal advice to ensure that the remedy is a genuine pre-estimate of loss and could not be construed as a penalty (which is likely to be unenforceable). Employers are reminded that termination payments which are guaranteed by statute cannot be subject to a claw-back.

To conclude, a well-drafted confidentiality clause can mitigate the temptation of a party to breach the obligations of confidentiality and/or the risk of an innocent party being left without the desired remedies should such a breach occur. As there is no standardised approach, employers would be best placed seeking legal advice when drafting confidentiality clauses in settlement agreements to ensure that they are tailored to the unique circumstances. In case of employment law related queries, please get in touch with Andrea Randall ([andrearandall@gallhk.com](mailto:andrearandall@gallhk.com) / +852 3405 7688).

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