Cripps

Settlement Agreements – Avoiding the pitfalls

Settlement agreements can be an extremely useful tool in an employer's armoury. They are a means of establishing a clean break with a departing employee and a way that employers can avoid the lengthy and labour intensive processes that are required to legally terminate an employee's employment. However it is important that employers are aware of the potential pitfalls that can arise when drafting a settlement agreement or negotiating its terms with an employee.

Why use a Settlement Agreement?

By entering into a legally binding settlement agreement an employee is agreeing to waive (give up) any claims that they may have against their employer arising out of their employment or its termination usually in return for some form of compensation or other consideration.

They are most commonly used in the following situations:

1. In order to settle a claim that an employee has already instigated in an employment tribunal or via the ACAS early conciliation process;
2. In a redundancy situation either where an employer does not want to go through a full redundancy consultation exercise and/or is willing to pay an employee an enhanced redundancy payment that exceeds their statutory entitlement;
3. In a situation where an employee is under-performing or lacks capability to do their role due to a health condition and an employer wants to avoid or curtail a lengthy performance management or capability process;
4. In cases where an employer has commenced, or has grounds to commence, disciplinary proceedings

against an employee for misconduct and wants to offer the employee an alternative route through which they could avoid any "black marks" against their name.

How to avoid potential pitfalls

From an employer's perspective, the whole purpose of putting a settlement agreement in place is to avoid the risk of future litigation. If this goal is to be achieved it is essential that employers avoid the many pitfalls that can arise when negotiating or drafting the terms of a settlement agreement.

Set out below are some of five common issues that we have seen employers encounter when embarking on settlement negotiations with their employees and some tips about how they can be avoided.

Failing to ensure that negotiations are properly protected

Many employers label a conversation or a piece of correspondence "without prejudice" without really understanding what this means. It is a common misconception that using this label means that they will be adequately protecting themselves in the event that settlement discussions break down and litigation ensues. However this is not necessarily the case.

The without prejudice principle has its limitations because it only applies when there is a pre-existing dispute between the parties. This principle does not fit neatly into an employment context because employers will often want to have a conversation with an employee before a dispute arises. For example, in the case of poorly performing employee to whom they wish to offer an exit package as an alternative to going through the trials and tribulations of a performance management process. As there would not normally be an existing dispute at the point that such conversation takes place, the without prejudice principle would not protect the employer in this situation and this conversation could subsequently be brought to the Tribunal's attention in the context of any subsequent unfair or constructive dismissal claim that the employee may bring. It would then be very difficult for the employer to prove that any dismissal was fair and not pre-meditated.

The "protected conversation" principle was introduced to get around the need for there to be an existing dispute between an employer and an employee before a full and frank conversation about an employee's potential exit could take place. Protected conversations allow both employer and employee to speak openly without fear of their comments being reported to the tribunal in any subsequent proceedings and potentially prejudicing their case.

The main limitation of a "protected conversation" is that it only provides confidentiality protection in the case of "ordinary" unfair dismissal claims. If an employee brings an automatic unfair dismissal claim linked i.e. to whistleblowing or maternity or if an employee brings a breach of contract or discrimination claim, the protected conversation will not provide protection and evidence of any pre-termination negotiations could therefore be put before a tribunal (unless of course the without prejudice principle applied).

Employers should also note that some parts of pre-termination negotiations will be admissible in tribunal proceedings if either party engages in "improper behaviour" which includes any form of harassment or intimidation or putting undue pressure on a party to accept an offer.

Forgetting that confidentiality is paramount

Properly drafted settlement agreements will usually contain robust confidentiality provisions which prevent an employee speaking to anybody other than a small number of people such as immediate family members, professional advisers etc. about the circumstances leading up to the termination of their employment or the existence or terms of the settlement agreement. These confidentiality obligations will only come into effect at the

point that the employee signs the settlement agreement and therefore they will be absolutely meaningless if, before signing the agreement, the employee has already spoken to colleagues about the fact that their employer has offered them lots of money to sign a settlement agreement.

Therefore it is essential that the employee is reminded during any protected conversation that such discussions are, and must remain, confidential and that the employee could be subjected to disciplinary proceedings, and the settlement offer withdrawn, if they are found to have spoken to anybody about the terms of the offer that has been made.

Failing to set a deadline for acceptance of an offer

We often see situations in which a settlement offer has been made and yet an employer has failed to set any deadline for acceptance of the offer. This often leads to negotiations with employees becoming overly protracted which can be particularly frustrating if an employer is paying an employee but they are not doing any work during that period.

It is important that an employee is given a reasonable period of time to consider the terms of any settlement offer, which ACAS suggests should be a minimum period of ten calendar days. However we would always recommend setting a deadline by which an offer must be accepted or else it will be withdrawn. Even if you subsequently have to extend the deadline it is far better than leaving it open-ended. It is also important to spell out to an employee exactly what will happen if they do not accept the offer by the given deadline i.e. you will continue with the disciplinary/redundancy process.

Not treating payments correctly for tax purposes

The proper tax treatment of termination payments can be complicated and we would always recommend that employers seek legal advice before promising to make any payments to employees without deducting income tax or national insurance contributions.

Whilst payments can be paid to employees without deductions for tax or national insurance contributions, this only applies to ex-gratia sums that represent genuine compensation for loss of employment up to £30,000 in total (or in some cases payments made in respect of ill health or disability). It does not apply to anything that could be classified as a contractual payment, earnings from employment or post-employment notice pay.

Getting the tax treatment of termination payments wrong can be costly to employers in the event of an HMRC investigation because it may result in the employer, not only being required to account to HMRC for the tax that they had incorrectly failed to deduct from the payments in the first place, but also being required to pay interest on those sums and penalties.

It is common to include tax indemnities in settlement agreements whereby the employee is required to indemnify their employer in the event that it is subsequently found that the parties have treated any of the payments under a settlement agreement incorrectly for tax purposes. However such an indemnity is worthless to an employer unless it is prepared to take legal action against their employer to enforce it or if an employee has insufficient funds to satisfy their obligations under the indemnity.

Losing sight of the bigger picture

Employers often get bogged down in negotiating the minutiae of settlement agreements. Days and even weeks (and hundreds of pounds in legal fees) can be spent arguing with employees' about issues such as whether to increase the contribution to their legal fees by £250, whether to reduce the period of a non-compete restriction by a month or two or whether to add a few sentences to a reference. Employers should try not to lose sight of

the bigger picture and always carry out a cost vs benefit analysis in their negotiations.

"Nit-picking" or playing games of "one up man ship" with employees in settlement agreement negotiations is rarely worthwhile. Employers should remember how great a value there is in being able to achieve a risk free clean break from an otherwise tricky employment relationship.

How we can help

If you would like any advice on having a protected conversation with an employee or assistance with drafting a settlement agreement or negotiating its terms with an employee please contact Camilla Beamish or another member of the employment team.

Camilla Beamish

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