The definitive employer's guide to

# Settlement Agreements

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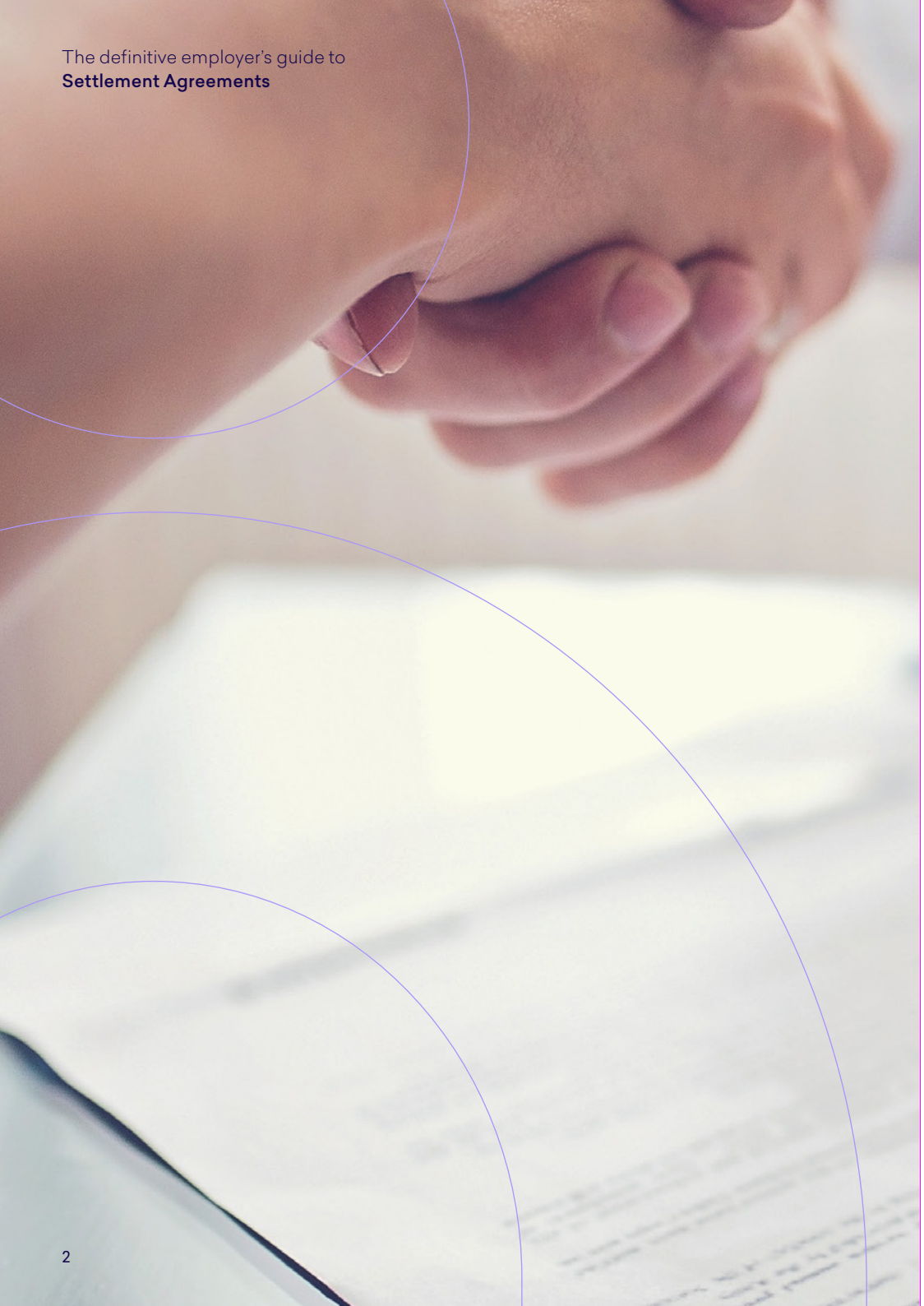



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# In Employment Law, the nearest thing to a magic wand is a settlement agreement (formerly known as a compromise agreement).

**In one document, you can waive an employee's right to present claims to an Employment Tribunal. However, as with most things in life, it is not without its risks and costs.**

In this definitive guide, we will explore what these agreements are, what they can offer employers, how they can be used, what happens if they are breached and much more. We will also give you expert tips and warnings to alert you to potential pitfalls and explain best practice.

# Contents

In this definitive guide, you will learn:

# 1. What is a settlement agreement?

A settlement agreement is a legally binding document between an employer and employee which settles any claims that arise from the employment relationship or the termination of employment.





**The main characteristics are as follows:**

- An employee waives their rights to bring legal claims against their employer in return for a discretionary severance payment (and often a factual reference)
- Settlement agreements can be proposed by either party
- It is voluntary. Neither party is obliged to enter into a settlement agreement and as the process moves forward, either party may decide to not pursue it
- It is agreed through a process of negotiation – the terms and conditions agreed should suit both parties and there may be offers and counteroffers made before a final agreement is reached
- They can be made at any time, not just at the end of the employment relationship
- If an agreement is not reached, the negotiations may be inadmissible as evidence to support their claims before an Employment Tribunal or court
- The final agreement must be made in writing
- The employee will need to obtain independent legal advice on the terms of the agreement for it to be legally binding

**Is a settlement agreement the same as a COT3 agreement?**

A COT3 agreement sets out the terms of settlement of an Employment Tribunal claim (or potential claim) which has been agreed between the employer and the employee following a process of conciliation with ACAS.

It is different from a settlement agreement in a few ways, for example, it can be entered into verbally (however generally the agreement is recorded in writing on a COT3 form), it is much simpler and shorter and it is typically signed by representatives rather than the parties themselves. In addition, there is no requirement for the employee to obtain independent legal advice.

# 2.
# What is needed to make a settlement agreement legally binding?

In order for a settlement agreement to be legally binding, there are a number of conditions under the Employment Rights Act that need to be satisfied:

- The agreement must be in writing
- The agreement must relate to a particular legal claim or complaint
- The employee must receive independent legal advice – this must be from a legal adviser such as a qualified solicitor or barrister or a certified officer, official, employee or member of an independent trade union or a certified and authorised advice centre worker who is not connected to, or employed by, the employer. The adviser will ex- plain the terms and conditions of the agreement and that the employee cannot pursue claims in an Employment Tribunal or civil courts. The adviser must have professional indemnity insurance in place
- The agreement must identify the adviser
- The agreement must state that the legal conditions regulating settlement agreements are fulfilled

**Warning**

If the agreement does not fulfil all these requirements, it will be invalid and unenforceable. This means that the employee can still lodge a claim at an Employment Tribunal, but they will need to repay any payments received under the settlement agreement.

# 3.

# When are settlement agreements commonly used?

### Remember

Settlement agreements can be entered into at any time in the employment relationship, not just on termination of the employment relationship.

For example, an employee may claim that there has been a breach of contract during the employment relationship.

Equally, a job applicant may claim that there were discriminatory recruitment practices and the employer may deem it appropriate to settle the dispute by way of a settlement agreement.





A settlement agreement can be used in a number of circumstances such as:

- To end an employment relationship which, for whatever reason, is no longer working
- To end a workplace dispute or settle an employee grievance (or multiple grievances)
- If you think you are at significant risk of a claim
- To avoid the uncertainty of going to an Employment Tribunal and not knowing the outcome (and pay out)
- You do not have the time or resource to go through a long formal disciplinary, grievance, capability or redundancy procedure

### Expert Tip

You may not need to resort to a costly settlement agreement in cases where a robust management approach can be adopted.

For example, if you do have a long-serving employee who is struggling with their performance, it may be worth going through a formal performance management procedure to see if their performance improves before deciding to offer them a settlement agreement. This may help to retain long standing employees and save recruitment costs.

If you do not have an Employee Handbook which contains workplace policies and rules, our Employment Law Advisers can draft one for you. Equally, if you are unsure how to go through a specific procedure to ensure it is fair, our Employment Law Advisers can guide you step-by-step.

# 4.

# What employee rights can be waived?

The main premise of a settlement agreement is that an employee waives their rights to bring legal proceedings against their employer in an Employment Tribunal or civil court in return for something of value to the employee, which is more often than not a discretionary severance payment.





Typically, most legal claims regarding statutory and contractual rights can be waived as part of the agreed terms in a settlement agreement, including:

- Unfair dismissal
- Discrimination
- Unlawful deduction of payments
- Entitlement to statutory redundancy pay

**However, not all claims can be settled this way, such as:**

- Claims for accrued pension entitlement
- Claims of personal injury which have not Arisen at the date of this agreement
- Claims due to a breach of the settlement agreement itself

**Remember**

Employees cannot be prevented from making a protected disclosure under whistle blowing laws. Any provisions in the settlement agreement which try and do this will be unenforceable.

# 5. What should a good settlement agreement include?





Depending on the individual merits of the case, the terms of the agreement will differ but in general a good settlement agreement will include:

**Termination date**
It should clearly set out what date the employment relationship ends.

**Payment**
It should include what salary, benefits, outstanding holiday pay, payment in lieu of notice or bonus is owed to the employee.

**Termination payment**
It should state the final settlement sum agreed and the arrangements for payment.

**Legal fees**
You may decide to pay or contribute towards reasonable legal fees (for example, up to a specified maximum) incurred by the employee when obtaining legal advice on the terms of the agreement. Given the bargaining positions of the parties, it is customary for the employer to make a contribution of between £250 and £350 plus VAT.

**Legal advice**
It should specify that before entering into the agreement, the employee received independent legal advice regarding the terms of the agreement and the effect on their ability to pursue any claim before an Employment Tribunal or other court.

**Waiver of claims**
The agreement should state how the agreement is made in full and final settlement of all and any claims that have already been presented or may potentially be submitted to an Employment Tribunal or court. ACAS make it clear that simply stating that the agreement is in 'full and final settlement of all claims' is not enough to waive an individual's right to initiate or continue legal proceedings - it must clearly specify the claims which the parties are settling.

**Return of property**
Before the termination date, the employee will return the employer's property which is in their possession, for example, a laptop, mobile phone, security pass, keys, company car, documents etc.

**Expert Tip**

There is no legal requirement for the person who has provided the legal advice to sign the agreement. The settlement agreement should include a certificate from the adviser who confirms that the employee has received advice, they are authorised to do so and have relevant insurance.





**Confidentiality**
The parties will agree to keep the terms of the agreement and the circumstances surrounding the termination confidential. It will also impose an obligation onto the employee to not use confidential information or trade secrets after the employment relationship has ended (or at least remind them of ongoing duties of confidentiality already contained in their contract of employment). However, it should be made clear that this will not stop them from blowing the whistle on wrongdoing or reporting matters to the Police or a Regulator. This is an evolving area and advice should be taken.

**'Non derogatory' clause**
This stops the employee from making negative or derogatory comments about the employer, including on social media.

**Restrictive covenants**
The settlement agreement may reaffirm any post-termination restrictive covenants in the employee's Contract of Employment. If there aren't any in the employee's contract, it may be possible to set out new restrictions in the agreement.

**Employee warranties**
The employee promises that there are no circumstances that they are aware of or ought to be aware of which would amount to a breach of a term of the contract that would have entitled the employer to terminate the contract without notice or payment in lieu of notice.

**Announcements**
For particularly senior positions, you may consider how the announcement of the employee's departure will be made to colleagues, clients and other relevant parties.

**Pension**
The agreement should cover what happens to their pension entitlement.

**Reference**
On receipt of a request from a potential employer, you will provide an agreed form of reference. This will often be attached to the end of the agreement.

**Tax**
Most agreements will contain a clause about tax indemnity. The first £30,000 of the termination payment (including a redundancy payment) will normally be tax-free. However, the rules on taxation of termination payments are not straightforward and specialist advice should be taken.

### Expert Tip

Get an Employment Law Adviser to draft your settlement agreement to ensure that it complies with all legal requirements and is in your organisation's best interests.

# 6. How do I negotiate a settlement agreement?

The negotiation process may be fairly straightforward and only require one meeting to discuss the terms. However, some cases are more complex and may require a series of meetings to talk through offers and counteroffers.





## Can what has been discussed in the settlement agreement negotiations be used in subsequent legal proceedings?

If the parties do not reach agreement, there are some circumstances where the negotiation discussions cannot be used as evidence in legal proceedings by either party to support their cases.

There are two ways to maintain the confidentiality of the conversations:

- Under the 'without prejudice' principle; and/or
- Section 111A of the Employment Rights Act 1996

**'Without prejudice' principle**

The without prejudice principle is a common law principle, which means it is not statutory. It allows the parties to have off the record discussions to talk freely about the proposed terms of settlement and conditions.

The principle can apply regarding any Employment Tribunal or court claim, for example breach of contract, discrimination, unlawful deduction of wages, etc.

To apply, certain conditions must be fulfilled:

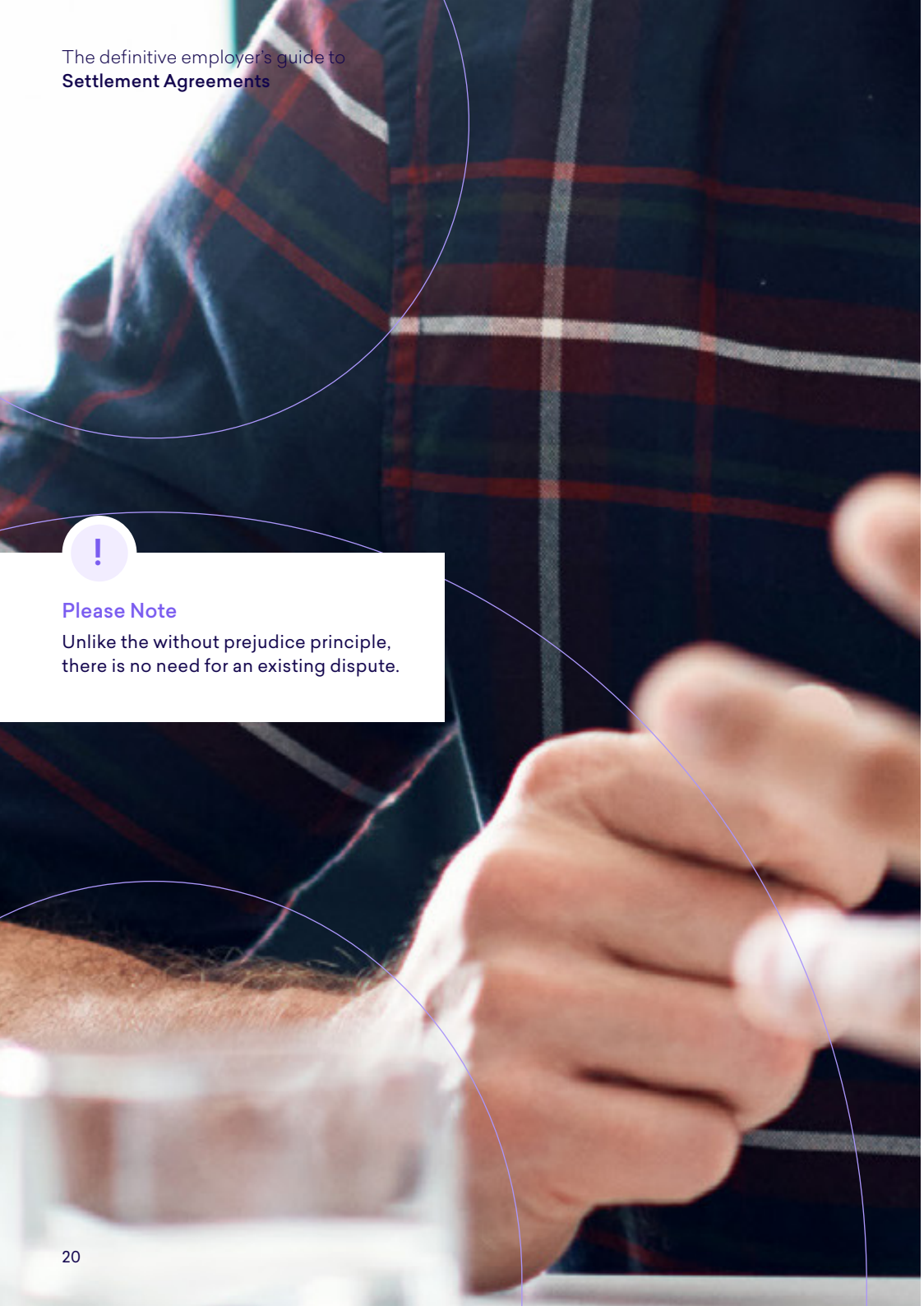
- It must relate to an existing dispute
- The discussions must be a genuine attempt to settle the dispute
- There must be no 'unambiguous impropriety' in the conduct of the parties during the negotiations and discussions. Examples include blackmail, fraud and physical violence

**Remember**

For example, if you offer a settlement out of the blue without having spoken to an employee about their work performance issues, you will not be covered by the without prejudice principle as there is no existing dispute. There is a significant risk here that the employee will argue that the relationship of trust and confidence has broken down and as such they can resign and claim constructive dismissal and use the content of these discussions to support their claims.

**Warning**

Confidentiality of negotiations is a complex area of law and, without such confidentiality in place, can cause a significant risk in any future litigation.



**Please Note**

Unlike the without prejudice principle, there is no need for an existing dispute.





It is also advisable that there is agreement between the parties that the discussions and negotiations would be held on a without prejudice basis. If the employee refuses to discuss matters on a without prejudice basis, you should not continue with those discussions.

**Section 111A of the Employment Rights Act (ERA)**

The provisions of section 111A of the ERA cover pre-termination negotiations and can, in some situations provide confidentiality to those discussions.

It applies to any offer made or discussions held, before termination of employment, with a view to the employment being terminated on terms and conditions agreed between the parties. It only applies to claims of 'ordinary' unfair dismissal. This means that the provisions of section 111A do not apply to 'automatically unfair dismissal' claims, for example, if an employer dismisses an employee because they have taken paternity leave, or discrimination claims.

However, it does not apply if there was improper behaviour or conduct in something that was said or done during negotiations, for example bullying, harassment, discrimination, victimisation, not giving the employee enough time to consider the terms of the offer made, telling them they will be dismissed if they do not accept the settlement, etc.

**Right to be accompanied to meetings**

In relation to section 111A discussions, the employee does not have a statutory right to be accompanied into the meeting, but ACAS does state in their guidance that it is good practice to allow a companion and to enable them to play a full part in the meeting.
It is worth noting that there may be times when refusing the employee from having a companion could land you in trouble, for example it may be a reasonable adjustment to enable an employee with a disability to be accompanied into the meeting and the fact that you have denied this may be considered discrimination.

**Warning**

When an employee makes a claim for unfair dismissal, it is typically accompanied by other claims. The protection under section 111A will only cover ordinary unfair dismissal claims, not other claims.

**How much money should you offer them?**
There is no set amount laid down in the law.

The following factors may assist when considering how much to offer the employee:

- How long the employee has worked for you
- The circumstances around why you are offering the settlement agreement
- How long it will take to settle the dispute if an agreement is not reached
- The potential liability and cost of having to defend a claim or multiple claims in an Employment Tribunal

You will also need to cover benefits accrued up to the termination date, any untaken holiday allowance, notice or payment in lieu of notice, outstanding holiday pay, any bonuses, etc. If an employee has worked for you for two years or more and you are making them redundant, they will be entitled to a statutory redundancy payment. The amount they receive will depend on their age and their length of service.

Under the statutory scheme, the employee is entitled to:

- Half a week's pay for each full year if the employee is under the age of 22
- One week's pay for each full year if the employee is 22 or older, but under 41
- One and half week's pay for each full year if they are 41 or older

The maximum length of service is capped at 20 years. A week's pay is subject to a cap set by the government. Some employers may provide their employees with a contractual right to enhanced redundancy payments.

The way this is calculated should be clearly outlined in your Employee Handbook. Most employers will also offer to pay or contribute towards the employee's legal fees. Without them getting independent legal advice, the agreement will not be legally binding. As mentioned above, it's normal to offer to pay between £250 and £350 plus VAT.

**What do you do if their demands are too high?**
Rather than feel pressured to provide unreasonable payouts, there are other options you could consider exploring, such as offering them contractual benefits to go beyond the proposed termination date (for example, until they need to be renewed by you).

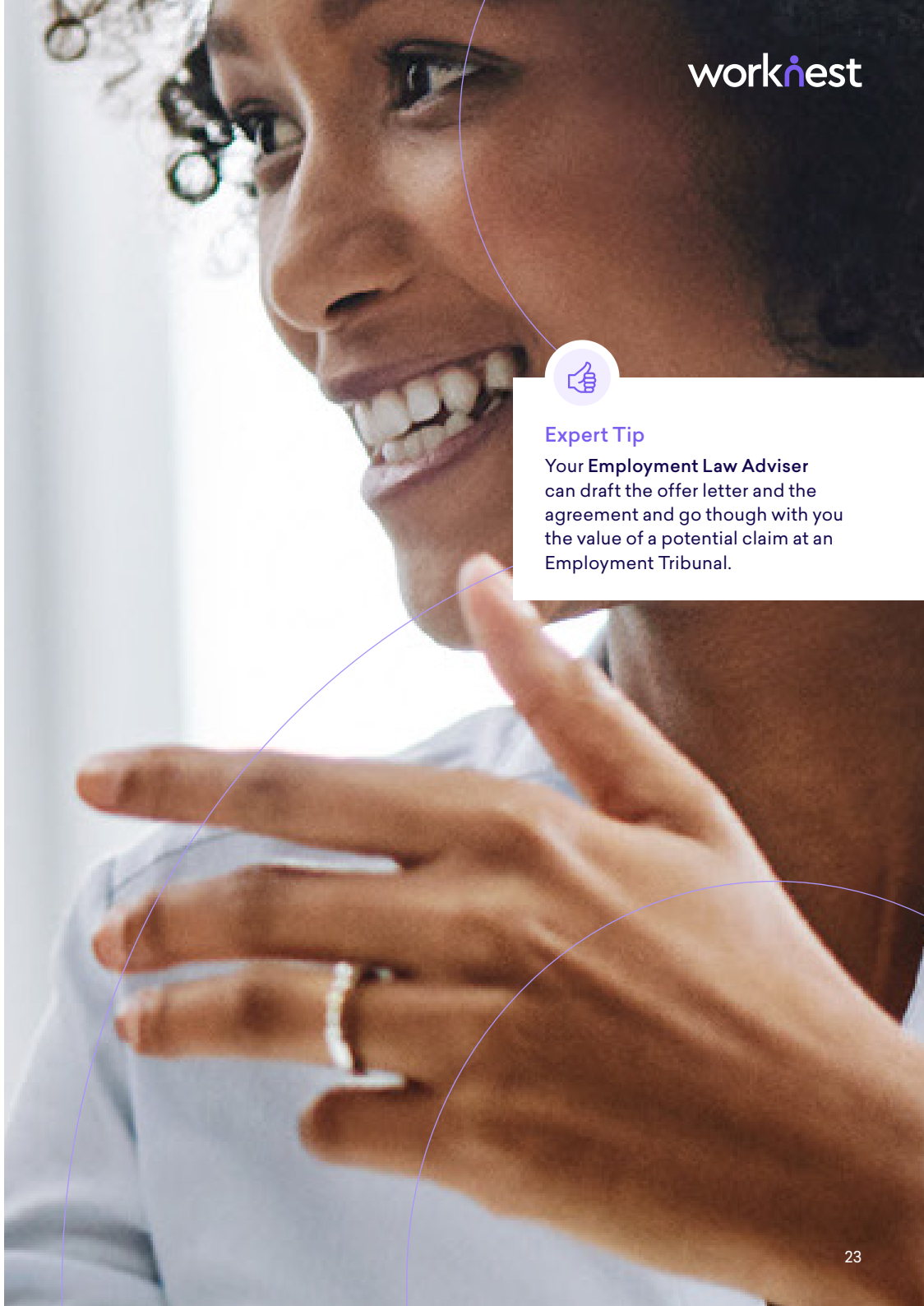
Alternatively, you could perhaps give them outplacement support to help them find another job quickly.

**How long should the employee be given to think about it?**
In relation to section 111A discussions, you need to give your employee at least 10 calendar days to consider the proposal and to seek independent legal advice.

The adviser will be responsible for going through the terms and conditions of the agreement with the employee and ensuring they understand what they mean.

**If we reach agreement, what happens next?**
If an agreement is reached, both parties need to sign it and retain a copy for their records.






### Expert Tip

Your **Employment Law Adviser** can draft the offer letter and the agreement and go though with you the value of a potential claim at an Employment Tribunal.

# 7. What happens if no agreement is reached?

Engaging in a settlement agreement is voluntary. Therefore, you cannot force an employee to consent to the terms and conditions you wish to enforce in the agreement.





If no agreement can be reached, you may decide to continue the employment relationship. Of course, this may not be easy to do – the issue that was the source for seeking a settlement agreement may remain.

Depending on the reason for trying to obtain a settlement agreement, you can fall back on formal procedures: disciplinary, grievance, redundancy or capability. Or alternatively you could explore if there are any other solutions, such as mediation, to resolve the dispute.

# 8.

# Am I legally obliged to give a reference?

There is no general duty imposed on employers to provide a reference to a former or current employee.





## However, as always, the law is not that straightforward and there are certain exceptions, for example:

- There may be an express term in the employee's Contract of Employment that states that you will provide a reference, although this is rare.
- You will need to see if there any sector-specific rules. For instance, in some highly regulated sectors, a reference will be required for a person to conduct certain functions.

As part of the negotiations, the employee will be keen to be provided with a reference. If you agree to this, the reference should be attached to the end of the settlement agreement.

If you do provide a reference, you should take reasonable care when writing it to ensure that the information you supply is fair, truthful and accurate and it is not misleading.

This is because you could end up in trouble with a future employer if the information provided gives off the wrong impression, is inaccurate and/or misrepresents the true position.

If you are providing a reference within the settlement agreement, it is important to make sure that it is this reference which is provided on receipt of any request. Failure to do so will be in breach of the agreement.

### Expert Tip

We would recommend keeping your reference brief to reduce the risk for liability.

In the settlement agreement, you should reserve the right to amend or decline to provide one in case something serious occurs after the date of the agreement which affects your decision to provide a reference.

# 9.

# What happens if one of the parties breaches the terms of the agreement?

Remember, settlement agreements are legally binding.





If the employee breaches an important term or condition in the settlement agreement before you have made the severance payment, you can refuse to pay this.

In some settlement agreements there may be provisions which state that if the employee does commit a material breach of the terms and conditions of the agreement, the employer is indemnified for any losses they suffered due to the breach, including all reasonable legal fees incurred.

Even if there is no such provision in the agreement, if the employee commits a breach after the payment was made, an employer can potentially claim for breach of contract and take legal action for damages for loss suffered as a result of the breach in the county or high court (or in Scotland, it will be in the Sheriff Court).

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**Please Note**

A material breach must be significant and serious. For example, if the employee breached the settlement agreement by submitting a claim to an Employment Tribunal.

# 10. What to take away

From an employer's perspective, there are a numerous positives in using settlement agreements:

1. They provide a quick end to a dispute or issue and, when terminating employment, a clean break;
2. The final agreed terms give the employer some peace of mind and certainty;
3. It avoids time, resource and money that would be needed to defend a claim;
4. It can save you from going through lengthy disciplinary, performance, redundancy or dismissal procedures;
5. What is discussed in negotiations is often not admissible in subsequent Employment Tribunal or court proceedings;
6. Employees must keep the arrangement and circumstances of the agreement confidential, so it can avoid bad publicity for you and the business. However, the employee should not be stopped from making certain disclosures, such as protected disclosures or those to Police and Regulators.

However, there are some important things to consider:

1. It can generate huge costs;
2. It is not a solution for every problem;
3. You need to think about what happens if you can't agree terms with the employee.

**At WorkNest, our Employment Law Advisers are on hand to help you understand your legal obligations and protect your organisation's best interests. Contact us to find out more about our services and what we can do for you.**

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