

**Report of the
Controller and
Auditor-General**

**Severance Payments
in the Public Sector**

May 2002

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under section 20 of the Public Audit Act 2001

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Foreword

This report was prompted by a number of agreements between public sector employers and their staff, under which an employee agreed to resign in return for a payment of compensation and an undertaking of confidentiality.

“Golden handshake” payments, as they are known, have come regularly to our attention over the past few years. Some – for example those involving members and the chief executive of the New Zealand Tourism Board in 1999 – were subjected to intense scrutiny and public reports. Others we have reviewed, and reported to the entity concerned, without further publicity.

We have identified a number of common themes in these cases. Some involve failures of process – for example, a failure to seek comprehensive legal advice. Others involve defects in substance – for example, unjustifiably high non-taxed compensatory payments. Such failings can expose a public sector employer to intense criticism if details of the settlement are made public. Many of them result, we believe, from an inadequate appreciation of the risks that employers in general – and those in the public sector in particular – face when deciding to enter an employment settlement rather than dismissing the employee and defending any personal grievance that the employee may raise.

At the end of my term of office as Controller and Auditor-General I believe it appropriate to report, in general terms, on the lessons I believe can be drawn from some of these cases.

D J D Macdonald
Controller and Auditor-General
3 May 2002

Acknowledgments

In preparing this report, we:

- reviewed recent examples of employment settlements on our files;
- consulted with several government departments, the Employment Relations Authority, representatives of public sector employers, and practitioners in the employment law and human resources fields; and
- discussed a draft of our report with those persons and entities, and with the Employment Law Committee of the New Zealand Law Society.

We acknowledge their help.

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Overview

The “golden handshake” syndrome

The public keep a close and wary eye on how their taxes and rates are spent. They can be quick to react – and rightly so – to suggestions of public officials gaining unreasonably at their expense.

Few things are more likely to provoke outrage than a perception that a public sector organisation has secretly agreed to make a substantial, tax-free, payment to an employee in return for the employee’s departure from the organisation.

The media and some politicians like to describe these payments as “golden handshakes”. The term can be misleading, but it nevertheless evokes several vivid images.

The image with the closest link to tradition is of a parting gift or bonus to a long-serving employee – the modern equivalent, perhaps, of the gold watch. Such gifts or payments tend not to be objectionable – provided they are properly authorised and not unreasonably large.

But there are several other images. They include:

- **a damaged or broken working relationship**, where the parties agree to put aside their differences, shake hands (metaphorically), and part company – with compensation paid to the employee;
- **an unsuitable or poorly performing employee**, perhaps on a fixed-term contract, being “paid off” for the balance of the term; and
- **an organisation in restructuring or on the verge of abolition**, making *ex gratia* "sympathy" payments to departing employees.

Why we are concerned

During the last few years, we have inquired into a number of “golden handshake” cases in the public sector. Their common characteristic is that they involve an arrangement where the employer makes a severance payment, and (in some cases) gives an undertaking of confidentiality, in return for the employee’s resignation.

In many of our reports of these inquiries, we have been critical of the way in which the public sector employer handled the process leading up to the agreement – along with the substance of the agreement itself.

We have observed a number of themes – among them:

- In some cases, employers have rushed to sign an agreement, before obtaining specialist advice about the other options that might have been open to them.
- In other cases, employers have structured settlements in a questionable manner, involving unjustifiably high tax-free compensatory payments.
- Secrecy clauses have featured in most of the agreements we have seen.

It seems to us that many severance payments are also open to criticism because the employer has failed to establish, and follow, fundamental employment practices – resulting in the needless termination of the employment relationship. The principles of good employment practice are well known:

- a fair and transparent recruitment and appointment process;
- a clear and comprehensive employment agreement – with express provisions regarding termination and redundancy;
- regular reviews of performance against measurable benchmarks; and
- a clear and well-documented process for resolving disputes.

Our expectations about severance payments

This report draws together the common themes, in order to illustrate the risks involved in severance payments – and other kinds of non-contractual payments to departing employees – in the public sector. And, in order to provide some practical guidance, the report sets out my expectations of what public sector employers can do to address those risks.

The report is not a guide to managing an employment relationship or resolving an employment dispute. Its main focus is much narrower – on how to deal with a situation where an employment dispute escalates to a point where termination of the employment relationship appears to be the only feasible option. However, we acknowledge the obvious point that an employer should endeavour to manage the employment relationship in a way that makes these situations truly exceptional.

In some of these exceptional situations, a severance agreement may be the most appropriate, fair, and cost-effective means of terminating the employment relationship. In other cases it may not. Public sector employers need to act in a manner that is consistent with their obligations both as an employer and in respect of the public funds that they manage. Balancing the two sets of obligations can be difficult. The main purpose of the report is to find an effective way of doing so.

From our inquiries, we have formed a set of expectations of what a public sector employer ought to do or consider before making a severance payment. These expectations are reflected in the six principles set out in Part 2 on pages 16-28.

In summary, we expect a public sector employer to:

- seek and obtain specialist advice (in writing) before reaching a severance agreement;
- use a fair, sound, and documented process leading up to the severance agreement;
- ensure the terms of the severance agreement are fair, reasonable, transparent, and properly authorised; and
- keep its stakeholders appropriately informed throughout the process – taking into account the nature of the stakeholder’s interest and the need to protect other interests (such as the privacy of employees).

We hope this report raises the awareness of public sector employers of the risks involved in making severance payments in the public sector, and provides helpful guidance on how the risks can be addressed.

Comments on scope and definition

What we mean by an “employment settlement”

The report uses the term “employment settlement”. At its broadest, this means any settlement of an employment dispute which results in a payment of money to the employee – whether or not the employment relationship continues.

Our main focus – reflected in the title of the report – is on payments made to employees when the employment relationship comes to an end. Payments which result directly in, or bring about, the employee’s resignation are commonly known as “severance payments” because, in effect, they signify severance of the employment relationship.

But many other types of payment can be made on termination – for example:

- bonus and *ex gratia* payments (mentioned above); and
- payments made to resolve a personal grievance or other dispute which arose in connection with, or contributed towards, the employee’s departure.

The risks which the report discusses can apply to *any* decision by a public sector employer to make an abnormal type of payment to an employee.

What we mean by “the public sector”

The report is about the risks facing employers in “the public sector”. We should stress that “the public sector” covers both central and local government and the wide range of other organisations that are subject to our auditing mandate under the Public Audit Act 2001. The principles in Part 2 have been expressed in a way which acknowledges the diversity of interests and activities involved.

Some of the principles, and the examples which illustrate them, are relevant to all employment situations – whether in the public or private sector. Accordingly, we hope that the report will be useful to all employers and their advisers.

1 – Employment Settlements and the Risks Associated With Them

1.1 This Part describes the context in which employment settlements are made. We address three questions:

- Why do employment settlements happen?
- Should a public sector employer ever agree to enter into an employment settlement?
- What are the risks in doing so?

Why do employment settlements happen?

1.2 Employment disputes are a fact of life. A dispute can result in either party deciding to terminate the employment relationship – or indicating an intention to do so.

1.3 The **employee** can terminate the relationship by resigning. But if the resignation was triggered by the employer’s conduct, the employee can also raise a “personal grievance” with the employer – claiming constructive dismissal or some other breach of the employer’s obligations under the employment agreement.

1.4 The **employer** might terminate the relationship because, for example:

- the employer believes that the employee has breached the employment agreement or performed unsatisfactorily;
- the relationship has broken down; or
- the employee’s position is redundant.

1.5 Alternatively, the term of the employment agreement may have expired and the employer may not wish to renew it.

1.6 The employee has the right to contest the termination (or, as the case may be, the non-renewal) of the agreement, by raising a personal grievance.

1.7 In any of the above circumstances, the Employment Relations Act 2000 encourages the parties to explore the possibility of resolving the dispute by agreement, *without* having to resort to litigation¹. This is so whether termination has actually happened or has merely been indicated as a

¹ We use the term “litigation” to describe any process which results in a binding determination – including, for example, investigation and adjudication by the Employment Relations Authority.

possibility. Mediation is the primary means by which the Act encourages resolution. However, either party may choose litigation if it wishes. (Appendix A on pages 29-31 contains a more detailed description of the procedures and remedies available under the Act.)

1.8 An **employer** therefore has a choice whether to:

- refuse to mediate or enter negotiations for a settlement – leaving it to the employee to pursue the avenue of litigation;
- agree to explore possibilities of resolution through a process of mediation – reserving its options if mediation is unsuccessful; or
- enter negotiations directly with the employee with a view to reaching an employment settlement.

1.9 If the employment relationship ends with a settlement, there is a strong expectation (arising from practice in the employment industry) that the settlement will include:

- a payment to the employee of lost remuneration;
- compensation for humiliation, loss of dignity, and injury to feelings (referred to from here on as a “payment for hurt and humiliation”); and
- a confidentiality clause to protect the terms of settlement from publication.

Should a public sector employer ever agree to enter into an employment settlement?

1.10 Public sector employers are subject to the same rules about resolving employment disputes as employers in the private sector.

1.11 Different interests and incentives may influence an employer’s decision to enter settlement negotiations – for example:

- who has been most at fault, and the likely outcome if the personal grievance is taken to litigation; or
- commercial, management, and reputational issues (or, put another way, economic and emotional costs).

1.12 The “bottom line” may be that the cost of an employment settlement is not only cheaper than litigation but all that the employer can afford. Alternatively, an employer may decide to defend a case on principle, whatever the economic and emotional costs.

- 1.13 For these reasons, we do not think there is any basis for restricting public sector employers' ability to settle employment disputes. Each case is unique. Some cases may not justify settlement. Others will. For example, a settlement may be inappropriate where:
- the origin of the dispute is in poor performance or misconduct by the employee;
 - the employer is confident that it could justifiably dismiss the employee; and
 - the employer believes that it has used a fair and appropriate process to manage the dispute.
- 1.14 In other circumstances, it may be just and reasonable for a public sector employer – acting on appropriate legal advice about its liability in respect of a personal grievance – to make a considered decision to settle and make a payment to the employee.

The risks involved in employment settlements in the public sector

- 1.15 The question, therefore, is not so much whether, but when, employment settlements are appropriate.
- 1.16 Employment settlements pose particular risks for public sector employers. An employer ignores such risks at its peril. From our observations, the risks are of two kinds – relating to matters of:
- external accountability; and
 - lawful authority.

External accountability

- 1.17 Any institutional employer can be held to account by its stakeholders – whether they be shareholders, beneficiaries, a responsible Minister, or – more broadly – taxpayers or ratepayers.
- 1.18 Standard practice in corporate governance is for external stakeholders (such as a company's shareholders) to appoint the entity's governing body which is, in turn, responsible for employing the entity's staff. An external stakeholder does not, therefore, have a *direct* interest in an entity's employment decisions.

- 1.19 Nevertheless, the governing body may need to keep a stakeholder *informed* about:
- the entity's general performance in discharging its functions as an employer; and
 - specific employment decisions which may have strategic implications or affect the entity's reputation or credibility.
- 1.20 These considerations are especially important in the public sector, where the governance environment can be both complex and politically charged – which can affect:
- the way an entity makes sensitive or strategic employment decisions;
 - the extent to which the entity is externally accountable for those decisions; and
 - to whom the entity is accountable.
- 1.21 Because employment settlements can so easily create adverse public perceptions, it is essential that a public sector employer not only understands its governance environment but also considers the full range of factors which might affect its ability to justify an employment settlement to its stakeholders.
- 1.22 These factors are likely to include factors in addition to those which normally arise in the employment law context. We think the additional factors fall into the three groups discussed in paragraphs 1.23 to 1.26.
- 1.23 A decision to settle a dispute by a monetary payment may not – despite the normal incentives to do so – be in the wider **public interest**. Examples include:
- The risk in paying taxpayers' or ratepayers' money to an employee whose legal entitlement or deservedness has not been put to the test by independent adjudication. The conventional cost-benefit analysis – that it is more efficient to settle than to litigate – may not sufficiently justify a settlement decision.
 - The risk of setting a precedent (such as, about the employer's general willingness to settle personal grievances, or the amounts it is willing to pay).
 - The notion of a wider employment interest beyond that of the entity itself. For instance, a confidential settlement with a poorly performing employee could result in the employee being re-employed elsewhere in the public sector, without other employers being aware of why the employee left his or her last position. In some sectors, the employee could also keep entitlements which he or she would otherwise lose by having a break in service.

- 1.24 A public sector employer faces high stakeholder expectations as to **integrity** – such that:
- The **employer’s conduct** during the dispute will be **beyond reproach** – reflecting the public nature of the funds involved. For example, the employer should not make an over-generous payment to an employee out of sympathy. Conversely, the employer should not use technical or petty arguments to resist an otherwise sensible settlement.
 - The **settlement package** will be **appropriate**. The way settlements are structured poses particular risks. There is an incentive for parties to structure a settlement primarily around a payment for hurt and humiliation (which is usually not taxable) rather than lost remuneration (which always is). This can increase the overall cash value of the settlement to the employee, but make no difference to what the employer has to pay. It is a common employment practice, but one which has tax implications² and can expose a public sector employer to criticism, and potential tax penalties, if used inappropriately.
- 1.25 Making a settlement confidential is directly inconsistent with public expectations of **transparency and accountability**. Confidentiality has its place – such as to protect information which is genuinely sensitive commercially, or to prevent unwarranted damage to an employee’s privacy or state of personal health. But this protection can also be at the cost of transparency.
- 1.26 For many, secrecy is evidence of public officials having something to hide. Indeed, if an employer has been at fault in its conduct leading up to or during a dispute, it should be accountable for that. Yet the confidentiality clause prevents explanation if questions are asked – which in high-profile cases they inevitably are. Adverse publicity about a confidential agreement can result in far more scrutiny of – and damage to – the parties’ reputations than the confidentiality clause was designed to prevent.

Lawful authority

- 1.27 Many public entities are subject to **statutory** or **administrative constraints** in their role as employers. From our observations, once a dispute gathers momentum and heads towards settlement, important matters such as lawful authority are easily overlooked. The result can be contracts or payments which are unlawful.
- 1.28 Here are three examples of these constraints:
- Many Crown entity boards must consult (or obtain the concurrence of) the State Services Commissioner before agreeing or varying the terms and conditions of employment for their chief executive. Others must also consult about terms and conditions of employment for other employees.

² We explore the tax implications in Part 2 (paragraphs 2.34-2.35) and Appendix B on page 32.

- Chief executives of government departments cannot authorise expenditure for compensation or damages or settlement of claims if the amount exceeds \$100,000 without reference to their Minister.³
- A chief executive may be required to report to the governing body (or, in the case of a government department, the responsible Minister) on sensitive matters of expenditure. An employment settlement with a senior employee would be a case in point.

1.29 Decisions on employment matters must also be consistent with **internal delegations**. An entity's chief executive is often expected to deal with all employment disputes.⁴ However, the chief executive's authority to incur expenditure is likely to be subject to an explicit delegation from the governing body, which may include a financial limit.

1.30 The governing body may also need to be involved in decision-making about an employment settlement where the manager responsible for dealing with the matter has a conflict of interest.

Conclusion

1.31 Settling disputes is at the heart of employment law and practice, which applies in both the public and private sectors. Some settlements in the public sector are inevitable. What is important is that they are:

- made for the right reasons;
- structured appropriately; and
- as transparent as possible.

1.32 We find that public sector employers sometimes pay inadequate attention to the kinds of risk discussed in this Part. In our view, this has been a major cause of public criticism of some employment settlements.

³ Cabinet Office Circular CO (99) 7 *Financial Delegations and Delegation Limits for Responsible Ministers and Departmental Chief Executives* (30 June 1999). Expenses for compensation or damages for settlement of claims must be endorsed either by the Crown Law Office or a court judgment. Claims under \$50,000 need not be referred to the Crown Law Office if a departmental solicitor certifies that such claims are in order.

⁴ In the case of a local authority or a tertiary education institution, the chief executive is the statutory employer of the entity's staff.

2 –Taking a Principled Approach to Employment Settlements

2.1 In this Part, we identify six key principles which we think should underlie a public sector employer’s approach to resolving employment disputes.

Principle 1 – Minimise the Potential for Terminating Employment

Any dispute with an employee arises in the context of an employment relationship. A good employer should manage the relationship in such a way as to minimise the potential for an emerging dispute to develop into one where termination of the employment becomes the only feasible option for either party.

2.2 The parties to an employment relationship have mutual duties of good faith, trust, and confidence. As well, most public sector employers are required by law to be “good employers”. (Appendix B on page 32 describes the duties of a public sector employer in more detail.)

2.3 Any employment dispute should be seen in the context of the overall employment relationship. A “good employer” should manage the employment relationship constructively to deal with emerging problems and prevent them from escalating into full disputes. This may include:

- ensuring that the terms and conditions of employment – especially those in respect of termination – are clear and appropriate to the needs of the position;
- establishing clear expectations about the employee’s performance, and having adequate systems for performance appraisal;
- managing the employment relationship constructively, to enable the employee to perform to his or her full potential; and
- having clear procedures to deal with disputes.

2.4 In other words, the employer’s objective should be to deal with problems in an employment relationship so as to preclude the problems escalating to the point where termination of employment is the only feasible option. Termination of employment leading to a settlement and severance payment such as we discuss in this report should be a truly exceptional occurrence.

2.5 In the following example, the employer chose to terminate the employment relationship and make a substantial severance payment – rather than manage the relationship in a way which enabled the employee to meet the changing requirements of the position.

Entity A, a local authority subsidiary, engaged a chief executive for a role which was primarily managerial. No formal employment agreement or written performance criteria were prepared. Over time, it became apparent that the managerial focus of the chief executive's role was not compatible with the entity's strategic requirements.

The governing body decided that it needed a chief executive with strategic vision, and that the existing chief executive did not have the appropriate skills. It rejected the option of developing a new job description and performance criteria, and giving the chief executive an opportunity to meet the new expectations. Instead, it decided to terminate the employment relationship.

Anticipating that the chief executive would respond by raising a personal grievance, the governing body initiated negotiations for an employment settlement. The negotiations resulted in a severance payment of over \$80,000.

- 2.6 A public sector employer can reduce the risk of public criticism arising from an employment settlement if it can show that it managed the changing employment relationship in a way which:
- was fair to the employee; and
 - made termination of the relationship the last resort.

Principle 2 – Reach a Soundly Based Decision to Settle

If termination of employment becomes the only feasible option for resolving a dispute, a public sector employer's decision to settle (rather than pursue a dismissal and/or defend a personal grievance raised by the employee) should be one which:

- **is properly authorised;**
- **is based on specialist advice that assesses all options for resolving the dispute and appreciates the wider public sector dimension; and**
- **is reasonable and appropriate – having regard to the interests of the organisation and the wider public interest.**

Authorisation

- 2.7 Questions of authorisation may arise under legislation, an external administrative direction, or an internal delegation.⁵ These should be considered at the time that a decision is made to enter negotiations for an employment settlement. In the case of an internal delegation, it is common for a governing body to designate one or more members or officers to undertake or oversee negotiations, within identified parameters.
- 2.8 The following example shows how a failure to involve the governing body can result in unauthorised payments.

Entity B, a Crown entity, was undergoing restructuring. It was in financial difficulty, and as a condition of additional funding the Crown had appointed a Manager (“the Crown Manager”) who had financial oversight powers.

The chief executive was the “employer” for the purposes of dealing with any personal grievance or other employment dispute, and had a delegation to spend up to \$70,000 on personnel matters. All items beyond the chief executive’s delegation were to be approved by a committee of the governing body.

The Crown Manager made it clear to the chief executive that he expected the chief executive to consult him on any unusual or large expenditure items – even those within the chief executive’s delegation.

The chief executive entered into employment settlements, following mediation, with four senior managers who had raised grievances about the restructuring. The chief executive did not involve the Crown Manager or the governing body in any of the decisions. The payments to two of the four employees exceeded the chief executive’s delegation and were therefore unauthorised.

Assessing the available options

- 2.9 The statutory framework for resolving employment disputes⁶ gives an employer several options where a dispute involves both performance concerns and a threatened or actual personal grievance.
- 2.10 There can be good reasons to settle, rather than litigate, an employment dispute. Employment advisers typically weigh up the likely economic costs of settling against the cost of the worst-case scenario – defending, and losing, a personal grievance in the Employment Relations Authority. This analysis forms the basis of the decision whether to defend or settle and, where settlement is chosen, determines the limits of the employer’s negotiating position.

⁵ See paragraph 1.28 for some examples.

⁶ See Appendix A on pages 29-31.

- 2.11 Other non-cash costs – such as opportunity costs and the cost of management time and effort – are often included in this analysis.
- 2.12 Settling can be beneficial for other reasons, because it:
- avoids the unpleasant and emotionally damaging aspects of litigation;
 - achieves finality; and
 - enables the parties to move on.
- 2.13 However, a public sector employer should also be alert to factors and risks that may make an employment settlement undesirable. For example, paying compensation to a poorly performing employee in return for the employee’s resignation may result in a public perception that the employer has rushed needlessly into settlement and effectively rewarded the employee for poor performance. Alternatively, if the employer has agreed to settle in response to a threatened or actual personal grievance, it may be perceived as having given an undeserved windfall to someone whose entitlement has not been independently determined by the Employment Relations Authority.
- 2.14 This could encourage other employees to raise personal grievances instead of working through issues with the employer.
- 2.15 Ultimately, a public sector employer needs to ensure that it can justify a decision to settle as reasonable and appropriate. It should take comprehensive, specialist advice that assesses:
- all the options for settlement; and
 - the benefits, as well as the cost, of litigating the dispute.
- 2.16 We use the term “specialist advice” to mean advice which covers not only the ‘employment law’ context but also the ‘public interest’ factor (see paragraph 1.23).
- 2.17 The following example shows the risks in not obtaining comprehensive specialist advice about the options for resolving a dispute.

The chief executive of Entity C developed concerns about a manager’s performance, and sought legal advice about how to address them. The chief executive then became aware of potentially serious misconduct by the manager.

The chief executive told the manager that addressing the more general performance concerns would be postponed until completion of the investigation into the alleged misconduct. The manager responded by initiating a dispute over the interpretation of documents relevant to the alleged misconduct. The chief executive denied there was a genuine issue of interpretation.

The manager then:

- *applied to the Employment Tribunal⁷ for mediation assistance on the interpretation issue; and*
- *raised a personal grievance, alleging (among other things) unfair treatment during the performance review process.*

The entity took advice from a human resources specialist (which was not in writing) and canvassed:

- *the remedies available to employees in the event of a successful personal grievance claim; and*
- *the potential monetary liability should the entity wish to proceed with dismissal.*

The entity denied any liability under the personal grievance, but decided to enter negotiations with the employee. These resulted in a settlement, under which the cost to the entity (excluding its legal fees and management time) was over \$40,000. It included a tax-free payment for hurt and humiliation of \$25,000.

- 2.18 The entity did not obtain written legal advice on the options open to it. The oral advice which it got did not cover any implications of structuring a settlement primarily on a payment for hurt and humiliation.
- 2.19 The example also illustrates how the ground can shift in favour of the employee during settlement negotiations. The entity went from a position of concern about an employee's performance and potential serious misconduct, to making a significant payment to the employee for hurt and humiliation (albeit with no admission of liability).
- 2.20 On the other hand, there may have been some benefit for the parties in reaching a full and final settlement, and avoiding the expense and other disadvantages associated with defending a personal grievance in litigation.

Principle 3 – Observe Appropriate Standards of Probity and Integrity

When negotiating an employment settlement, a public sector employer should conduct itself in a manner that reflects appropriate standards of probity and integrity.

⁷ Under the Employment Contracts Act 1991, then in force.

- 2.21 The law requires all employers, whether in the public or private sector, to observe a fair process when dealing with employees. A failure to do so can result in the employer's actions being held to be unjustified by the Employment Relations Authority – even if the employer had substantive grounds for taking them.
- 2.22 The requirement to follow a fair process is consistent with an employer's duties of good faith, trust, and confidence, and a public sector employer's obligation to be a "good employer".⁸
- 2.23 One aspect of these duties is the need to identify conflicts of interest, and take necessary steps to remove affected persons from the process. The following example illustrates how this can be done.

In Entity C, the chief executive took steps to address a concern about an employee's performance and alleged misconduct. The employee then raised a personal grievance alleging inappropriate personal conduct by the chief executive and unfair treatment. The chief executive had a conflict of interest, but acted appropriately by involving the chairperson of the entity's governing body, who took steps to enable the dispute to be resolved.

Principle 4 – Ensure That Terms of Settlement Are Appropriate

A public sector employer which enters an employment settlement should ensure that the terms of the settlement are consistent with:

- **the employer's contractual obligations to the employee; and**
- **the employee's legal entitlement to, and acceptable levels of payment for, tax-free compensation.**

- 2.24 This principle recognises the high standards which public sector entities are expected to meet, consistent with their stewardship of public funds or publicly-owned assets.

Consistency with contractual obligations

- 2.25 We said in Part 1 that an employment settlement usually involves the employee agreeing to resign in return for a payment for any lost remuneration, as well as payment for hurt and humiliation.⁹ At the termination of employment, the employee will also receive payment for any other entitlements (such as holiday pay).

⁸ See Appendix B (page 32) for more detail.

⁹ Both types of payment are made under section 123 of the Employment Relations Act (see Appendix A on pages 29-31).

2.26 Payments other than payments for hurt and humiliation should be:

- consistent with the provisions in the employment agreement as to termination, notice, and redundancy; and
- taxed at source.

2.27 Neither of these requirements was satisfied in the following example.

In Entity B's restructuring process, several employees who were to be made redundant raised personal grievances about the way the restructuring process had been conducted. The chief executive settled all the personal grievances following mediation.

Under the settlements, the employees received payments which were equivalent to their contractual entitlements had they been made redundant. However, none of the payments were expressed as redundancy payments. In some of the cases, an additional amount was added which was not provided for in the employee's employment agreement.

All the employees received their settlement payments on a tax-free basis. Had the employees been made redundant and paid in accordance with their contractual entitlements, the payments would have been taxable as income. A review of the substance of the employee's personal grievances raised doubt as to whether any of the grievances were genuine.

2.28 An employer should ensure that the employment agreement contains adequate protections in the event of termination. This is especially important in the case of a fixed-term employment agreement,¹⁰ where early termination can expose the employer to a substantial payment of lost remuneration for the remainder of the fixed term. The following example illustrates this point.

Entity D, a Crown entity, appointed its chief executive for a period of three years, subject to good performance. The agreement provided for termination on three months' written notice, or on a date agreed by both parties. There was also provision for payment of remuneration in lieu of notice.

Half-way into the term of employment, the entity's governing body resolved to extend the appointment to a term of four-and-a-half years. The termination provision was amended to provide that, should the entity terminate the contract (except in the case of serious misconduct), the amount due under the remainder of the contract would be paid to the chief executive in full.

¹⁰ Some public sector employment agreements – such as those for the chief executives of government departments and local authorities – must by statute have a fixed term. In other cases, an employer must have genuine reasons for a fixed term, and must specify them in the employment agreement: section 66(2) of the Employment Relations Act.

Soon afterwards, the employment relationship broke down – following the resignation of the chairperson and several board members and the appointment of a new chairperson. Under the ensuing employment settlement, the chief executive received a gross sum of more than \$500,000, which represented the amount payable for the remainder of the contracted term.

- 2.29 Most Crown entities are obliged to consult with the State Services Commissioner about (or, in some cases, obtain the Commissioner’s concurrence to) the terms and conditions of employment of their chief executive or other employees. The State Services Commissioner plays a valuable role in helping Crown entities to ensure that their employment agreements contain adequate protections in respect of termination and redundancy. In the example of Entity D, the entity failed to consult the Commissioner (as it was required to do) on the variation of the termination provision.
- 2.30 We are aware that some fixed-term employment agreements contain an “irreconcilable breakdown” clause to limit an employer’s liability if the employment relationship breaks down during the term. Clauses of this type:
- recognise that a good working relationship between the employer and the employee is fundamental;
 - acknowledge that the employee is entitled to a payment if the relationship breaks down irrevocably through no fault of the employee;
 - establish a formula to calculate the payment; and
 - enable the employer to terminate the agreement after giving notice to the employee.
- 2.31 A clause of this type was formerly included in the standard-form agreement for government department chief executives. It is now considered to be inconsistent with the Government’s policy in respect of severance payments, because it would require a payment in the event of early termination.

Payments for hurt and humiliation

- 2.32 Payments for hurt and humiliation are made under section 123(c)(i) of the Employment Relations Act. Section 123(c)(i) concerns damages that may be awarded where the Employment Relations Authority determines that an employee has a personal grievance and has suffered *humiliation, loss of dignity, and injury to feelings*.

- 2.33 If an employee takes a personal grievance to the Employment Relations Authority, the Authority must be satisfied that there is a valid grievance – which has caused humiliation, loss of dignity, and injury to feelings – before the employee is entitled to any payment under section 123(c)(i). In contrast, the focus in an employment settlement involving a personal grievance is on resolving the dispute between the parties.
- 2.34 However, the almost invariable practice is for employment settlements to include a payment for hurt and humiliation – described as having been made as if it were an award of damages under section 123(c)(i). This practice raises important probity and tax issues, because:
- No judicial institution has determined that the employee has a valid personal grievance and is entitled to a payment for hurt and humiliation.
 - As we said in Part 1, there is an incentive for parties to structure a settlement primarily around a payment for hurt and humiliation (which is not taxable) instead of remuneration (which is). This often results in the payment for hurt and humiliation being higher than what would have been awarded if the employee’s entitlement had been determined judicially – which may bring the payment into question from a tax point of view.
 - If the parties fail to ensure that the settlement is consistent with their respective tax obligations, they undermine the principle of voluntary compliance which lies at the heart of the tax system.
- 2.35 We believe that a public sector employer should ensure that its specialist advice about the settlement covers the following issues:
- what the employee is entitled to receive as a taxable payment under the employment agreement;
 - whether there is also a legal basis for making a payment for hurt and humiliation;
 - if so, what the employee would be likely to receive if the case was determined by the Employment Relations Authority; and
 - what would be an acceptable level of a voluntary payment – in order to achieve a full and final settlement and recognise the employee foregoing the right to pursue a personal grievance by litigation, while genuinely compensating the employee for humiliation, loss of dignity, and injury to feelings.
- 2.36 Appendix C on pages 33-37 considers the tax question in more detail, with two illustrations. In general, we think that a payment made on the basis of advice on the issues listed in paragraph 2.35 ought also to be acceptable for tax purposes.

Principle 5 – Preserve Maximum Transparency

A public sector employer should ensure that any confidentiality agreement reached as part of an employment settlement:

- **is genuinely necessary, and in the interests of both parties;**
- **is consistent with the employer’s obligations as to disclosure of information; and**
- **does not otherwise prevent the employer from being accountable for its use of public funds.**

2.37 Most employment settlements require the parties to keep details of the settlement, and the events which led to it, confidential. Confidentiality clauses are a common feature in the employment settlements we see in the public sector.

Reasons for confidentiality clauses

2.38 There is no single reason for confidentiality clauses. For example, a clause may be designed to protect:

- the reputations of either or both of the parties;
- specific interests such as personal privacy or commercial confidentiality; or
- the process by which the agreement was reached.

2.39 These interests are recognised by the Employment Relations Act.¹¹ But it is also fair to say that many confidentiality clauses find their way into agreements by default.

Confidentiality in the public sector

2.40 Most employers in the public sector face significant limits on their ability to guarantee confidentiality to an employee under an employment settlement, because:

¹¹ Section 148 extends confidentiality to all aspects of the mediation process under the Act. Clause 10 of Schedule 2 enables the Employment Relations Authority to prohibit publication of proceedings before it – including a consent order as to terms of settlement.

- Most public entities are subject to either the Official Information Act 1982 or the Local Government Official Information and Meetings Act 1987 (referred to collectively as “the OIA”). The OIA requires information to be made available on request unless there is a specified “good reason” to withhold it. The OIA overrides an employee’s entitlement to privacy under the Privacy Act 1993.¹²
- Other statutes (such as the Local Government Act 1974 and the New Zealand Public Health and Disability Act 2000¹³) require information relating to payments on termination of employment to be included in an entity’s annual report.
- Government departments, Crown entities, State-owned Enterprises, and some other public organisations are subject to Parliamentary scrutiny, through the doctrine of Ministerial responsibility and the financial review and inquiry powers of select committees. Select committees have extensive powers under Standing Orders to obtain evidence.
- A public entity may be required to make disclosure to an Ombudsman (under the Ombudsmen Act 1975) or the Auditor-General (under the Public Audit Act 2001). Both officers have extensive powers to report publicly on matters which come to their attention in the exercise of their functions.¹⁴

2.41 None of these provisions prevent an employer from accepting an obligation of confidentiality in respect of an employment settlement. Their significance lies in the potential for that obligation to be overridden in particular circumstances.¹⁵

2.42 A public sector employer should therefore turn its mind actively to the question of confidentiality, why it is needed, and to what extent the parties could meet any obligation they agree to. If necessary, the employer should take specialist advice. But, ultimately, the issue may turn on the employer’s judgement as to whether, and (if so) to what extent, it should either seek or agree to confidentiality in the wider public interest.

¹² Section 7 of the Privacy Act.

¹³ Section 223E(12) of the Local Government Act, and section 42(3)(f) of the New Zealand Public Health and Disability Act.

¹⁴ The Auditor-General has twice reported publicly since 1999 on the amounts paid under employment settlements which were subject to confidentiality clauses: see *Inquiry Into Certain Events Concerning the New Zealand Tourism Board* (1999) and *Airways Corporation Limited: Review of Certain Matters Concerning the National Air Traffic Services Consortium* (2000).

¹⁵ For example, section 9 of the Official Information Act protects information on grounds such as privacy and prejudice to commercial interests. It also recognises the importance of confidentiality obligations. However, these interests must be weighed against any countervailing “public interest” favouring disclosure – for example, the accountability of officials.

2.43 There is evidence that many public sector employers recognise the value of transparency, and are conscious of the need to avoid committing themselves to unrealistic or undesirable levels of secrecy. Options for doing this include:

- making an undertaking of confidentiality subject to the OIA or any other statutory obligation;
- agreeing to observe confidentiality in respect of how the settlement was reached (consistent, for example, with the confidentiality of mediation proceedings), but not in relation to the outcome; and
- agreeing to a limited form of disclosure (such as in the form of an agreed statement) as a separate term of the agreement.

Principle 6 – Avoid Exposure to Public or Political Embarrassment

A public sector employer should not expose an external stakeholder to public or political embarrassment in relation to an employment settlement by failing to:

- **address political or public interest risks; or**
- **keep the stakeholder adequately informed.**

2.44 This principle recognises the ‘goldfish bowl’ factor – that public entities operate in an environment of political risk, in which their actions can be subjected to intense scrutiny.

2.45 A settlement involving a payment to a departing employee involves sensitive expenditure. Both the decision to settle and the payment of public funds under the settlement usually involve political as well as legal risk. The degree of political risk can increase with the seniority of the employee or the size of the payment. Addressing it may require specialist advice. Possible sources of advice are:

- the Crown Law Office or the State Services Commission (for departments and Crown entities);
- Local Government New Zealand or the Society of Local Government Managers (for entities in the local government sector); and
- lawyers with recognised expertise in public law.

- 2.46 Keeping external stakeholders informed is a critical part of political risk management. Each public entity has external stakeholders with a range of interests. Stakeholders may include:
- the governing body, in the case of a local authority or Crown entity whose chief executive has employer responsibilities;
 - the State Services Commissioner and the responsible Minister, in the case of a government department;
 - the overseeing department and the responsible Minister, in the case of any Crown entity;
 - the shareholding Ministers and their advisers, in the case of a State-owned Enterprise; and
 - the local authority, in the case of a local authority trading enterprise or other Council-controlled organisation.
- 2.47 Stakeholders such as these may not have any *direct* responsibility for employment matters.¹⁶ However, the public may hold them accountable or responsible in an indirect, or ultimate, sense for an employer's decision to pay money under an employment settlement. Experience shows that there is considerable room for a stakeholder to be politically embarrassed if a settlement lacks transparency or is hard to justify on its terms.
- 2.48 The employer owes it to each relevant stakeholder to ensure that it keeps the stakeholder adequately informed about the settlement – consistent with the respective governance responsibilities and other interests (such as the privacy of the parties). The timing and content of the communication is a matter of judgement. It may, for example, be sensible to inform a stakeholder of an *intention* to enter an employment settlement, and possibly seek the stakeholder's advice or concurrence – rather than simply informing the stakeholder of the settlement after it has happened.
- 2.49 Negotiating a confidentiality clause requires particular care, because of the potential for an obligation of confidentiality to limit the employer's ability to defend the settlement to stakeholders and – if the settlement comes to public knowledge – the public.

¹⁶ Indeed, the public entity may be required by law to act independently of its stakeholders in employment matters: see, for example, section 33 of the State Sector Act 1988.

Appendix A

Relevant Employment Law and Practice

A.1 This Appendix describes the procedures set out in the Employment Relations Act 2000 for resolving employment disputes, and the main remedies available to employees in the event that a personal grievance is found to be valid.

Procedures

A.2 The Employment Relations Act encourages parties to maintain good relationships and voluntarily resolve any disputes that arise during the employment relationship. The Act promotes mediation as the primary problem-solving mechanism.

A.3 The Department of Labour provides a mediation service for this purpose. Parties to a dispute can use the Department's mediation services in two ways:

- They can seek the active involvement of a mediator – using a process which is confidential unless the parties agree otherwise. If the mediation results in a settlement, the mediator can sign the agreement – making the settlement enforceable against either party.¹⁷
- Alternatively, the parties can negotiate an employment settlement independently of the mediation service, but then ask an authorised mediator¹⁸ to sign the agreement. This is a common approach, which achieves the same result in terms of enforceability.

A.4 The mediator plays a facilitative role. We understand this may involve alerting the parties to the risks involved in a particular approach to settlement – such as those associated with large tax-free payments. In general, however, the parties are responsible for the terms of any settlement and bear the risks associated with it.

A.5 Similarly, the mediator's responsibility when signing an employment settlement is usually limited to ensuring that the parties understand the final and binding nature of the settlement.¹⁹ It would be unusual for a mediator to question the terms of an agreement – although this does sometimes happen when the agreement appears to be substantially inconsistent with what would have been awarded had the case been submitted to binding determination.

¹⁷ Section 149(1) of the Employment Relations Act.

¹⁸ Meaning a mediator authorised by the Department of Labour.

¹⁹ Section 150(2), (3) of the Employment Relations Act.

- A.6 If the parties cannot reach a settlement at mediation, they may agree to the mediator making a binding decision.²⁰ Alternatively, either party may submit the dispute to the Employment Relations Authority for investigation. The Authority will consider the merits of the dispute and issue a binding determination.²¹
- A.7 If either party is dissatisfied with the determination made by the Employment Relations Authority, they can ask the Employment Court to:
- grant a full hearing of the matter; or
 - determine a question of law or fact.²²
- A.8 There is a further right of appeal to the Court of Appeal on questions of law.²³

Remedies

- A.9 If the Employment Relations Authority or the Employment Court determines that an employee has a valid personal grievance, it can provide for one or more of the following remedies:
- reinstatement in the former position or one that is no less advantageous;
 - reimbursement of lost wages or other money; and
 - a payment of compensation, including compensation for:
 - humiliation, loss of dignity, and injury to feelings; or
 - loss of any benefit (monetary or otherwise) which the employee may reasonably have expected to obtain.²⁴
- A.10 Reinstatement is the “primary” remedy. In other words, the Authority or the Court must order reinstatement where it is practicable to do so – irrespective of whether any of the other remedies are provided.²⁵

²⁰ Section 150 of the Employment Relations Act.

²¹ Sections 159 and 160 of the Employment Relations Act.

²² Section 179 of the Employment Relations Act.

²³ Section 214 of the Employment Relations Act.

²⁴ Section 123(a) to (c) of the Employment Relations Act. Additional remedies are available in cases involving sexual or racial harassment: section 123(d).

²⁵ Sections 125 and 126 of the Employment Relations Act.

A.11 Reimbursement of lost wages is usually limited to the lesser of:

- the amount actually lost; or
- three months' remuneration.²⁶

A.12 The amount payable under a remedy may be reduced if, and to the extent that, the employee's actions contributed to the situation that gave rise to the personal grievance.²⁷

²⁶ Section 128 of the Employment Relations Act. There is discretion to award a larger or lesser amount in appropriate cases.

²⁷ Section 124 of the Employment Relations Act.

Appendix B

Duties of Public Sector Employers

B.1 This Appendix describes the general duties imposed by legislation and the common law on employers in the public sector.

Fundamental duties

B.2 The parties to any employment agreement have mutual obligations of trust and confidence in their dealings with each other. Under the common law, these obligations are an implied term of every employment agreement.²⁸

B.3 The Employment Relations Act requires the parties to any employment relationship to deal with each other in good faith. The duty of good faith is also a reciprocal duty, owed by each party to the other. The Act does not define what it means to act in “good faith”. However, in the context of individual (as opposed to collective) employment agreements, it says that “good faith behaviour” is consistent with the implied term of mutual trust and confidence.²⁹

“Good employer” obligations

B.4 In addition to the duty of good faith and the implied term of mutual trust and confidence, most employers in the public sector have a statutory duty to be a “good employer”.

B.5 Most “good employer” duties are found in the entity’s enabling legislation. They require the entity to operate a personnel policy that “complies with the principle of being a good employer” – namely, a policy that contains “provisions generally accepted as necessary for the fair and proper treatment of employees in all aspects of their employment”.³⁰

B.6 Aspects of the “good employer” obligation overlap with the duty of good faith and the implied term of mutual trust and confidence. However, unlike those duties, the “good employer” obligation is borne by the employer alone.

²⁸ See *Auckland Shop Employees Union v Woolworths (NZ) Ltd* [1985] 2 NZLR 372.

²⁹ Section 60(c)(ii) of the Employment Relations Act.

³⁰ See, for example, section 56(1) and (2) of the State Sector Act 1988.

Appendix C

The Tax Implications of Payments for Hurt and Humiliation

C.1 It was common ground among the employment lawyers and human resources advisers we spoke to that the average size of payments for hurt and humiliation in employment settlements is much higher than what the Employment Relations Authority and the courts commonly award in cases which they determine.

C.2 This may be a justifiable cost of a system which encourages parties to resolve their disputes voluntarily and on a “full and final” basis – thus foregoing their right to have their legal entitlements determined judicially. There is also a view that structuring a settlement around a large payment for hurt and humiliation tends to reduce the total size of the settlement package.

C.3 However, the practice raises an important question, namely:

*what is the benchmark for deciding whether a voluntary payment is acceptable from a **probity** and **tax** point of view?*

C.4 We think this question should be addressed by reference to:

- the Employment Relations Act itself – in particular, the need for the employer to be satisfied that there is genuine humiliation, loss of dignity, and injury to feelings which justifies a payment for hurt and humiliation; and
- what is acceptable from a tax point of view.

C.5 To explore these issues further, we:

- examine the amounts typically awarded under section 123(c)(i) by the Employment Relations Authority and the courts, and paid under employment settlements;
- consider the possible reasons for the different practices;
- discuss the approach of the Inland Revenue Department (“IRD”); and
- consider the implications for public sector employers – with illustrations from cases we have seen.

Levels of Payments for Hurt and Humiliation

- C.6 The trend in judicial decisions is for limited amounts of damages to be awarded under section 123(c)(i) of the Employment Relations Act (previously section 40(1)(c)(i) of the Employment Contracts Act). In each case, the relevant court or tribunal has considered the nature and extent of the harm suffered by the employee, and awarded damages accordingly.³¹
- C.7 The following table shows that payments for hurt and humiliation made under employment settlements – especially those negotiated without the involvement of the Mediation Service – tend to be higher than what the Employment Relations Authority is willing to award as damages under section 123(c)(i).

Hurt and Humiliation Payments Under the Employment Relations Act: 2 October 2000 to 20 March 2002

Amount	Damages awarded by the Employment Relations Authority ³²		Payments under settlements mediated by Mediation Services		Payments under settlements agreed by parties and recorded by authorised mediators	
	\$	No. of files	%	No. of files	%	No. of files
1 - 4,999	50	61.6	1,358	61.8	259	38.3
5,000 - 19,999	31	38.4	702	32.1	280	41.3
20,000 +	–	–	136	6.2	138	20.4

Source: Department of Labour.

- C.8 The employment lawyers we spoke to about their experience with employment settlements confirmed this picture. Payments between \$20,000 and \$60,000 were said to be common, and there was said to be frequent anecdotal evidence of much larger amounts.

³¹ See the Court of Appeal's recent decision in *Charta Packaging Limited v Howard et al* (unreported, 22 February 2002, CA12/02) in which the Court substituted awards of \$7,000 for compensation for humiliation, distress and injured feelings in place of the Employment Tribunal's awards of \$11,000-\$15,000. The Court of Appeal emphasised that awards of compensation of this type are confined to compensation for *unjustifiable elements* of the employer's conduct and that, under this head, an employer is not required to compensate an employee for the loss of the job.

³² These statistics continue the picture of decisions of the Employment Tribunal under the Employment Contracts Act.

Possible Reasons for the Divergent Practices

- C.9 There is little or nothing in the way of a principled explanation for this divergence between adjudicated awards and employment settlements. In much of the professional advice we have seen, the nexus between the alleged grievance and the size of the compensation payment is either not readily apparent or completely lacking.
- C.10 In some cases, employers were advised without question to make a payment for hurt and humiliation on the basis of a threatened personal grievance rather than an actual one, or even on an assumption that a personal grievance might be raised in response to an attempt at dismissal. In others, there was no scrutiny or consideration of (or advice about the employer's need to investigate) an alleged grievance.
- C.11 Instead, some advisers appear to assume that a payment for hurt and humiliation will form part of an employment settlement, and base their advice as to the amount of such a payment on what they think would be acceptable in tax terms. However, there are no reported tax cases on what is acceptable.
- C.12 We think it more likely that:
- most advice is simply based on recent experience,³³ and
 - the result is determined by what the employer is willing to pay.
- C.13 The lack of a principled foundation to the practice is therefore not surprising.

IRD's Approach

- C.14 A payment for hurt and humiliation awarded to an employee by the Employment Relations Authority does not form part of an employee's gross income under the Income Tax Act 1994. The reason is that the payment is in the nature of damages, and is too remote from the employment relationship to be "monetary remuneration".
- C.15 IRD also accepts that, if a voluntary payment for hurt and humiliation is **genuinely** based on an employee's right to compensation under section 123(c)(i), it will be treated in the same way. This position has recently been confirmed in a Public Ruling.³⁴

³³ Under both the Employment Contracts Act and the Employment Relations Act.
³⁴ Inland Revenue Department Public Ruling – BR Pub 01:04 *Assessability of Payments Under the Employment Relations Act for Humiliation, Loss of Dignity and Injury to Feelings*.

- C.16 However, the Ruling also makes it clear that payments that are in reality for lost wages or other income – but which are merely characterised by the parties as being for humiliation, loss of dignity, or injury to feelings – are open to challenge. This is so, irrespective of whether a settlement agreement has been signed by a mediator.³⁵
- C.17 When investigating a payment for hurt and humiliation, IRD would need to be satisfied that the employee’s grievance was genuine and that the transaction was not a sham. For this purpose, it is likely to focus on the cause of the humiliation, loss of dignity, and injury to feelings, and consider:
- the link between the cause and the amount awarded; and
 - the proportion of the compensatory amount against the total payment.
- C.18 The onus would be on the parties³⁶ to prove both that the grievance was genuine and that the amount of the payment was justifiable in relation to the nature of the humiliation, loss of dignity, and injury to feelings suffered.

Implications for Public Sector Employers

- C.19 An employer is entitled to rely on professional advice that a proposed payment for hurt and humiliation is both justifiable under employment law and acceptable for tax purposes. However, the payments for hurt and humiliation we have seen in recent years in the public sector range from \$25,000 to over \$240,000. In most cases, the payment for hurt and humiliation comprised a significant proportion of the total settlement. In several cases, the entire settlement was expressed as a payment for hurt and humiliation, despite the amount being apparently calculated on the basis of a (taxable) contractual entitlement on termination.
- C.20 Payments at the higher end of this scale (whether absolutely or as a proportion of the total settlement) are not only out of step with what an employee might be awarded by judicial determination, but are also inconsistent with what we have identified as common practice in respect of employment settlements. In some cases, we have doubted whether the payment was genuinely for compensation arising from a personal grievance.
- C.21 The following examples illustrate this point.
1. *A majority of the governing body of Entity E in the local government sector wished to replace the chief executive, who had one year to run on a fixed-term agreement. The agreement did not provide for automatic renewal at the end of the term, but the parties were to meet one year from the end date to negotiate a new agreement. If the*

³⁵ Mediators are not necessarily qualified to take an active role in advising parties on any consequences of the structure of settlements: see Appendix A on pages 29-31.

³⁶ The tax liability – including any shortfall penalty – could fall on either the employer (by virtue of its PAYE obligations) or the employee (as the recipient of the payment).

negotiations failed, the agreement would end and the chief executive would be paid 6 months' salary.

The chairperson of the governing body obtained legal advice to the effect that the entity should not enter into renewal negotiations if it did not intend to renew the agreement. The governing body decided (by a majority vote) not to negotiate a new agreement, and to terminate at the end date – one year away. The chief executive's lawyers threatened court action in relation to the entity's process, but said that the chief executive was willing to explore early departure on mutually agreeable terms. (It was common ground that it would be difficult for the chief executive to work out the remaining year of his contract under the circumstances.)

After negotiation, the parties entered into a full and final settlement, under which the chief executive received over \$240,000. This appeared to represent roughly one year's salary, but was expressed entirely as a tax-free payment for hurt and humiliation. Lawyers acting for both parties advised that there was no tax liability.

2. *In considering options for negotiating the employment settlement with its chief executive, Entity A received advice from an employment adviser that, under the particular circumstances, any payment for hurt and humiliation would need to be within the upper limit for such payments. The advice was that the employment adviser would be "comfortable" with a tax-free payment of \$35,000, and that the entity should be aware of the potential tax liability if it paid above that limit.*

The governing body authorised the chairperson to proceed with settlement, and specified financial parameters which appeared to contemplate a taxable payment for lost remuneration as well as a payment for hurt and humiliation. However, as negotiations progressed, the entity appears to have lost sight of the need to distinguish between taxable and non-taxable elements of the settlement package. The chief executive received a tax-free payment of over \$80,000 – which was within the authorised parameters but well above the employment adviser's "comfort zone".