



## Settlement Agreements: An Employer's Guide

**Are you a business owner or manager with questions around employee settlement agreements? This practical guide gives you all of the information you need about what they are, why and when they are used, and any legal pitfalls you need to be aware of.**

Employers have a useful legal tool at their disposal in the form of settlement agreements. These agreements can be used for parting with an employee in a way that leaves your business protected from any future tribunal claims. Settlement agreements, however, can be complicated and it is vital that the correct procedures are followed for the agreement to be legally binding. Below, we answer all of the questions you might have about them.



## What is a settlement agreement?

**Settlement agreements, which were formerly known as compromise agreements, are legally binding agreements between an employer and employee. The agreement is usually centred around some form of severance payment by the employer in return for the employee agreeing not to pursue any claims in a tribunal court, and can only be used in relation to particular proceedings (meaning there must be some dispute or issue between the employee and employer to settle).**

The agreement is usually used in connection with ending employment of a staff member on agreed terms. However, they can also be used where employment is not terminated, but where both parties want to quickly settle a dispute that has arisen.

The settlement agreement process is recognised by statute and is one of the few ways that such an agreement between an employer and employee can be completely binding by law.

Employers usually require the employee to keep the terms of the settlement agreement completely confidential. This includes the amount of any severance pay and the circumstances surrounding the contract termination.

## Is a settlement agreement the same as redundancy?

**No. Redundancy involves terminating an employee’s contract due to a cessation or diminishment of work of a particular kind, and does not always end in settlement agreements. If you believe you have conducted a fair redundancy process, you may decide to proceed without any kind of settlement agreement package.**

Having said this, many employers do offer a settlement to employees who have been made redundant. A settlement may be offered by employers to ensure the employee leaves the company smoothly, and to protect themselves from any future claims. Redundancy consultation periods are often time-consuming and stressful for both parties, especially if there are a few redundancies being made at once. Settlement agreements can be a useful solution for employers who want to waive this process and achieve a “clean break”.

## When should employers offer settlement agreements?

There are a number of scenarios where settlement agreements might be used by an employer, whether during or after employment. Their fundamental purpose is to avoid the plethora of long performance meetings, disciplinary hearings or redundancy consultations that can accompany an employment dispute. The key reasons for using settlement agreements are their speed, the ability to manage risk, and the added bonus of “closure”.

Each scenario is different; one employee may be looking for more money, whereas another might be after a good reference. Below, we list some examples of when an employer might want to use a settlement agreement:

- A job is now redundant, but the employer wants to avoid the long consultation process. In this scenario, an employer would need to offer something above the employee’s contractual and/or statutory entitlements that would be due in the event of a redundancy dismissal.
- An employer has evidence that an employee has committed gross misconduct, or the employer is concerned the staff member’s performance is below standard. Again, the employer may wish to avoid the time involved in dealing with those processes, and offer to let the employee leave quietly so they do not have to go through hearings or risk a dismissal on their record.
- An employee brings an unfair dismissal claim against an employer, and the evidence is in favour of the employee. Rather than going through the tribunal court, a settlement agreement can be used to settle the dispute out of court.

- An employee brings an unfair dismissal claim against an employer, but the company is adamant that the claim is false. The employer may be prepared to settle the claim out of court to save going through the tribunal court process, but the settlement agreement might be limited to the costs that would be incurred in defending the claim.
- If an employee has a terminal illness and their health is deteriorating, they are classed as a disabled person and are protected under the Equality Act 2010. If they are no longer able to work, even after the employer has made appropriate adjustments, the employer may agree to terminate the contract through a settlement agreement in return for the employee signing an “ex gratia payment”. This ensures the employee cannot bring a claim for disability discrimination in the future, and in return receives some extra money.

## What is included in a settlement agreement?

**Each settlement agreement is different. Below are some of the key points that will usually be covered:**

- A termination of employment date
- Notice pay, and any holiday pay that is owed
- Details around whether there will be termination on notice or payment in lieu of notice
- The amount to be paid for the settlement agreement
- Confidentiality and non-derogatory comments, also known as non-disclosure agreements (NDA)
- An agreement on legal costs. It is usual practice that an employer will cover the cost of the employee’s legal fees incurred in obtaining advice on the terms and effect of the settlement agreement
- Information on which payments are tax-free and which are subject to income tax and national insurance
- Practical issues like handovers, resignation of directorships and return of property



## What are the advantages of settlement agreements?

*Employers may initially be reluctant to consider a settlement agreement, but there are advantages in doing so. Employment tribunal proceedings can be lengthy, stressful and expensive, meaning that settlement agreements can bring a smoother resolution to what may have been a difficult period for the company.*

Settlement agreements are also a lot more flexible than a tribunal decision. Because both parties are negotiating the terms, there can be leeway given to each side, which the court often doesn’t provide.

Settlement agreements are also not just for dismissals. If an employee has raised an issue that you deem valid, but you wish to keep confidential, you can come to an agreement where termination of employment isn’t necessary.

## When do settlement agreements become legally binding?

**There are a few conditions that must be met for a settlement agreement to become legally binding:**

- The settlement agreement must be in writing
- It must relate to a specific complaint or proceedings
- The employee has to receive independent legal advice
- The adviser must have a current contract of insurance or professional indemnity insurance covering the risk of a claim by the employee
- The settlement agreement must name the adviser
- The settlement agreement must note that the applicable statutory conditions regulating the agreement have been met
- It must be signed by all parties
- There must be consideration, meaning the employee must be getting something more than the payments that would have been due to them should their employment have been terminated.

Acas also recommends a ten-day “cooling-off period”, running from the date of the terms of the settlement agreement being issued to the employee. This time frame enables the employee to consider the offer made in the agreement and gives them time to seek advice, though the employee can come back before this period if they wish.

## What happens if an employee refuses to sign a settlement agreement?

**Settlement agreements are voluntary and do not require the employee to agree to anything. In fact, the employee does not even need to agree to enter into any discussion. In this scenario, a resolution may be pursued through performance management and disciplinary meetings, or - if the employee feels they have a claim against the employer - an employment tribunal.**

If the employee does not sign the agreement, they reserve their full rights to make a claim against the employer.

## What happens if a settlement agreement is breached?

**Once the agreement has been signed, it is legally binding. This means that if either party breaches the settlement agreement, the other party can:**

- Seek to enforce the terms; and/or
- Seek damages by bringing a breach of contract claim

A breach of contract claim can be raised in the civil courts.

## How can Percy Hughes & Roberts help?

If you are a business owner and you are thinking of offering an employee or employees a settlement agreement, but do not know where to begin, Percy Hughes & Roberts can help.

At Percy Hughes & Roberts, our Head of Employment, [Sarah Simcott](#), boasts years of experience and promises a confidential, friendly and honest approach to all issues within the employment law field.

If you have any questions regarding settlement agreements and the potential pitfalls, you can get in touch with us for expert advice. Get in touch with our [Wirral employment law solicitors](#) today by calling 0800 781 3894 or by completing the [contact form](#) on this site.

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