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Guide to settlement agreements

Employment relationships do not always run smoothly. In some cases, they may break down to such an extent that it may be necessary to bring the working relationship to an end. But the end of the relationship can mean the start of a claim.

One way of facilitating the end of the relationship without claims being made is through the use of settlement agreements. These are legally binding agreements, entered into voluntarily and agreed through negotiation, which set out the financial and other terms on which an employer and employee will go their separate ways.

Usually, they include a severance payment made by the employer in return for the employee agreeing not to bring certain legal claims. Settlement agreements are a way to avoid costly and time-consuming disputes and Employment Tribunal cases.

The government has also introduced a mechanism whereby employers can initiate 'pre-termination negotiations' to discuss an amicable parting of the ways. In that context, offers of settlement cannot be presented as evidence in unfair dismissal cases provided there has been no improper behaviour during discussions about the agreement.

This guide sets out some of the key points involved in settlement agreements but seeking legal advice is essential if you are considering ending an employment relationship in this way.

"Cover all the angles"

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Why use a settlement agreement?

There are various circumstances in which a settlement agreement may be appropriate. Some employers choose to use settlement agreements even where there is little or no risk of a claim, just to be 100% safe. Others use settlement agreements where, perhaps for commercial reasons, they do not have the time to go through a full performance management or disciplinary process and are therefore at a greater risk of a claim.

They can be offered at any stage of an employment relationship though employers need to exercise caution when making such an offer. The offer should be made on a 'without prejudice' basis so that the employee cannot refer to the offer in any subsequent Employment Tribunal claims. There are complex rules about 'without prejudice' negotiations so advice should be sought in each individual case.

> *The settlement agreement involves various costs, but once it is signed by employer and employee, the employee cannot make any claims to the Employment Tribunal. This gives the employer peace of mind and means that they don't have to spend valuable time and money defending claims.*

The government has taken steps to encourage greater use of settlement agreements as a way to end employment relationships by mutual agreement before they have reached the stage of a formal dispute.

The introduction of pre-termination negotiations makes it easier for employers to raise the possibility of an agreed parting of the ways before a formal dispute arises. However, there are strict rules about conducting these pre-termination negotiations and they only protect an employer in the event of an unfair dismissal claim, not in other types of claim such as discrimination. While pre-termination negotiations are going on, employees will continue to enjoy full protection of their employment rights as they can choose to reject the offer of a settlement agreement and proceed to a tribunal.

What does a settlement agreement include?

Every settlement agreement is unique because the circumstances of each case will be different. However, there are some elements that are common to most agreements. Typically, they will contain details of:

- the amount of money to be paid (which may include payments for redundancy, outstanding wages, bonuses, pay in lieu of notice, accrued holiday pay and an 'ex gratia' or compensation payment)
- any restrictions on the employee's future employment
- confidential business matters, such as trade secrets
- a confidentiality clause to bar the employee from telling anyone they have signed a settlement agreement or to allow them to tell people they have done so, but not to discuss the contents
- the reference that will be provided by the employer upon request
- whether there will be an announcement made to the employee's colleagues/clients
- a mutual agreement that the parties will not make derogatory comments about each other
- who is liable for any tax or National Insurance (NI) due
- the employer's contribution to the employee's legal fees.

The employee cannot be asked to (and is not allowed to agree to) waive a possible future claim for a personal injury that neither they nor their employer is aware of, for example for a condition such as asbestosis, which can take many years to develop. The employee is also not allowed to contract out of any accrued pension rights.

Payments made in respect of salary, bonuses and holiday pay up to the termination date will be subject to the normal deductions for tax and national insurance contributions. Generally speaking, compensation for loss of employment (including a redundancy payment) is tax-free up to £30,000, but specialist advice should be sought about taxation of severance payments.

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Legal implications

To be legally valid, the settlement agreement must comply with a number of conditions, including:

- it must be in writing
- it must relate to a particular complaint or legal claim
- the employee must have received legal advice from a solicitor or approved adviser, on the terms and effect of the proposed agreement and its effect on their ability to take a claim to an Employment Tribunal. It is standard practice for the solicitor/adviser to sign a certificate confirming that they have provided such advice
- the solicitor/adviser must have professional indemnity insurance to cover the risk of a claim by the employee in relation to the advice provided
- the agreement must state that the conditions regulating settlement agreements have been satisfied.

> *The employer is under no obligation to contribute to the employee's legal fees but it is usually the case that they will make a contribution of between £250 to £1,000 (inclusive or exclusive of VAT). This contribution usually covers advice in relation to the terms of the agreement and the signing of the agreement.*

Pre-termination negotiations and 'improper behaviour'

If the employer chooses to start the conversation about an agreed exit under the 'pre-termination' negotiations rules, those discussions, cannot be used in any subsequent unfair dismissal claim at an Employment Tribunal. However, there are two very important things to bear in mind.

Firstly, this rule does not apply in discrimination cases. Secondly, this exclusion will not apply if there is any improper behaviour involved in the discussions. Such improper behaviour is likely to include:

- harassment through offensive language or aggressive behaviour
- physical assault
- discrimination
- undue pressure on one of the parties, for example, an employer saying the employee will be dismissed if they reject the settlement agreement offer or an employee threatening to discredit the employer's reputation unless the employer does a deal.

What happens if there is no agreement?

If the employee decides not to sign, their employment may continue or the employer may choose to terminate their employment depending on the circumstances.

If they decide not to sign and to instead pursue an Employment Tribunal claim, they will usually have three months, minus one day, from the date of termination to lodge the claim.

Meet our employment law expert

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