



Department  
for Business  
Innovation & Skills

**Ending the Employment  
Relationship:**

**Government Response to  
Consultation**

JANUARY 2013

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# GOVERNMENT RESPONSE TO ENDING THE EMPLOYMENT RELATIONSHIP CONSULTATION



## Foreword from the Minister for Employment Relations and Consumer Affairs

This Government is committed to maintaining and building on the flexibility of the UK's labour market, ensuring that businesses feel able to create new jobs, whilst protecting a strong system of employee rights.

We are now mid-way through our Employment Law Review, where we are seeking to improve every stage of the employment process, from making the decision to take on a very first member of staff, to ending the employment relationship in a fair and reasonable way.

We are making some legislative changes which are currently before Parliament as part of the Enterprise and Regulatory Reform (ERR) Bill, including provision of the confidentiality of settlement conversations for the purposes of Unfair Dismissal claims, and taking a power to increase or decrease the Unfair Dismissal Compensatory Award cap. *The Ending the Employment Relationship* consultation sought views on two key issues to supplement the legislative changes:

- how to support changes aimed at facilitating the use of settlement agreements as a consensual end to employment relationships; and
- whether the compensatory cap in unfair dismissal awards is appropriate.

I have been pleased by the level of response received on the consultation. There is clearly a great strength of feeling from all parties. It reinforces that this is an important aspect of the employment relationship and getting it right is vital to provide the necessary protections for individuals, but also give businesses the certainty and flexibility they need to flourish. I am grateful to the large number of HR and legal practitioners, trade unions and businesses and their representatives who have taken the time to give their expert and operational views on the questions raised.

I remain convinced that supporting the use of settlement agreements as a consensual and mutually beneficial way of ending the employment relationship can bring dividends for individuals and businesses.

The responses received on settlement agreements have helped to inform the picture of the guidance materials and tools required to support effective and fair ways to offer settlement. We have taken particular care to consider the points raised on the principles to underpin the Statutory Code and my Department continues to work closely with Acas on the production of the Statutory Code and other guidance products.

Responses on the unfair dismissal compensation award clearly demonstrated the wide range of views on the topic. It is the role of Government to look at the evidence and views presented and make decisions on what is appropriate, considering both the needs of the individual and business.

The cap on compensation for unfair dismissal was subject to a large one off increase in 1999 and has risen by more than inflation since. It is greatly in excess of the average award. Responses to the Ending the Employment consultation showed that perception amongst employees and employers was not realistic, creating difficulty on both sides.

It is also important, however, to set the cap at a level that compensates claimants appropriately. Therefore I am recommending the introduction of a cap based on 12 months' pay, but retaining the overall cap. This approach would provide employers and employees with greater clarity on the maximum level of award based on an individual's circumstances, which more closely reflects the reality of how awards are decided by employment tribunals.

A handwritten signature in blue ink, appearing to read 'Jo Swinson'.

**Jo Swinson MP, Minister for Employment Relations and Consumer Affairs**

## Executive Summary

1. The Government is taking legislative changes through the Enterprise and Regulatory Reform (ERR) Bill currently before Parliament, to support a programme of labour market reform developed through the Employment Law Review. The Bill includes measures to provide for the confidentiality of a settlement offer in non-dispute situations, for the purposes of an unfair dismissal claim, and a power to amend section 124 of the Employment Rights Act (ERA) 1996 to increase or decrease the limit of the compensatory award for unfair dismissal.
2. On 14 September 2012 the Government launched a 10-week consultation on issues relating to the implementation of these legislative changes. There were over 170 responses to the consultation, which closed on 23 November 2012.
3. Businesses were generally supportive of the aim to facilitate the increased use of settlement agreements, and their concerns centred on seeking clarity and certainty about how the measure would work in practice, and guidance for successful use of the system. Trade unions expressed broad concern about the use of settlement agreements. They did, however, agree with businesses and legal representatives when identifying specific areas of potential complexity, and therefore where clear guidance will be critical.
4. Businesses supported the introduction of a pay based cap on the compensatory award for unfair dismissal, with some concerns being around employees bringing additional uncapped claims. Trade unions opposed changing the cap, though the majority of these respondents opposed the notion of any cap on compensation for unfair dismissal.

## Settlement Agreements

5. There was broad support for the inclusion of new templates in a Statutory Code of Practice. The main divergence of opinion was between employers who said that the Code should not be overly prescriptive, and trade unions who expressed concern that the Code might not go far enough to protect employees' rights.
6. We have asked Acas to include template letters in a Statutory Code, to provide certainty for employers. But guidance would make it clear that these templates are not compulsory, and that they will sometimes require amendment to reflect particular circumstances.
7. Employers, legal representatives and trade unions all told us that a clear definition of 'improper behaviour' is critical. We have asked that the Acas Code set out an explanation of this test, taking into account specific comments received. An Acas Code itself would be the subject of a public consultation.
8. Accompanying guidance will be developed to supplement the Statutory Code, including advice for employers regarding 'good practice' in offering settlement as part of their broader approach to management. The guidance will explain the practical implications of the new inadmissibility provision. It will also include a model settlement agreement, which can be updated to reflect any changes in the broader regulatory framework.
9. Trade unions, business representative bodies and legal representatives were all strongly opposed to Government setting a guideline tariff. The broadly consensual view was that a guideline tariff might in fact impede the successful negotiation of settlement.

Government will therefore not set a guideline tariff for settlement agreements but will give some guidance as to considerations that may be taken into account when negotiating and deciding the level of the financial settlement.

10. The Government is working towards the amended legislation, a Statutory Code of Practice, and accompanying guidance being in place by summer 2013.

### **Unfair Dismissal Compensatory Award Cap**

11. There was no consensus among key stakeholders on the compensatory cap. Businesses believed that a cap would help bring perceptions amongst employers and employees more in line with what they might reasonably expect. Trade unions did not agree there was an issue with perception of awards. The Government found arguments that the high level of the current cap is creating unhelpful perceptions persuasive. Empirical studies have shown a number of claimants hope for awards far in excess of the median award.
12. Businesses and legal representatives argued that parties entering negotiations with a more realistic idea of tribunal awards would lead to quicker settlement. Given that there is no bar to claimants bringing multiple claims, which is at present the case in most instances, the Government did not find the concerns about additional claims persuasive.
13. The majority of respondents, particularly businesses, felt that the introduction of a salary based cap would increase certainty over costs of the dispute for employers. Those who thought it would not were mostly trade unions.
14. Some respondents felt there would be a discriminatory impact on certain groups of claimants on introducing a pay based cap. A data analysis does not indicate, however, that this is likely, nor is the Government persuaded that employers would act unfairly.
15. Based on the evidence from these responses, the Government intends to introduce a 12 months' pay cap on the compensatory award for unfair dismissal, subject to Parliamentary process.
16. With regards to the overall cap, no consensus emerged in terms of whether it should be changed, or, if so, how it should be changed. Only two thirds of business respondents felt it was not currently set at an appropriate level, and they were scattered on what level was appropriate. Government is not pursuing a change to the overall cap on the compensatory award for unfair dismissal at this time.

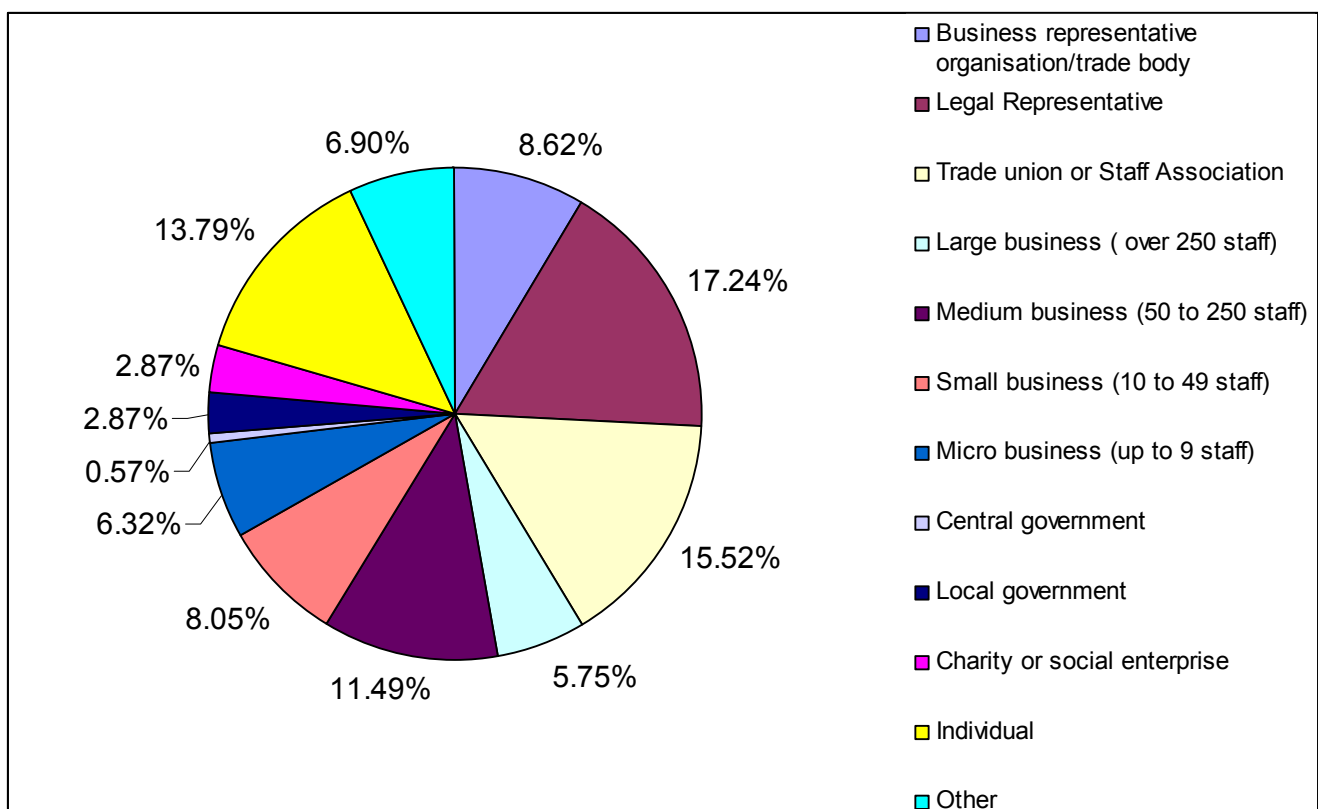
## 1. Introduction

17. Through the Employment Law Review, the Government is looking at the laws that affect the relationship between employers and employees. The Government's aim is to ensure that the legislative framework is flexible, effective and fair, to support an efficient labour market and enable economic growth.
18. Priorities for the Employment Law Review have been informed by the Red Tape Challenge process, through which the Government has actively sought feedback from the public on areas of legislation requiring reform, and the results of the 2011 Resolving Workplace Disputes consultation.
19. In response to these, the Government is taking the Enterprise and Regulatory Reform (ERR) Bill through Parliament. The ERR Bill will change legislation that inhibits innovation and enterprise and remove barriers to growth. The employment part of the Bill takes further steps to streamline the employment tribunal system, promote alternative routes to dispute resolution, and address factors that are causing perverse incentives.
20. The *Ending the Employment Relationship* consultation ran from 14 September to 23 November 2012. It considered two key issues in support of measures currently before Parliament as part of the ERR Bill:
  - how to support legislative changes aimed at facilitating the use of settlement agreements as a consensual end to employment relationships; and
  - whether the compensatory cap in unfair dismissal awards is appropriate.
21. In total, there were 174 respondents to the consultation, although many did not answer all of the questions posed. We received responses from a wide variety of respondents, including businesses of all sizes, business representative groups, trade unions, legal representatives, the HR profession, the public sector and individuals. The distribution of respondents is set out below in Figures 1 and 2.



**Figure 1 – Consultation Respondent Categories**

Indicated respondent category	Number	Percentage
Business representative organisation/trade body	15	8.62%
Legal Representative	30	17.24%
Trade union or Staff Association	27	15.52%
Large business ( over 250 staff)	10	5.75%
Medium business (50 to 250 staff)	20	11.49%
Small business (10 to 49 staff)	14	8.05%
Micro business (up to 9 staff)	11	6.32%
Central government	1	0.57%
Local government	5	2.87%
Charity or social enterprise	5	2.87%
Individual	24	13.79%
Other	12	6.90%
<b>Total</b>	<b>174</b>	<b>100.00%</b>

**Figure 2 – Consultation Respondent Categories**

22. This response provides a summary of the main points arising from the consultation, and outlines how the Government intends to address the issues raised.
23. Many of the respondents chose not to follow the format of the consultation questionnaire and made comments relevant to other questions across their response. For this reason, we have presented the analysis thematically rather than as a question-by-question analysis. However, where we have specific quantitative data by question we have presented that in a series of tables in **Annex 1**.

## 2. Settlement Agreements

24. In the Enterprise and Regulatory Reform (ERR) Bill, we are amending the Employment Rights Act (ERA) 1996 to provide that an offer of settlement is inadmissible as evidence to an employment tribunal in any subsequent unfair dismissal claim – effectively extending the existing ‘without prejudice’ regime to situations where no formal dispute has yet arisen. In this consultation, we set out our intention to underpin the legislative amendment with guiding principles for offering settlement in an appropriate way, to give employers and employees the confidence to increase their use of settlement agreements. Responses to the consultation have universally corroborated the importance of guidance to take-up of the policy in practice.

### The Underpinning Principles

25. We consulted on 12 possible principles, and asked respondents whether these are the correct principles to underpin the legislative change. It is important that we get these principles right as they will largely inform the content of the Statutory Code and accompanying guidance, which will in turn determine how the measure is used in practice and interpreted by employment tribunals.
26. There was broad support from business groups and legal representatives for our stated policy aim to facilitate the increased use of settlement agreements, and for the proposed underpinning principles. One respondent from the HR profession referred to the changes as “a huge leap forward for both employers and employees”. The Law Society said that, “There are obvious benefits to the employer and employee in avoiding a protracted legal dispute and both parties can more or less negotiate the outcome they want”.
27. A majority (70%) of those respondents who answered Q1 agreed that the principles are correct to underpin the making of a settlement offer which will be inadmissible in any unfair dismissal case. The CBI responded that, “In proposing that businesses and their employees should be able to initiate a conversation with a view to concluding a settlement agreement at any time, the government will make it considerably easier to end employment relationships amicably where this is what both parties want”. It is also recognised throughout many of the responses that “the main beneficiaries of these changes will be smaller employers who do not currently make use of settlement agreements for a variety of reasons, including cost” (as expressed in the EEF response).
28. Many of those respondents who answered this question negatively were trade unions, who expressed fundamental concerns about the policy aim. Unions were concerned that our changes risk an erosion of workers’ rights, or mistakenly link them with the broader concept of ‘protected conversations’ and ‘no fault dismissal’ proposals, neither of which the government is taking forward. Many trade unions were concerned that the principles assume an equal balance of power between employer and employee in the relationship, which they refute, and therefore fear that employees would not have a genuine choice when offered settlement. There was some specific concern from trade unions about the intention for a Statutory Code and guidance on settlement agreements to closely reflect the current ‘without prejudice’ regime. This concern largely reflects their underlying reservations about the impact of the policy on employee rights.
29. We have been clear that the Government will not take forward proposals for a broader concept of ‘protected conversations’ or ‘no fault dismissal’. We do not believe that a

system of protected conversations would be the best way to address the specific problem of facilitating an agreed separation effectively. We believe that in reality protected conversations would not provide businesses with the certainty they are looking for, but may lead to unintended administrative burdens.

30. We believe that our change to the way in which settlement can be offered is a more effective way of dealing with workplace problems than 'No Fault Dismissal'. Settlement agreements offer a consensual and mutually beneficial solution for employers and employees to end the employment relationship. Employees will be able to decline a settlement offer if they want to, with all the existing safeguards in place. The offer and negotiation of a settlement agreement is a distinct and self-contained process – if agreement is not reached, and the employer still wishes to pursue ending the employment relationship, they will need to enter into a different process to resolve the issue, following full dismissal or disciplinary procedures. Furthermore, an agreed settlement gives an employer surety that they will not face a tribunal case on any grounds covered by the settlement agreement – something that a no fault dismissal regime would not do.
31. The legislative change in the ERR Bill builds on the existing system of compromise agreements which is already successfully used by many employers. One trade union commented that they "negotiate a large number of compromise agreements on behalf of members. Coming to such agreements is very often in the best interests of the employer and employee. In almost all cases there will be detailed discussion and negotiation concerning the terms of that agreement."
32. Many trade unions, whilst concerned with the policy aim, were broadly comfortable with most of the underpinning principles when setting out their views in more detail. For example, the TUC said that, whilst they opposed the proposed change in legislation, "an Acas Code of Practice may assist in deterring some good employers from adopting bad management practices". The TUC explicitly supported the following principles consulted on, citing their importance for safeguarding employees' protection and enabling the successful use of settlement agreements:
  - Either party may propose settlement;
  - The reason for being offered the settlement should be made clear;
  - Settlement offers should be made in writing and set out clearly what is being offered (e.g. settlement sum and if appropriate agreed reference) as well as what the next steps are if the individual chooses not to accept the offer;
  - The Code should make clear that if an employer handles settlement in the wrong way (i.e. not as explained in the Code) there is a risk that this will give rise to a breach of the implied term of trust and confidence and allow the employee to resign and claim constructive dismissal;
  - Where an individual refuses settlement, the employer must go through a fair process before deciding whether to terminate the relationship;
  - Individuals should be given a clear, reasonable period of time to respond;

- The Code should give specific examples of what may constitute “improper” behaviour;
  - No undue pressure should be put on a party to accept the offer of settlement; and,
  - The employer should not make discriminatory comments or act in a discriminatory way when making an offer of settlement.
33. The principle that ‘It would not be necessary for an employer to have followed any particular procedure prior to offering settlement’ elicited the most concern from trade unions and the CIPD, as well as from some legal representatives. Many of these respondents felt there should be some formal process undertaken by the employer prior to the settlement offer. Trade unions felt that this principle could encourage employers to make an offer ‘out-of-the-blue’, as a way of circumventing good management practice, and subsequently weakening the rights of the employee. The CIPD was similarly concerned about the risk of undermining good performance management. Legal representatives feared that employers will be open to complex legal disputes if there is no process in place prior to the settlement offer.
34. We are building on a system that is already in place and used successfully by many employers. We expect that most employers will use settlement agreements within the context of good management, and that in practice most employees are unlikely to feel that an offer is completely ‘out-of-the-blue’. The EEF felt that “The concept that managers will manage less effectively... is unrealistic”, and that any risk of bad practice by employers is no greater than that which exists within the current system.
35. Equally, we are keen to avoid the Code and guidance becoming overly prescriptive or undermining the effective extension of the ‘without prejudice’ regime to non-dispute situations. There is a risk that imposing formal requirements on the employer prior to the offer of settlement could move the system towards something akin to the ‘3-step process’. The process which was introduced in October 2004 required employers to undertake a minimum of 3 steps before making a fair dismissal. Where employers did not follow the process, or made a mistake during it, their actions (and therefore the dismissal) were found to be procedurally unfair – regardless of whether the reasons to dismiss were fair and the decision to dismiss reasonable. The 3-step requirement was removed in April 2009.

### Government Response

36. To achieve our policy aim, whilst reassuring all groups that there will be adequate clarity for employers and protection for employees, we will work with Acas to set out in accompanying guidance how the appropriate use of settlement agreements sits within broader good management practices, and the type of good practice we expect businesses will normally follow.
37. Furthermore, the employee’s existing safeguards – including the requirement to receive independent legal advice - continue to be upheld. Both parties will be protected against any ‘improper’ behaviour by the other, and in such instances the rule on inadmissibility of the settlement offer will not apply.

38. Some business representatives, including both the EEF and the CBI, felt the protection should be widened to other forms of claim in order to give employers more confidence in the use of settlement agreements, as a way of resolving workplace disputes without risking an employment tribunal claim. The EEF suggested that the provisions in the ERR Bill for the confidentiality of settlement agreement discussions should “apply to all types of potential workforce issues.”
39. Business representatives specifically had concerns about the potential for employers to face constructive dismissal claims as a result of offering settlement. According to the CBI, “the success of settlement agreements as a tool relies on businesses being confident in proposing them... [a] flaw in the government’s proposal is the fact that...it leaves open the possibility of claims for damages for breach of contract”.

### Government Response

40. The Government’s aim in introducing the change in legislation is to make clear that an offer of settlement is an acceptable option to employers and employees as a means of ending an employment relationship. There is nothing inherently wrong in offering settlement in the right way. We will make it as clear as possible in guidance that employers offering settlement, when done correctly, should have little to fear.
41. We will clarify in guidance the status of a settlement offer in such instances – namely that the offer would not be admissible in cases of constructive unfair dismissal. So an individual who chose to resign rather than accept an offer of settlement would not be able to use the offer to support a claim that they were unfairly dismissed, unless they could show the employer’s behaviour to be improper. Therefore we feel that the changes we are making will reduce the likelihood that responsible employers will face constructive unfair dismissal claims as a result of offering settlement.
42. The Government believes that its role is not to get involved in agreements made directly between the parties in an employment relationship. For that reason, we do not intend for the legislative measure to apply to contractual disputes such as wrongful dismissal. Therefore, the fact that settlement was offered would remain admissible in the wrongful dismissal part of any claim i.e. a claim for payment of the employee’s notice period. In practice, we think there is a relatively low risk that individuals would resign and claim constructive wrongful dismissal in response to an offer of settlement, where the claim would generally be limited to the value of the notice period.
43. The Federation of Small Businesses (FSB) and the Institute of Directors (IoD) both expressed some concern about the principle that ‘either party can offer settlement’, fearing that the option for an employee to propose settlement may lead to perverse incentives, and that “it could encourage employees who may secretly intend to resign to propose settlement in the hope that they can extract a payout” (FSB).

## Government Response

44. One of the central features of the policy is that it offers a mutually beneficial and consensual option for ending the employment relationship. Whilst we envisage that in most cases the settlement negotiation will be instigated by the employer, it is important that the balance and flexibility is maintained for both parties. Furthermore, employers will be protected by the provision that ‘improper behaviour’ by the employee would make the request for settlement admissible as evidence. It is likely that, for example, an individual requesting a settlement from their employer, and implying that until the employer agrees to settlement they will underperform at work, would be considered improper. However, we have not seen evidence that such perverse incentives or behaviour on the part of the employee, as feared by some respondents, are a significant problem within the current system.

## A Statutory Code of Practice

45. We want to make it easier, cheaper and faster for both parties to agree settlement. For this reason we are underpinning the legislative change with a Statutory Code of Practice and accompanying guidance, to give employers and employees certainty about how to go about negotiating a settlement agreement.
46. We asked respondents whether template letters and model agreements should be included in the Statutory Code, and what the likely impact would be. We also asked for qualitative comments on the templates themselves. We hoped to elicit, from a range of potential users of settlement agreements, what the correct balance is between provisions included in a Statutory Code, and issues addressed in accompanying guidance. One respondent representing trade unions said that "The Acas code will be critical in ensuring consistency and in general the list of principles covers the necessary aspects." We will ensure that the most important safeguards and areas of concern, such as the definition of ‘improper behaviour’, are explained in the Statutory Code, in response to the issues raised by respondents.
47. We want to strike the right balance of giving employees protection, and giving employers materials and tools that they feel confident using, whilst allowing enough flexibility in the system to adapt to the wide range of circumstances in which settlement agreements may be negotiated. We want to ensure that the Code of Practice supports and does not inadvertently stifle the ways in which settlement agreements are already satisfactorily developed between parties. This means that principles of good practice should be presented as such – so they do not prevent employers and employees taking a different approach where there are sensible reasons to do so, and do not unintentionally create an additional requirement where it is not appropriate.
48. We are keen not to make the Statutory Code any more prescriptive than is essential. Business groups in particular encouraged this approach – the Institute of Directors for example, was supportive of a Statutory Code “as long as it is concise and straightforward”. The EEF favoured a model based on principles and examples, rather than prescribing detailed rules which then create a technical maze for employers. Trade unions had some concerns that the Code as proposed may not go far enough to protect employees’ rights and give employers adequate guidance to approach settlement negotiations in a fair and appropriate way. This corroborates the importance of the accompanying guidance that we are working closely with Acas on, and within which we will address the key concerns raised

in consultation and provide substantive good practice guidelines.

49. The majority of respondents agreed that templates should be included in a Statutory Code of Practice: over 65% of respondents to Q2 agreed this. The largest group of respondents to answer this question negatively was trade unions (over 44% of those who responded negatively to this question were trade unions, and 25% were legal representatives). Their concern was grounded to some extent in the view that templates will not be able to apply to the wide range of circumstances in which settlement may be offered. We recognise this, and will allow flexibility for organisations to adapt the templates to individual situations, or to use their own, as appropriate.
50. A view from business is that making a template letter available in the Statutory Code will help employers to feel confident that they can use it 'off-the-shelf', in those situations where it is appropriate. The CBI view is that: "The two most common obstacles to a small firm using a settlement agreement are a lack of knowledge about the options available and being unsure how to approach the employee with the offer. These firms would benefit from template letters and agreements being made available." One trade union representative commented that "Templates could be a useful reference point, particularly for the employee who would be more easily able to assess whether he/she is being treated fairly". Trade unions and legal representatives also made specific comments on both templates, on which we are reflecting and which are addressed later in this response.

### Government Response

51. In response to these views, we have asked Acas to include a template letter in the Statutory Code, in order to provide certainty for employers – particularly smaller employers who currently don't use settlement agreements or do not have in-house HR or legal functions. But it should be very clear that this is not compulsory – thereby protecting flexibility in the system and allowing for the fact that letters will sometimes require amendment to reflect particular situations.
52. We have decided that the model settlement agreement is more appropriate to be included in guidance, so that it can be easily updated to reflect any changes in the broader regulatory framework. The Statutory Code will principally complement the legislative change being taken through the ERR Bill, whereas the model settlement agreements can be used in a wider set of circumstances than those reliant on the confidentiality provisions. It will remain an example that employers can use or adapt as a template for their own agreement. Comments on the model settlement agreement are discussed in more detail in paragraphs 86 to 94.
53. The EEF commented that a breach of the Statutory Code should not automatically render the fact or content of a settlement conversation admissible in an Unfair Dismissal claim. We will make it clear that failure to follow the Code does not, in itself, make a person or organisation liable to proceedings. However, employment tribunals will take the Code into account when considering relevant cases.
54. There was concern amongst many respondents about the potential for ambiguity in our introduction of new terms, particularly 'improper behaviour', and subsequent satellite litigation. Respondents of all types broadly agreed that a clear definition of 'improper behaviour' will be critical to the implementation and take-up of settlement agreements. The CBI for example specifically cited the potential for confusion arising from the



simultaneous existence of two legal tests, ‘unambiguous impropriety’ within the current without prejudice regime, and ‘improper behaviour’ in the use of settlement agreements. The CBI felt that for the sake of clarity, ‘improper behaviour’ should closely mirror, and add to as appropriate, the current understanding of ‘unambiguous impropriety’.

### Government Response

55. It is our intention that ‘improper behaviour’ will largely reflect ‘unambiguous impropriety’, and one of the key things we hoped to elicit from this consultation and ongoing discussion with stakeholders is what the appropriate definition of the term should be. We believe that the Statutory Code should set out an explanation of ‘improper behaviour’ in order to provide as much certainty as possible, taking into account the comments submitted in consultation as we develop the definition with Acas. We will supplement an explanation in the Code with some explanatory advice and illustrative examples of ‘improper behaviour’ in the accompanying guidance, as well as an indication of how the two tests fit together.
56. We have also asked Acas to set out in the Code what a ‘reasonable period of time’ should be for the employee to consider an offer. Parties need to be given sufficient time to consider an offer of a settlement agreement, but it should not prevent speedy resolution where both parties are in agreement.

57. There was some confusion amongst respondents as to whether or not the 25% uplift in awards/costs where there has been a breach of the code, applicable in the current system, will apply in settlement agreements. The uplift will not apply and this will be made clear in the Code.
58. Many respondents raised the importance of public consultation on the Code itself – Acas will consult separately on the Statutory Code. We have been working closely with them throughout the policy development and consultation process, and will continue to do so.

### Guidance and Dissemination

59. The accompanying guidance will explain the process in more practical detail and give both employers and employees the confidence to successfully negotiate a settlement agreement. We asked for qualitative comments on the guidance, and remarks made throughout the responses will inform the key issues to be addressed within it. We are also keen to ensure that the tools are accessible to as wide a range of employers and employees as possible, and so asked for views on the best way to disseminate the materials that will be made available.
60. There was general agreement across respondents as to the importance of Acas in the effective implementation of the policy, and that the new system should complement the existing Discipline and Grievance Code. Suggestions as to how best to disseminate guidance and materials included via Acas, the Citizens’ Advice Bureaux, the Government website, business representative bodies, and trade unions. Trade unions flagged some concerns about funding cuts to certain statutory bodies, and future Acas resource, and the fact that this might impact negatively on their ability to disseminate the materials effectively. BIS is currently working with Acas to understand their funding requirements for future years.
61. Some respondents cited the need for government to communicate the availability of Acas Codes and guidance more effectively to smaller employers. Many stated that a central

function of the guidance must be to make it straightforward for smaller businesses without in-house HR or legal functions to use settlement agreements with confidence. The Government is currently working with Acas to produce an interactive online tool for small businesses which will guide them through issues with discipline. This tool is expected to be available online from spring 2013.

62. A number of responses expressed concern about potential complexity in the system, and the subsequent risk of satellite litigation, and raised a set of specific issues.

### Government Response

63. It is important to note that we are building on a system which is already successfully used by many employers. Our aim through the current changes is to facilitate the increased use of settlement agreements, by a wider range of employers. We will address the concerns raised within the Statutory Code and accompanying guidance, working closely with Acas, to give employers and employees the certainty they need to use the system with confidence. Some of the key issues which we will address in guidance are outlined below.

### 'Improper Behaviour and 'Undue Pressure'

64. A large number of respondents asked that the guidance provide some illustrative examples of 'improper behaviour'. To complement the direction that will be given in the Statutory Code, we will include some practical examples in guidance, as well as some advice as to what might constitute 'undue pressure' in a settlement negotiation. The Employment Lawyers' Association (ELA), amongst other respondents, said that the term 'undue pressure' could be ambiguous in interpretation or application, as some level of perceived pressure may be inevitable in an offer of settlement, and therefore guidance needs to make clear the point at which it becomes 'undue'.

### What the Legislative Amendment means in Practice

65. We will use the guidance to explain in more practical detail the implications of the new provision – in response to a range of specific issues raised in consultation. This will include:
- The admissibility of settlement offers in multiple claims;
  - How the rule on inadmissibility applies, and what information will become admissible when an individual asserts that an element of the process has constituted 'improper behaviour';
  - How the inadmissibility measure fits with the common law 'without prejudice' regime;
  - The implications for potential constructive dismissal claims; and
  - The expectations for the status of leaving employment via a settlement agreement, for the purposes of Jobseeker's Allowance (JSA) and other benefits.

### Good Practice

66. We will set out in guidance 'good practice' for employers, to help them understand how to offer and negotiate settlement in a fair and appropriate way as part of their broader

approach to management, whilst acknowledging that the process will vary in different circumstances. For example, we will offer some guidance as to:

- Informal processes prior to the settlement offer, to contextualise the settlement discussion within good management practices; and
- Whether an employer may want to consider paying the individual's legal costs as a means of facilitating the process (without making this compulsory, which was strongly opposed by business respondents to the consultation).

67. We will also explain in guidance the relationship between settlement agreements and redundancy procedures. As it is for the employer to decide when and where they wish to offer a settlement agreement, there is the possibility that this may be used in what would otherwise have been a redundancy situation. For example, where an employer expects to need to lose a post, they may approach a number of individuals to see if they would be interested in settlement. But, if settlement is not reached with an individual and the employer wishes to pursue redundancy, they must follow the usual proper procedure in full, unaffected by the unsuccessful offer of settlement. So far as rules around collective redundancies are concerned, it will remain the case that, where an employer is proposing to dismiss as redundant 20 or more employees at a single establishment in a 90-day period, the employer must consult with employee representatives about the redundancies.
68. Responding to views on the type of guidance that would be most appropriate regarding a settlement tariff, we will set out some considerations that both parties might take into account when agreeing the level of the financial offer. This is dealt with in detail in paragraphs 69 to 78 below.

## A Settlement Tariff

69. We understand that many organisations that already make use of settlement agreements have established processes for negotiating the value of the settlement payment. However, organisations that have no experience of the system may not feel confident in the most appropriate way to approach deciding the level of their financial offer.
70. The consultation asked whether the Government should set a guideline tariff for settlement agreements. We also sought views on what the expected impact of such a tariff might be, and the approach that should be applied to setting the level.
71. The majority of direct respondents to Q8 indicated that it would not be helpful for government to set a guideline tariff (58%). Legal representatives and trade unions were not in favour of a tariff. Micro, small and medium-sized businesses were more likely to think that a tariff would be helpful than large businesses and other types of organisation.
72. The narrative comments from trade unions, business representative bodies, and legal representatives all strongly objected Government setting a guideline tariff. Most felt a guideline tariff would set unrealistic expectations for employees who might use it as a minimum from which to negotiate the value of the settlement upwards. Equally, some felt that a tariff might be viewed by employers as a maximum from which they would try to negotiate downwards.

73. In general, respondents felt that a Government-set guideline may in fact impede the successful negotiation of settlement. The ELA felt that "too low a tariff would inhibit settlement, too high would create unrealistic expectations and a range of financial tariffs (by reference to the reason for termination) would put a price on levels of conduct and capability, which must be bad for industrial relations".
74. Trade unions agreed that setting a guideline tariff would effectively attach a price to employment rights, which they felt should be avoided. However, it is worth noting that settlement agreements already exist and employers and employees are already negotiating what they consider to be a fair price reflecting individual circumstances.
75. A large number of respondents felt that whilst some guidance may be helpful to smaller employers, in practice it would be impossible to set an appropriate tariff or formula which would reflect the enormous variety of circumstances in which settlement could be offered and agreed. As set out in the consultation, employers consider a wide range of factors when making an offer of settlement.

### Government Response

76. Given the strength of feeling about the difficulty and possibly damaging consequences of setting a guideline tariff for settlement, the Government has decided not to take forward a guideline tariff for settlement agreements.
77. However, many respondents suggested that some guidance about the factors that should be considered when making a financial offer would be useful – particularly for those smaller employers who are likely to benefit most from the introduction of templates. The EEF felt that "Guidance should therefore be provided but not on a monetary scale". Similarly, the CIPD indicated that "A list of factors to be taken into account...could help some smaller employers". There are risks in applying anything prescriptive where circumstances will vary so significantly, but we will include in guidance some considerations that both employer and employee might bear in mind when negotiating a financial settlement.

78. The factors that both parties may consider when negotiating the financial settlement could include:
- Terms of contract such as remuneration, notice period, and untaken annual leave;
  - Length of employment;
  - Reason for offering settlement;
  - Length of time it would take to follow the full process for a fair dismissal if the employee refused the offer;
  - How difficult it would be to fill the post and the value of the individual to the organisation;
  - The individual's perception of how long it would take them to find another job; and,

- The perceived liability to the employer of any potential employment tribunal claim.

## Template Letters

79. We sought to elicit from consultation how to strike the correct balance between providing certainty for employers, robust protections for employees and maintaining a flexible and not overly burdensome system. In light of this, we asked respondents whether template letters should be included in a Statutory Code; whether they should be compulsory; and what the likely impact would be of introducing them. The consultation also sought qualitative comments on the content of the letters themselves.
80. As discussed initially in paragraphs 49 to 51, there was broad agreement that templates would be helpful and should be included in the Statutory Code, but that they shouldn't be compulsory. Over 65% of respondents to Q2 agreed that templates should be included in a Statutory Code, and almost 90% of respondents to Q7 agreed that template letters should not be made compulsory. Of those respondents that felt that template letters should be made compulsory, or indicated that they were not sure, these were fairly evenly split between legal representatives, individuals, and smaller businesses.
81. Responses suggested that the availability of template letters in the Statutory Code will have a greater impact for smaller employers, particularly those without in-house HR or legal functions, or those who do not currently use settlement agreements. Smaller businesses indicated that the introduction of templates will reduce their costs in negotiating settlement agreements. For example one small business representative commented that "it would lead to substantial cost savings on legal fees: under the current arrangements we have to take a highly 'risk averse' approach and ensure all wording is checked (as a minimum, if not drafted) by lawyers. It creates disproportionate cost." Business respondents were clear that the templates should be simple and easy to use by smaller employers.
82. On the other hand, templates will have less impact for larger employers and those who already utilise settlement agreements, many of whom have their own templates. This is reflected by the 62% of respondents to Q4 who felt that the use of settlement agreements would not change as a result of the introduction of templates.
83. There was some concern that as template letters will not be able to apply to the entire range of possible circumstances, they may give employers a false sense of security. Many respondents, particularly trade unions and legal representatives, felt that employers would take independent legal advice on the templates. We will make it clear that the published templates are not compulsory, nor are intended to prescribe a one-size-fits-all approach. In many situations employers will have their own templates to use, or will want to amend the templates to suit particular circumstances. However, we will make a template available that can be used 'off-the-shelf', in those circumstances where it is appropriate.
84. Many respondents provided comments on the template letters themselves. Some respondents, mostly trade unions, expressed concern regarding the tone of the draft letter. They felt it to be intimidating, directive and suggestive of a pre-judged decision, which could impede the chance of agreeing settlement, and make employers feel at risk of a subsequent tribunal claim. Some respondents, particularly legal representatives, suggested that there should be two separate letters - one inviting the employee to a

meeting, and another setting out the settlement offer.

### Government response

85. We recognise and are taking into account the concerns and suggestions registered in response to the consultation, both regarding the tone of the letter, and more specific comments. Our view is that a template letter is most effective if included in a Statutory Code. This is an issue which Acas will consult on separately. In line with the broad agreement in the consultation, we will not be making the use of templates compulsory. We hope that their inclusion in the Code will give employers the confidence to use them 'off-the-shelf', where appropriate to the situation.

### Model Settlement Agreement

86. In seeking to strike a balance between providing certainty for employers and protection for employees, whilst maintaining a flexible system, we sought views on the provision of model settlement agreements, the content of the templates, and the likely impact of making them available.
87. There was broad agreement that templates would be helpful but should not be compulsory. Many respondents, particularly trade unions and legal representatives, felt that employers should or would take independent legal advice on the template agreement. As set out in more detail in paragraphs 81 to 82 above, the availability of templates will have a more significant impact for smaller employers and those that do not currently use settlement agreements regularly, for whom the introduction of templates is likely to reduce costs. The introduction of templates will have less impact for large employers who already utilise settlement agreements and have their own templates.
88. Approximately half of the respondents had comments on the content of the model agreement itself. Legal representatives were more likely to comment, followed by trade unions and then businesses. The responses related to the overall structure and style of the agreement as well a number of specific drafting points. We will address the key concerns in the model agreement and the guidance, and will issue a final version of the template when the policy is implemented next year.
89. A number of respondents considered that the template agreement should be shorter and simpler. It is important that it uses language which is easily understood and is in an accessible format, and we will reflect this when issuing the revised template. However, it is inevitable that some of the content will be legalistic in nature and at times detailed. There are certain provisions which are necessary in order for both the employer and employee to feel confident entering into an agreement. We will provide explanatory notes within the accompanying guidance to help employers and employees understand and use the template agreement.
90. There were a number of specific issues raised by respondents, for example regarding the inclusion of provisions relating to garden leave, taxation and liability. We recognise that provisions included in an agreement will depend on the particular circumstances of the case including the contractual arrangements, the nature of the employer's business, the employee's role, and the reasons behind the negotiation of settlement. It would not be possible to produce a template that caters for every situation, as is reflected by the majority of responses.

91. We understand that in many cases the employer will seek a commitment in the agreement that the employee will keep the terms of the agreement confidential. This can also be an important issue for the employee. We will therefore include such a provision in the model agreement, without making this compulsory.
92. A number of respondents suggested that the template would be improved if a blanket waiver could be used instead a list of the individual claims. We have considered this issue previously in response to the Resolving Workplace Disputes consultation and concluded that, whilst it may appear simpler to have a blanket waiver statement, it would lead to a significantly increased need for guidance and legal advice for the individual to fully understand what they are agreeing to. This would add to the time and cost implications for the individual in considering an offer of settlement, and as in many cases, the costs of legal advice are met by the employer, this would also lead to increased employer costs. For this reason we will not include a blanket waiver in the model agreement.
93. Some respondents appear to have inferred that the template agreement should only be used where an offer of settlement is made in reliance on the clause in the ERR Bill regarding the confidentiality of settlement negotiations. That is not the case. Settlement agreements are already used widely and many settlement discussions will not be affected by the new provision. The aim is to provide a template which can be used widely and tailored as appropriate to the circumstances, facilitating the increased use of settlement agreements by a wider range of employers.

#### **Government response**

94. We recognise and are taking into account the concerns and suggestions registered in response to the consultation. A final template agreement will be made available as part of accompanying guidance alongside the Statutory Code, and we are working closely with Acas on this. We have decided that the model settlement agreement is more appropriate to be included in guidance so that it can be easily updated to reflect any changes in the broader regulatory framework.

### 3. Cap on Compensatory Award for Unfair Dismissal

95. The second part of the *Ending the Employment Relationship* consultation considered whether the cap on compensation for unfair dismissal is set at an appropriate level. We asked respondents about the option of a cap on individual awards of 12 months' pay alongside the overall cap, where the applicable limit is the lesser of the two figures. We sought responses on whether this would lead to more realistic perceptions of the likely level of awards, thereby encouraging earlier resolution of employment disputes.
96. We also asked about whether the current overall cap is at an appropriate level and if not, how it should be changed.

#### 12 Months' Pay Based Cap

97. A slight majority of respondents were in favour of introducing a 12 months' cap. Of the 119 respondents who answered, 48% were in favour of the introduction of a pay based cap, 45% were opposed and 7% were not sure. All trade unions except 1 were opposed. Amongst the 44 business respondents, 89% were in favour. It is worth noting, however, that two of the businesses who said no, and the one who was unsure, based this on the feeling that a 12 months' cap was not low enough. If these numbers were changed to 'yes', then overall 50% of all respondents would have favoured the introduction of a pay cap, or 95% of businesses. Of legal representative respondents 30% were in favour, 65% were opposed.
98. The respondents who supported introducing a 12 months' pay cap felt that doing so would help adjust unrealistic perceptions about levels of award, to the benefit of both sides. According to the Federation for Small Businesses, the difference between the current cap and the actual levels of award "leads to unrealistic expectations among employees and thus acts as an incentive to go to tribunal. It also creates heightened (and equally unrealistic) fears among businesses, many of whom may choose not to take on an employee as a result."
99. Those opposed felt that this cap would not change perceptions, either because there is currently no issue with perception or because it is caused by other factors. Trade unions opposed the notion of any cap on compensatory awards based on principle. As one trade union "fundamentally opposed to the introduction of a cap of 12 month's pay" put it: "We firmly believe that where an employee has been unfairly dismissed they should recover a sum to reflect their full losses."

#### Perception Change

100. We asked respondents if they thought the introduction of a 12 months' pay cap would lead to more realistic perceptions of tribunal awards for employers and employees. Respondents were split on this issue, but the largest proportion, 48%<sup>1</sup>, of those who answered felt that it would. Thirty seven percent felt it would not, while 15% were unsure. Among business respondents only 8% (4 respondents) felt that there would not be a change. Twenty seven legal representatives answered this question, with 30% believing perceptions would change, 44% feeling they would not, and 26% being unsure.

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<sup>1</sup> Of these respondents, 2 felt the perception change would be negative.



101. A common theme, shared by nearly a third of key stakeholders (overall 20% of respondents), businesses, trade unions, and legal representatives, was the importance of publicising clear information about awards. Those who felt perceptions would change were of the view that having a cap so disparate from what most claimants actually receive creates unrealistic expectations. Those who disagreed were of the view that either there is no issue with perception or that misperceptions result from other factors.
102. Respondents of all types felt that it was important to publish average awards and how they are calculated. A few legal representative and business representative respondents noted that the Government has already taken steps to publicise this information. On the issue of clear communication, a dozen key stakeholders, most in the legal field and the business community, were concerned that if a cap of 12 months' pay were introduced, the cap may create an impression that claimants are automatically entitled to 12 months' pay.
103. Businesses and business representative groups were particularly of the view that claimants are unaware that the median award for unfair dismissal claims is much lower than the statutory cap. The Confederation of British Industry (CBI) pointed out that this perception is due in part to the cap itself rising rapidly in recent years: "The gap between the amount that a claimant is likely to receive and the cap jumped when it was more than quadrupled to £50,000 in 2000. The gap has widened further since then as the up rating of the cap has outstripped rises in median earnings." Other factors could be at play as well in creating false expectations. The EEF felt that, "[c]oupled with a wider compensation culture which has emerged over many years and aggressive advertising targeting potential claimants in many forms of media, the very large rises in the upper limit has conveyed a message to claimants that they should seek large settlements from their former employers."
104. In addition, "Tribunals are reluctant to attempt any assessment of the losses likely to be suffered by a claimant extending more than a year into the future, and the practical impact of a limit based on 12 months' pay is therefore likely to be very limited."<sup>2</sup> The fact that the SETA survey demonstrates that only 0.3% of all claimants receive more than their annual salary supports the assertion that employment tribunals rarely make such high awards.
105. Those who did not feel there would be a change in perception were either of the opinion that there is no current problem with perception, or that there was an issue with perception but caused by factors other than the current cap. Among trade unions, 58% argued that there was no issue with perception. Some cited the SETA 2008 study,<sup>3</sup> which showed that the median award claimants taking unfair dismissal cases *hoped* to receive was £5,000, while a few respondents from the legal field felt in their experience that claimants' expectation of their likely award was much higher.
106. Legal representative respondents, and 26% of trade unions, suggested that other factors are more likely to have caused issues with perception. Causes suggested included: poor or inadequate advice, failure to understand how damages are calculated, and media reporting of unusually high awards. One major legal representative stakeholder argued that

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<sup>2</sup> EEF Response, p. 3.

<sup>3</sup> *Finding from the Survey of Employment Tribunal Applications 2008*, Employment Relations Research Series No. 107, March 2010. Available at <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/10-756-findings-from-seta-2008>

changing the cap would only set a different expectation which might be just as unlikely for an individual as the current cap, stating: “it is difficult to see how setting up an expectation of recovering 5.7 times (using the median wage of £26,000 as a baseline) the average award is much better than one of recovering 15.8 times,” noting that the £4,560 median award figure includes the basic award, “so the compensatory award figure is actually much less.”

## Government Response

107. On the issue of correcting perceptions around awards, the Government has already implemented several changes to assist with wider dissemination of information. As of April 2012, HMTCS have included details of the median award on the cover sheet accompanying the ET1, and in the ET3 guidance.<sup>4</sup> The “mean average” award figure is skewed by a small number of exceptionally large awards and the median award figure is therefore more representative of what most claimants can expect.
108. In addition, the *Enterprise and Regulatory Reform* Bill currently before Parliament will introduce a new requirement for prospective claimants to contact Acas with details of their claim before proceeding to tribunal. This will be an opportunity for prospective claimants and their employers to learn, at an early stage, how awards are calculated and therefore what level of compensatory award they might, if successful, expect. At least one major legal stakeholder respondent to the consultation believed that conciliation will be compulsory, but that is not the case; while prospective claimants are required to contact Acas, either party will be able to refuse the offer of conciliation if they so wish.
109. The Government will make information on any adjustments to the compensatory cap on unfair dismissal awards available through government digital channels.
110. The Government does not find the suggestion that there are no issues with perception of unfair dismissal awards persuasive. The SETA 2008 data cited by trade unions shows that the median amount claimants hoped for was £5,000. But it also shows that there are some very high expectations. For example, out of a sample of over 150 unfair dismissal claimants, 38% expected to receive £10,000 or more, and of those, 37% expected more than £25,000 (14% of the total). Though the sample size is relatively small, these are large proportions of claimants with expectations far in excess of the median award.
111. Whilst the expectation of an award equivalent to a 12 months’ cap would be more realistic than the expectation of an award of £72,300, the Government is committed to ensuring claimants do not substitute one false expectation for another. Changing the cap to align with the median award, however, would not be fair to claimants. The median marks the midpoint of awards, not the maximum.
112. Moreover, given that the cap applies to many different circumstances, a pay based cap could better strike the balance between ensuring that claimants are fairly compensated and giving the parties more realistic expectations.

<sup>4</sup> ET1 and ET3 Guidance, available at [www.justice.gov.uk/forms/hmcts/employment](http://www.justice.gov.uk/forms/hmcts/employment)

### Earlier Resolution of Disputes

113. The *Ending the Employment Relationship* consultation sought views on whether introducing a pay based cap would encourage earlier resolution of disputes. Of the 114 respondents who answered the question, 35% felt it would, 33% felt it would not, and 32% were unsure. The majority of business representatives, trade associations and businesses who answered (63%), felt that it would. Only 9% of businesses felt it would not lead to earlier resolution of disputes. Trade unions were slightly more divided on this question, of those who answered, 30% were unsure and 70% felt it would not. The legal representative respondents were more evenly divided.
114. There were differing views across respondents as to the effect a change in perception might have. Some felt if perceptions became more realistic, then claims might settle more quickly, as both parties would have a better informed expectation of what might be the outcome should the case go to tribunal hearing. Others suggested the filing of additional uncapped claims to get around a lower cap would preclude earlier resolution of disputes. This issue is considered in the section on 'Certainty on the Costs of a Dispute'.
115. A few legal representatives felt putting the cap at 12 months would not make a difference because "most settlements are significantly below the level of 12 months' salary and will continue to be so." This line of reasoning does not undermine, however, the argument that settlement might be reached more quickly if parties begin with an expectation closer to reality. It was also suggested that employers may become less willing to settle, if the amount they could end up paying in tribunal is lower.
116. Four percent of respondents noted that monetary compensation is only part of why employees pursue claims. These respondents quoted statistics from SETA 2008 which indicate that 22% of claimants wanted an apology as an outcome of their employment tribunal case. As one trade union put it, "the reason many claims fail to settle is not because of upper limits but a sense of injustice by an employee who has been treated unfairly or in a discriminatory fashion." The same survey showed that for 58% of individuals surveyed, however, money was the desired outcome. However, it is worth noting that an employment tribunal cannot order an employer to give an apology: a claimant is likely to receive an apology only if the parties agree to that condition as part of a formal settlement outside of the ET system.

## Government Response

117. As previously discussed, the Government is of the view that perceptions would be affected by the introduction of a pay based cap. The fact that settlement amounts agreed are now far below the cap does not mean lowering the cap could not have an impact on how quickly disputes are resolved. Changing the cap is intended to alter perceptions which both employers and employees bring to the table before they sit down to negotiate disputes. And although the award of damages is not the only reason claimants pursue claims, it is the most common.
118. The Government is not convinced by the supposition that employers will be more willing to go to tribunal if the amount they may have to pay is reduced, as it ignores the costs, which can be substantial for the business, of following a tribunal claim to conclusion. As a number of trade unions pointed out, according to SETA 2008, half of employers who had made an offer of settlement “cited factors related to saving money (for example keeping costs to a minimum, more cost effective to settle) and one-quarter (25%) said they had done so for convenience and to save time.”
119. Predicting what level of compensatory award a particular case would receive is, in and of itself, time consuming and inconvenient. As explained in the consultation document, as well as covering loss of earnings between the date of the dismissal and the hearing, the compensatory award may also take account of loss of pension, company car and expenses. Future loss is also considered, including the likely length of unemployment and job prospects in terms of future earnings, based on the individual’s skills and labour market conditions. Then a number of adjustments are made, depending on the circumstances.<sup>5</sup> Therefore it would generally still be convenient and cost effective for an employer to settle a claim rather than go through tribunal.
120. The Government is persuaded that the introduction of a pay based cap would lead to earlier resolution of disputes.

## Certainty on the Costs of a Dispute

121. We sought submissions on whether introducing a pay based cap would create more certainty on the likely cost of legal disputes for employers. Altogether 111 respondents answered this question. In total 61% of respondents<sup>6</sup> believed it would, while 25% believed it would not and 14% were unsure. Of the business respondents, 83% felt it would, with 11% unsure. The vast majority of trade unions felt it would not. The 29 legal representative respondents were less clear: 35% felt that it would, 24% felt it would not, and 41% were unsure.
122. Those who believed it would thought that a cap based on annual pay would provide the employer with a clearer idea of what they might be expected to pay in compensation to an employee. Business respondents were overwhelmingly of this opinion. One organisation wrote, “the introduction of a cap of 12 months’ pay would provide certainty because the current statutory cap creates unrealistic expectations. At the moment, it is also very

<sup>5</sup> *Ending the Employment Relationship* consultation document, at pp. 24-25.

<sup>6</sup> Of these, 5.4% felt that this certainty would impact employers negatively.

difficult to predict what compensatory award will be made due to the different variables which affect its calculation.”

123. The presence of other additional claims was the most frequently stated reason for why a pay based cap might not lead to more certainty of the likely costs of a dispute for an employer. If individuals felt they could not get adequate compensation from an unfair dismissal claim, it was suggested they would bring claims for which awards are uncapped, such as discrimination or whistle blowing claims. These claims are considered “more costly and complex for employers to defend and can result in higher compensation awards.” A few expressed concern that satellite litigation may ensue over the concept of ‘pay.’

### Government Response

124. There is no data which indicates that more uncapped claims will likely be brought. If a claimant has the grounds to bring a claim for discrimination or whistle blowing, there is no barrier to them bringing multiple claims. As has already been pointed out, the majority of unfair dismissal claims are brought with other claims, so it would seem claimants are already aware that uncapped claims can be brought alongside unfair dismissal claims.
125. Moreover, as other respondents noted, the Government is introducing employment tribunal reforms to help address the problem of weak claims, including the introduction of early conciliation and new employment tribunal rules which will allow for more robust case management (including better targeted deposit orders to weed out allegations with little reasonable prospect of success).
126. With regard to the likelihood of satellite litigation in relation to the concept of ‘pay’, as a few legal representative respondents pointed out, the meaning of ‘week’s pay’ in the Employment Rights Act 1996 is a “well-known” concept and calculation for both the tribunals and parties. As a result, the Government considers that the risk of satellite litigation on this point is highly unlikely.
127. Consultation responses as a whole indicate that introducing a pay based cap would create more certainty over the likely total costs for employers of an unfair dismissal claim.

### Impact on Employee

128. Fifty four percent respondents who commented on the impact of a pay cap on claimants felt it would be negative. Of the remaining respondents, 17% felt it would have a positive impact, 16% felt it would have no impact, while 12% felt there would be a mixed impact. Most of the business respondents who answered this question felt there would be a positive or no impact. Trade unions all agreed the impact would be negative. Legal representatives mostly felt the impact on claimants would be negative. While a number acknowledged that few claimants would receive lower compensation, those few would not be recovering their full losses. The most widely cited potential impact, however, was that a pay based cap could have a disproportionate impact on certain groups.
129. The businesses and business representatives who felt there would be a positive impact on employees cited more realistic expectations of the level of award. The businesses and legal representatives who felt there would be no impact cited the statistics showing only 0.3% of claimants would be affected by a 12 months’ cap.

130. A number of trade unions and legal representatives (around 22% of all responses) felt that certain groups are more likely to take longer than 12 months to find a new job. These groups included older workers, younger workers, and disabled workers. One legal representative remarked that, based on figures from the Office of National Statistics, “the older the worker, the higher the chance that they will be out of work for longer than one year”. These figures found the re-employment rate for individuals over 50 three months after being made redundant is 11% lower than for individuals aged 16 – 50. Others made the point that women and ethnic minorities are more likely to be in lower paying jobs or working part-time. A cap based on a week’s pay, therefore, would mean women and minorities are more likely to receive less.
131. Issues were also raised about pension contributions, which are not included in the meaning of a week’s pay. Respondents also questioned how various up or down ratings factored in, such as a Polkey reduction or adjustment for failure to comply with the Acas Code of Practice on Discipline and Grievance would be affected.

### Government Response

132. All Governments have agreed that a cap on unfair dismissal is necessary since its introduction in 1971. Inevitably, such a cap risks negatively impacting claimants who would have received more than such a cap. The Government is committed to minimising the number of claimants negatively impacted while ensuring that the cap is fair and provides enough certainty for employers.
133. The Government has considered the issue of possible discriminatory impacts throughout its work on this policy and this was explored in the Equality Impact Assessment (“EIA”)<sup>7</sup> which BIS published alongside the consultation. According to the SETA 2008 survey around 52% of claimants surveyed were over the age of 45. According to data from the Department for Work and Pensions, over 40% of unemployed individuals over 50 have been so for more than a year. There is no data on what percentage of these, however, have filed claims for unfair dismissal or would have been entitled to compensation had they prevailed.
134. Other statistics show a more positive labour market. Of those making a new claim for Jobseeker’s Allowance, over half leave within 3 months and over 70% within 6 months, most because they have moved back into work.
135. The Labour Force Survey tells us that of those dismissed from their previous job almost 80% found work within 12 months. It is important to note that this group of people will include those who are not actively seeking work or who were dismissed for fair reasons.
136. We have no evidence on whether certain groups are systematically more likely to receive an award higher than 12 months’ salary. However, we do know that the majority of awards currently amount to significantly less than 12 months’ pay, with the median award less than a fifth of median earnings. We therefore do not believe that there will be a disproportionate impact on these groups.

<sup>7</sup> Equality Impact Assessment p 17.

137. The Government is not convinced that, on balance, the potential costs of creating a new definition of week's pay outweigh the benefits. The definition of 'week's pay' as defined by the Employment Rights Act does not include pension or benefits in kind.<sup>8</sup> This is a standard definition that is used in provisions directly related to unfair dismissal, and has been further clarified by a large body of case law.
138. Introducing a new term would create an added layer of complexity and possibly create more confusion and satellite litigation. Given how few claimants would be impacted by a pay cap, it is not likely many individuals will be adversely affected by the use of this standard definition of a week's pay.
139. The Government therefore considers that the very limited potential impact of retaining the standard definition of a week's pay does not justify the risk and impact of adopting a separate definition for the purposes of the limit on unfair dismissal awards.
140. Given so few claimants ever receive compensation worth more than 12 months' pay, on balance the Government is of the view that few individuals will be disadvantaged by a 12 months' pay cap.

### Impact on Employer

141. We also asked respondents what they thought the impact of an earnings' based cap would be on employers. Around 41% of respondents felt that there would be a positive impact on employers, while 36% felt the impact would be negative, 12% saw both negative and positive impacts, and 3% were unsure. Of the business respondents, 81% felt there would be positive effects. None said that there would be a negative impact on employers. Most of the 17 legal representative respondents felt there would be a negative impact (53%). Eighteen percent felt there would be a positive impact, and 29% were unsure.
142. Those in favour felt that the increased certainty and more realistic expectations would benefit employers. Changing perceptions could have a positive impact by giving employers more confidence to hire new staff, as there would be less fear that a single unfair dismissal claim could bankrupt an employer. The Institute of Directors referenced a 2012 study in which their members said "a reluctance to make justified dismissals can be detrimental to other employees and protect poor performers, while the fear of a tribunal claim encourages a 'pay off' culture." Giving employers and employees a clearly defined limit on tribunal awards for unfair dismissal could help mitigate these problems.
143. Those who felt it would have a negative impact referenced the fear of additional claims being brought, and feared that employers would have less incentive to act appropriately if the cost to a business of an unfair dismissal claim was seen as lower than it is currently. One legal representative remarked that since so few awards come close to the current cap the impact of any reduced deterrence would be minimal. Another business representative, which surveyed its members for views, stated that there would be no impact because so few awards exceed average annual salary.

### Government Response

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<sup>8</sup> Also excludes cash payable by someone other than the employer, expenses which represent a reimbursement of actual expenses incurred by employee, and discretionary bonuses.

144. Though responses were mixed, on balance it seems unlikely that employers will use a pay cap to treat their employees unfairly. Such practices would hurt the employer's reputation and make them unappealing to potential employees, reducing the pool of talent it would be likely to attract.

## Conclusion

145. Many respondents favoured the introduction of a pay based cap - if the 3 respondents who felt 12 months' was too high are factored in, a majority. A lowered cap could help correct perceptions that an unfair dismissal award is often very high. In reality, the median award is £4,560, which is nearly 16 times less than the current statutory cap. Claimants, with widely varying circumstances, may feel that £72,300 is expected when in reality awards are very rarely anywhere near this amount. Though respondents disagreed over whether this perception change might lead to earlier resolution of disputes, in large part this concern was based on fear of additional jurisdiction claims being brought. Most respondents felt employers would have greater certainty over costs, while respondents were split on whether the impact on employers and employees would be positive.
146. On balance, however, the benefits and support for the introduction of a pay based cap outweigh the possible risks and disadvantages. Therefore, subject to Parliamentary process, **the Government intends to introduce a 12 months' pay cap on the compensatory award for unfair dismissal.**

## Overall Cap

147. On the question of whether the overall cap is currently set at an appropriate level, views were broadly equal, with 37% of respondents believing that the cap was appropriate, 39% believing it was not, and 20% felt there should be no cap at all. Of the 38 business respondents who answered, 32% felt it was appropriate, while 63% felt it was not and 5% were unsure. This division of responses reflects the overall lack of consensus over how or if the cap should be changed. Amongst legal representative respondents, the statistics were flipped: around 60% thought the cap was appropriate while 16% felt it was not. Nearly 75% of trade unions felt there should be no cap at all.
148. One response, made on behalf of several stakeholders, presented an analysis of how the cap reached its current level. This analysis posited that the current cap is in fact in line with average earnings, as calculated in 1971. Others felt that decreasing it unfairly impacted more highly paid earners.
149. Those opposed to the current level of the cap felt it was not appropriate since it was so out of line with what claimants actually receive, the negative effects of which have already been discussed at length in the previous section.
150. Notably, there was no consensus on what level the cap should be changed to amongst those who did not feel the current overall cap was appropriate. Of the 26 respondents who suggested an amount (an additional 14 advocated the removal of a cap), 8 suggested £26,000, 6 suggested £78,000, 5 suggested £52,000 and 3 suggested £50,000. The rest of the amounts were scattered over the range of average annual earnings and three times that amount. Very few respondents made a suggestion or presented compelling evidence to support a new figure. Seventy five per cent of trade unions, and a few legal representatives, felt there should be no cap based on the principle that there should no



limit to the compensation an employer pays when they have been found by a tribunal to have acted unfairly.

### **Government Response**

151. The Government does not agree with the analysis proposed by some that increasing the level of the original cap in 1971 in a way which would reflect inflation over the period to identify the “correct” current level for the cap is appropriate. The original cap was based on 104 weeks’ earnings, but it is not a formula which has been continued by any government since 1971. Evidence of employment tribunal awards themselves (i.e. the small number which are likely to have to be reduced to comply with the cap) and support amongst respondents for the introduction of a 12 months’ pay cap indicates calculating the cap based on annual earnings is a more appropriate formula.
152. A major objection raised in that response was that it was misleading to include the large up rating in 1999 as evidence that the cap has been increasing at above the rate of inflation or earnings. However, we reiterate the point in the consultation impact assessment that in the period of 2000 to 2011 (not including the up-rating), the cap has increased by 45%, more than either RPI or median earnings (both approximately 38%).

### **Conclusion**

153. There was less support from respondents to the consultation for a change to the current overall cap. A minority of respondents wanted to change it, while one group wanted no cap at all. All Governments, however, have agreed that a cap is necessary.
154. Given the lack of consensus over if and how the current cap should be changed, the Government has decided not to change the overall cap on compensatory awards for unfair dismissal at this time.

## 4. Next steps and Implementation

155. Both issues considered in this response are measures being taken forward in the Enterprise and Regulatory Reform Bill. The Bill has passed through the House of Commons and is currently under consideration in the House of Lords. We expect the Bill to receive Royal Assent in spring 2013. We will explain in the Statutory Code and accompanying guidance the implications for implementation of our changes in the Devolved Administrations, reflecting Scotland's separate jurisdiction.
156. Actions to facilitate the use of settlement agreements and changes to the nature of the unfair dismissal compensatory award cap offer real potential to add certainty and confidence to employers in managing their staff at the end of employment relationship. We are keen, therefore, to see the changes implemented as soon as possible, subject to due parliamentary process.

### Facilitating Settlement Agreements

157. As set out in paragraphs above, the effective operation of the measure to facilitate the use of settlement agreements in the ERR Bill makes a Statutory Code to explain the nature of 'improper behaviour' desirable. The Bill measure which makes offers of settlement inadmissible in unfair dismissal cases will not come into force until there is a Statutory Code in place, to which employment tribunals will be able to refer.
158. Shortly following this Government response Acas will publish a draft Statutory Code for public consultation. Once the text of the statutory code is finalised, it will be laid in draft before Parliament, and should come into effect around 40 days later. At the same time, the measure in the ERR Bill which makes offers of settlement inadmissible in unfair dismissal cases will come into force. We anticipate this will be summer 2013.
159. Any offers of settlement and related negotiations which take place after the Statutory Code come into force, will be subject to the inadmissibility provision in the Bill. Offers of settlement and related negotiations which take place before the Statutory Code and Bill measure come into force, even if they take place after the ERR Bill has received Royal Assent, will not be covered by the protection.
160. We will disseminate information about the change through Government communication channels as well as working with stakeholders to raise awareness of the model settlement agreements and template letters. As set out above, the Statutory Code will be supplemented by more practical guidance for employers and employees which will enable both parties to make informed decisions about considering, offering and accepting settlement. We will continue to work closely with Acas as they develop the guidance.
161. Responses to the consultation suggested that the Government should make use of a wide range of channels to disseminate information, including Acas, Citizens' Advice Bureaux, business representative bodies, trade unions, and libraries. As the guidance materials are produced, we will work with stakeholders to ensure they have maximum reach.
162. The Government is already working with business representative groups to pilot the use of the model settlement agreement and supporting guidance with business, particularly smaller businesses, to encourage its use as an alternative to drafting settlement agreements from scratch. We will use feedback from the pilot to understand how

employers approach agreeing settlement, and to develop and improve the templates and supporting guidance.

163. We are also continuing to work with Her Majesty's Courts and Tribunal Services and other stakeholders to raise awareness of the average levels of award in tribunal cases, to address the misperceptions of employers and employees regarding the typical value of tribunal awards.

### **Changing the Unfair Dismissal Compensatory Cap**

164. The power in the ERR Bill gives the Secretary of State the ability to bring forward legislation to change the compensatory cap; it does not in itself bring about any change to the cap.
165. Following Royal Assent of the ERR Bill we will bring forward the necessary secondary legislation for Parliamentary debate. We anticipate that changes to the unfair dismissal compensation award would come into effect in summer 2013.
166. We will disseminate information about the change through Government communication channels as well as working with stakeholders to ensure awareness of the new formula. In particular, we will work with Her Majesty's Court and Tribunal Service and Acas to ensure that potential claimants and respondents are aware of the maximum value of the compensatory element of any successful unfair dismissal award.

## Annex 1: Answers to quantitative Consultation Questions, by type of respondent

### Question 1 – Do you agree that these are the correct principles to underpin the use of a settlement agreement which is inadmissible in unfair dismissal cases?

97 respondents indicated Yes, No, or Not sure in response to this question.

Respondent category	Yes	No	Not Sure	Total
Business representative organisation/trade body	7			7
Charity or social enterprise	1	1		2
Individual	5	5		10
Large business ( over 250 staff)	5	3		8
Legal representative	11	7	2	20
Local government	2	1	1	4
Medium business (50 to 250 staff)	11			11
Micro business (up to 9 staff)	8	1		9
Other	9		1	10
Small business (10 to 49 staff)	4		1	5
Trade union or staff association	5	6		11
<b>Total</b>	<b>68</b>	<b>24</b>	<b>5</b>	<b>97</b>
<b>Percentage</b>	<b>70.10%</b>	<b>24.74%</b>	<b>5.15%</b>	

## Question 2 - Do you agree that the model letters proposing settlement and a template for producing a settlement should be included in a Statutory Code?

115 respondents indicated Yes, No or Not Sure to this question.

Respondent category	Yes	No	Not Sure	Grand Total
Business representative organisation/trade body	9		2	11
Charity or social enterprise	1			1
Individual	6	4		10
Large business ( over 250 staff)	5	2	1	8
Legal representative	12	7	5	24
Local government	2	1	1	4
Medium business (50 to 250 staff)	10	1		11
Micro business (up to 9 staff)	7		2	9
Other	10			10
Small business (10 to 49 staff)	6			6
Trade union or staff association	7	12	2	21
<b>Total</b>	<b>75</b>	<b>27</b>	<b>13</b>	<b>115</b>
<b>Percentage</b>	<b>65.22%</b>	<b>23.48%</b>	<b>11.30%</b>	

#### Question 4 – Would model letters proposing settlement and a template for producing a settlement agreement be likely to change your use?

81 respondents indicated that their use would Increase, Decrease or Stay the Same, in response to this question.

Respondent category	Decrease	Increase	Stay same	Total
Business representative organisation/trade body		4	2	6
Individual		2	5	7
Large business ( over 250 staff)		4	3	7
Legal representative	1	4	10	15
Local government			3	3
Medium business (50 to 250 staff)		6	5	11
Micro business (up to 9 staff)		4	3	7
Other		4	5	9
Small business (10 to 49 staff)			6	6
Trade union or staff association		1	9	10
<b>Total</b>	<b>1</b>	<b>29</b>	<b>51</b>	<b>81</b>
<b>Percentage</b>	<b>1.23%</b>	<b>35.80%</b>	<b>62.96%</b>	

**Question 7 – Do you agree that the use of templates should not be compulsory?**

116 respondents indicated a Yes, No or Not Sure response to this question.

<b>Respondent category</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Total</b>
Business representative organisation/trade body	11	1		12
Charity or social enterprise	1			1
Individual	4		2	6
Large business ( over 250 staff)	9			9
Legal representative	24	3	1	28
Local government	4			4
Medium business (50 to 250 staff)	10	1		11
Micro business (up to 9 staff)	5	1	2	8
Other	10			10
Small business (10 to 49 staff)	5		1	6
Trade union or staff association	21			21
<b>Total</b>	<b>104</b>	<b>6</b>	<b>6</b>	<b>116</b>
<b>Percentage</b>	<b>89.66%</b>	<b>5.17%</b>	<b>5.17%</b>	

### Question 8 - Do you think it would be helpful if the Government set a guideline tariff for settlement agreements?

117 respondents indicated a Yes, No or Not Sure response to this question.

Respondent category	Yes	No	Not Sure	Total
Business representative organisation/trade body		10	1	11
Charity or social enterprise		1		1
Individual	2	5	1	8
Large business ( over 250 staff)	3	5	1	9
Legal representative	4	19	4	27
Local government		3	1	4
Medium business (50 to 250 staff)	6	4	1	11
Micro business (up to 9 staff)	4	2	2	8
Other	5	3	2	10
Small business (10 to 49 staff)	6			6
Trade union or staff association	5	16	1	22
<b>Total</b>	<b>35</b>	<b>68</b>	<b>14</b>	<b>117</b>
<b>Percentage</b>	<b>29.91%</b>	<b>58.12%</b>	<b>11.97%</b>	



## Question 16 – Do you support the introduction of a cap on compensation of 12 months' pay?

119 respondents indicated Yes, No, or Not sure in response to this question.

<b>Respondent category</b>	<b>Yes</b>	<b>No</b>	<b>Not Sure</b>	<b>Total</b>
Business representative organisation/trade body	14		2	<b>16</b>
Charity or social enterprise		2		<b>2</b>
Individual	6	7		<b>13</b>
Large business ( over 250 staff)	10	1		<b>11</b>
Legal representative	7	15	1	<b>23</b>
Local government	3	1	2	<b>6</b>
Medium business (50 to 250 staff)	9	1		<b>10</b>
Micro business (up to 9 staff)	3	2		<b>5</b>
Other	1	3	1	<b>5</b>
Small business (10 to 49 staff)	3	1	2	<b>6</b>
Trade union or staff association	1	21		<b>22</b>
<b>Total</b>	<b>57</b>	<b>54</b>	<b>8</b>	<b>119</b>
<b>Percentage</b>	<b>47.89%</b>	<b>45.38%</b>	<b>6.72%</b>	<b>100%</b>

**Question 20: Do you consider that the overall cap on compensation for unfair dismissal is currently set at an appropriate level (£72,300)?**

95 respondents indicated Yes, No, No Cap, or Not sure in response to this question.

<b>Respondent category</b>	<b>Yes</b>	<b>No</b>	<b>No Cap</b>	<b>Not Sure</b>	<b>Total</b>
Business representative organisation/trade body	2	9		1	<b>13</b>
Charity or social enterprise	1				<b>1</b>
Individual	3	6	1		<b>9</b>
Large business ( over 250 staff)	4	5			<b>10</b>
Legal representative	11	3	4	1	<b>19</b>
Local government	1	3		1	<b>4</b>
Medium business (50 to 250 staff)	5	4			<b>7</b>
Micro business (up to 9 staff)		2		1	<b>3</b>
Other	2	1			<b>3</b>
Small business (10 to 49 staff)	1	4			<b>5</b>
Trade union or staff association	5		14		<b>19</b>
<b>Total</b>	<b>35</b>	<b>37</b>	<b>19</b>	<b>4</b>	<b>954</b>
<b>Percentage</b>	<b>36.84%</b>	<b>38.94%</b>	<b>20.00%</b>	<b>4.21%</b>	<b>100%</b>

## **Annex 2: List of Organisations who responded to the consultation**

Respondents to the Ending the Employment Relationship consultation included:

Affinity Health at Work

Age UK

AJTC

Allaway Group Ltd

Alumet

Anglo European College of Chiropractic

ASLEF

Association of Recruitment Consultants

Association of School and College Leaders

Association of Teachers and Lecturers

Bar Council

BCHR Ltd

Birmingham Law Society

Bizerba (UK) Ltd.

British Private Equity and Venture Capital Association

British Retail Consortium

Catalyst Computer Systems Ltd

Confederation of British Industry

Council of Mortgage Lenders

Charles Russell LLP

Chartered Society of Physiotherapy

Chartered Institute of Personnel and Development

Citizens Advice

CMS Cameron McKenna LLP

Compuware Ltd

Design Initiative Ltd

EEF

Employment Lawyers' Association

Electrical Contractors' Assoc

Employment Law Group of Applicants Representatives

Eversheds LLP

F W Thorpe plc

Food and Drink Federation

Foot Anstey LLP

Fran'N'Bru Ltd

Federation of Small Busiensses

Guy Thompson & Co, Solicitors

Henderson

Hogan Lovells LLP

HR Consulting Associates Ltd

Imonic Ltd

Institute of Directors

Isode Limited

John Stamford & Associates Ltd

Joint Industry Board

Kent County Council

Kingsdale

Law Society of Scotland

London Borough of Camden

Lewis Silkin

Lighter Business Solutions

Liverpool John Moores University

Local Government Association

Lyons Davidson Solicitors

Magenta HR Consulting Ltd

Merseyside Fire and Rescue Service

Mind

Morrish Solicitors LLP

NASUWT

National Association of Head Teachers

National Union of Journalists

North East Chamber of Commerce

Network Partnership

News Direct (Scotland) Ltd

North West Employment Law

Northumberland County Council

Norton Rose LLP

Oxford University

Pardoes Solicitors

PCS

Personnel Solutions

Pickforal Kennels

Project HR Limited

Prospect

Research Sites

Restoration Ltd

RMT

Road Haulage Association

Royal College of Midwives

Scottish Trade Unions Congress

SDT Coaching & Consultancy

Simmons and Simmons LLP

SK Employment Law

Smith May Solicitors LLP

Society of Local Council Clerks

Sunsoa & Co.

The Law Society

Thompsons

Thorp Precast Ltd

Transport for London (TfL)

Trant Construction

TSSA

Trades Union Congress

UCATT

UCEA

UK Chamber of Shipping

Unison

Unite

University of Birmingham

University of Cambridge

University of Sheffield

University of Winchester

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