National Audit Office

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HC 130
SESSION 2013-14

21 JUNE 2013

Investigation

Confidentiality clauses and special severance payments

Key facts

£28.4m
is the total value of HM Treasury approvals for special severance payments, three years to 31 March 2013

1,053
approvals for special severance payments

£15,000
is the median value of approvals

49	of our sample of 50 compromise agreements included a confidentiality clause covering the existence and terms of the agreement
6	cases in our sample clarified that nothing in the agreement prevented the individual whistleblowing
0	cases in our sample would prevent someone making a public interest disclosure

Summary

Introduction

1 This report is the first in a number of risk-based investigations, designed to examine identified or suspected weaknesses in performance by public sector organisations. We decide what to investigate using a range of sources, including: our own analysis of trends and financial information; matters raised by MPs; issues referred to us by consumers of public services; and cases passed to us through whistleblowing. The aim of this work is to make recommendations to help organisations improve the delivery of public services, using the insight from our investigations.

2 Public sector workers are sometimes offered payment for terminating their employment contract and agreeing to keep the facts surrounding the payment confidential. This raises questions of transparency about how public funds are used. In such circumstances, the contract is often terminated through a compromise agreement, and the payment is known as a 'special severance payment'. Compromise agreements are commonly used in the public and private sector and can be in the best interests of employer and employee. They should not be used to prevent people raising issues of public interest, to reward failure or to avoid management action, disciplinary processes, unwelcome publicity or reputational damage.

3 With the public purse under sustained pressure, and public services increasingly provided at arm's length, compromise agreements should not be used to gag staff, or to reward individual or organisational failure. In response to the Committee of Public Accounts' interest in this area we investigated how the public sector uses compromise agreements in the termination of employment contracts.

Scope of this investigation

4 This investigation was designed to examine:

- the number of compromise agreements written, including the amount of each settlement made;
- the legal basis for confidentiality clauses, and the governance arrangements behind their use; and
- how far confidentiality clauses are used to gag employees, particularly regarding whistleblowing.

5 We focused on the Treasury's role in payment approvals, the overall number of agreements, and five government departments, to illustrate how agreements are used. In the time available we could only obtain information from four departments: health, defence, education, and communities and local government. We: reviewed central and departmental guidance; interviewed departmental staff; spoke to people who had signed compromise agreements; extracted and analysed data; and sought legal advice. Our work was hampered by incomplete records, and limited access to data. We highlight these limitations where appropriate and discuss our audit approach at Appendix One.

Key findings

6 **There is no central or coordinated system of controls over how compromise agreements are used.** We could not accurately gauge the prevalence of compromise agreements or the associated severance payments. This was owing to: decentralised decision-making; limited recording; and the inclusion of confidentiality clauses which mean they are not openly discussed. No individual body has shown leadership to address these issues. The Treasury's *Managing Public Money* sets standards to apply to special severance payments (paragraphs 1.8, 3.3, 3.4).

Compromise agreements are prevalent, but cannot prevent public interest disclosures

7 **Compromise agreements are commonly used in the private and public sector. When used to terminate an employment contract there is usually an associated special severance payment.** Compromise agreements can be used when one or both parties (the employer and employee) decide that terminating an employment contract is in their best interests. They are used to minimise potentially time-consuming processes. For example they may be used to manage poor performance, or to mitigate the chances of a grievance being taken to an employment tribunal. A financial consideration is usually given, which can exceed any contractual entitlement (paragraphs 1.2, 1.3, 1.4, 1.7, 1.8).

8 Compromise agreements normally keep some information confidential, which can benefit both parties. There are legitimate reasons for keeping some information confidential, such as intellectual property. The agreement also often includes a clause to ensure that the employer gives the employee a good reference, which benefits the employee. However, this could mean a poorly performing staff member receives a good reference which helps them gain employment in another part of the public sector (paragraph 1.5).

9 A confidentiality clause in a compromise agreement cannot legally prevent a person from making a public interest disclosure (whistleblowing) should they wish to do so. The Public Interest Disclosure Act 1998 (PIDA) (see footnote 6) amends the Employments Rights Act 1996, Section 43J (see footnote 7) which states that any confidentiality clause "is void in so far as it purports to preclude the worker from making a protected disclosure … this applies to any agreement between a worker and his employer" and would apply to both employment contracts and compromise agreements (paragraphs 1.10, 1.11).

10 None of the agreements we reviewed would restrict a person's rights under the Public Interest Disclosure Act. We reviewed 50 agreements across four departmental groups. Of these agreements 49 (98 per cent) contained a confidentiality clause preventing a person from disclosing the existence and terms of the agreement, 23 (46 per cent) had clauses not to disclose confidential information obtained during the course of employment. Twenty-three agreements (46 per cent) contained a clause prohibiting a person from publishing derogatory, defamatory or disparaging statements about the employer and 12 (24 per cent) contained a mutual clause in respect of the employee. No agreements would restrict the individual's rights under PIDA, and six, all in the health sector, stated that nothing in the agreement prevented the individual whistleblowing (paragraph 2.10, 2.11, Figure 3).

11 However, some people we spoke to who had been offered, or accepted, compromise agreements have felt gagged. An organisation's culture, the events leading up to the person being offered an agreement, and the wording of the agreements contributed to whether the individual felt gagged. Legal advice to the employee is a prerequisite of making a compromise agreement legally enforceable. However, the individuals we spoke to felt that it was not generally made clear that confidentiality clauses do not prevent employees from raising legitimate public interest concerns. Protection under the Public Interest Disclosure Act has not yet been tested in a court of law (paragraphs 2.11, 2.16, 2.17).

12 Because employees are at a relative disadvantage in negotiations they find it difficult to speak out. The public sector is a large employer, especially in health, and it is in a relatively strong position compared with the employees. If a person is unfairly dismissed and turns down a compromise agreement, they may be unable to find another job in their chosen profession without a reference. Getting compensation can be expensive, and the organisation has greater financial resources than the individual. Some people said that they had felt compelled to sign a compromise agreement to 'draw a line' under the issue. They felt that this maintained their chances of finding another job; but the terms of the agreement left them unable to speak out (Appendix Four) (paragraphs 1.5, 2.16, 2.17, 2.18).

It is not possible to identify the number of compromise agreements signed, the closest indicator is the number of related payments

13 There is little transparency in how government departments use compromise agreements. Neither the Cabinet Office nor the Treasury provide formal guidance to departments, nor keep records of how departments use compromise agreements. We appreciate an individual's rights to keep their personal data appropriately protected. However, the departments we reviewed could not tell us how many compromise agreements they had signed, within their departmental group, or the content of confidentiality clauses. Despite our access rights, we received only 68 per cent of the compromise agreements we requested from departments and their related bodies (see footnote 14). The Department for Culture, Media & Sport did not provide information within a reasonable timeframe (paragraphs 2.10, 3.1, Figure 3, Appendix One).

14 The only central oversight of the system comes from the Treasury, which approves associated payments. The Treasury's guidance *Managing Public Money* states that departments should get the Treasury to approve special severance payments, which often sit alongside compromise agreements. Any contractual element, such as pay instead of notice, does not need approval. The Treasury reviews each departmental request and does not assess, in aggregate, which bodies it received applications from, the sums involved, or whether it had approved them. We used the Treasury's data to create a list of approved cases for each department to estimate the number, and value, of compromise agreements (paragraphs 3.3, 3.4, 3.10, 3.12).

15 We estimate that in the three years to 31 March 2013, the Treasury approved some 1,053 special severance payments totalling £28.4 million for departments and their associated bodies, but this money was not necessarily paid out. This is an incomplete picture because: of limitations in the Treasury's data collection; it does not include judicially mediated settlements; and bodies do not always seek approval because of an oversight, or they have the Treasury's authority to make payments without approval. The £28.4 million represents approvals, not actual settlements, as departments will negotiate with the individual receiving the settlement. In a sample of 41 cases, amounts paid were on average 89 per cent of the approved amount. This figure should not include any contractual entitlement, which does not require the Treasury's approval; it also excludes any associated legal costs on either side (paragraphs 3.13, 3.14, Figure 5).

16 The median approval across all the Treasury's data was £15,000, but the number of approvals varies by department. A total of 40 per cent of approved payments was for £10,000 or less. In our four case study departments, the number of cases per year has fallen overall, while the annual value of approvals has increased (paragraph 3.13, Figure 6).

17 We could not identify the reasons for all payment requests, but the majority of approvals related to accusations of unfair or constructive dismissal, which might include discrimination. There were also several cases where the primary grounds for dismissal were for capability and attendance issues. In these cases, the department did not wish to follow the performance management process, owing to the length of time it might take, and wished to prevent a case of unfair dismissal (paragraph 3.12).

18 There are inconsistencies in the governance and use of special severance payments:

a **Policy:** From September 2012, the Treasury gave authority to academies to make some payments without approval, which the Department for Education feels is similar to the position in maintained schools. It has not offered this arrangement to other organisations with similar governance structures. Some organisations wrongly thought they had a similar authority. The Treasury also gives retrospective approval inconsistently (paragraphs 3.7, 4.3, 4.8).

b **Size of approvals:** The Treasury approves each request individually, assessing the proposed payment against possible tribunal damages. We found apparently similar cases which had significantly different approval amounts. (paragraph 4.16).

c **Who seeks the Treasury's approval:** Some organisations within a departmental group approach the Treasury directly and some go through the sponsor department. Organisations sometimes seek payment approval without apparent senior or independent oversight, for example from non-executive directors (paragraphs 4.2, 4.10).

d **Who gives the Treasury's approval:** The Treasury Officer of Accounts approves most payments, but the Treasury's spending teams approve some payments. There is no central record of approvals (paragraph 3.14).

19 Departments' and the Treasury's value for money test is primarily whether a special severance payment is less than the potential costs of defending an employment tribunal case, despite the Treasury's guidance that settling is not always advisable. On the cases we reviewed, approved payments were lower than the estimated damages had the employee won at an employment tribunal. However, this is not necessarily value for money. There must be a balance between protecting the public purse and compensating people for unfair treatment. Saving time and money by avoiding a tribunal should not be the overriding factor as some cases may be worth defending where the cost of defeating a claim will exceed the cost of the proposed settlement. For example, a case may show that the department does not reward failure, or it may prevent future similar claims. Moreover, if a failure of process has occurred within the organisation lessons must be learned to prevent reoccurrence (paragraph 4.21).

Concluding comment

20 There is a lack of transparency, consistency and accountability in how the public sector uses compromise agreements, and little is being done to change this situation. This is unacceptable for three reasons: the imbalance of power between the employer and employee leaves the system open to abuse; poor performance or working practices can be hidden from view, meaning lessons are not learned; and significant sums of public money are at stake. The responsibility to address these issues is shared, and the following recommendations are designed to bring better governance to this serious issue.

The Treasury view

21 "The Treasury agrees that it is important that special severance payments should be made to high and consistent standards. These payments should never be automatic and must always honour the value for money requirement in *Managing Public Money*. But the primary responsibility for making these settlements falls to departments, who are best able to scrutinise and assess each case on its merits and in context, including the case for any confidentiality clauses. The Treasury believes that there is no need for central collection of data on this limited area of public expenditure, amounting to less than £10 million a year across Whitehall."

Recommendations

22 Departments and their related bodies should include a provision in all compromise agreements stating that nothing within the agreement shall prejudice employees' rights under the Public Interest Disclosure Act 1998. This should avoid any doubt about whether signing a compromise agreement allows the individual to make a public interest disclosure (whistleblowing).

23 The Cabinet Office should provide guidance on the use of compromise agreements, including the appropriate application of confidentiality clauses and the requirement for independent accountability. This guidance should include the requirement that departments have a clear and published policy on the use of such agreements in their departmental group including the circumstances in which compromise agreements may be used.

24 Departments should improve their information on compromise agreements, and both the Treasury and departments should improve their information on the related severance payments. This would allow both parties to identify unusual patterns, such as departments or arm's-length bodies with unusually high numbers of agreements, individuals transferring between departments receiving large severance payments, and whether lessons from one area can be replicated more widely. It would also improve accountability. There is no single data source across government for the value of severance approvals and the value of the contractual amounts payable. Treasury does not have an overview of how much compromise agreements are likely to cost in total.

25 Departments and their arm's-length bodies should be more transparent in reporting special severance payments. Compromise agreements can protect public sector organisations from legal challenges. They can, however, be used to limit public accountability on the full cost of early departures. Our position is that there is no case for non-disclosure if statute (or the Treasury and Cabinet Office financial reporting guidance) requires it.

26 The Treasury should be consistent in offering authority to make payments without prior approval, and require organisations with authority to report payments so that it has a complete picture of approvals. This will ensure consistency of approvals across the public sector. The Treasury should also update its guidance to provide clarity over out-of-court settlements for serving employees. The Treasury should hold departments to account when they fail to request approval.

27 The Treasury should modify the special severance payment business case pro forma to include confirmations that strengthen transparency and accountability. The Treasury could replicate the amended pro forma for NHS trusts, which includes the following express confirmations:

- Any compromise agreements or undertakings about confidentiality leave severance transactions open to adequate public scrutiny, including by the NAO and the Committee of Public Accounts.
- Any compromise agreement or any undertaking about confidentiality associated with the severance transaction includes an express clause to say that no provision in the compromise agreement or undertaking can prevent the individual from making a protected disclosure.