UNFAIR DISMISSAL
COMPENSATORY AWARDS:

Final impact assessment

JANUARY 2013
Title: Unfair Dismissal Compensatory Awards

Final IA No: BIS0356
Lead department or agency: BIS, Other departments or agencies: HM Courts and Tribunals Service

Summary: Intervention and Options

<table>
<thead>
<tr>
<th>Cost of Preferred (or more likely) Option</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Net Present Value</td>
</tr>
<tr>
<td>£0m</td>
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</table>

RPC: Not Applicable

What is the problem under consideration? Why is government intervention necessary?
The cap on the compensatory element of unfair dismissal awards has increased rapidly in recent years. The cap was subject to a large one-off increase in 1999, from £12000 to £50000 and subsequently up-rated using a formula that has resulted in above-inflation increases in compensation in most years. The cap currently stands at £72,300. The Government considers that these factors may have resulted in a cap that goes beyond the level of compensation necessary to provide adequate redress to unfairly dismissed workers. The current high level of the cap on the compensatory award may lead to unrealistic expectations among both employees and employers as to the likely level of a tribunal award. These unrealistic expectations may also have a negative impact on hiring, as employers who feel they may be liable for very large amounts are more reluctant to take on new staff.

What are the policy objectives and the intended effects?
The intention is to:
• Set an appropriate cap on unfair dismissal compensation, taking into consideration the large one-off increase and subsequent above inflation increases which have increased the current cap to a historically high level.
• Improve certainty of the amount of award that businesses will pay and make expectations of awards more realistic among claimants, whilst retaining adequate levels of compensation for claimants who have been unfairly dismissed.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)
The options that have been considered are:
Do nothing
Option 1 - Introduce a cap on individual awards of 12 months’ pay (where this was less than the overall cap).
Option 2 - Reduce the cap on the compensatory award to a lower flat rate.

The preferred option is Option 1.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 01/2016

Does implementation go beyond minimum EU requirements? N/A
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.

<table>
<thead>
<tr>
<th>Micro No</th>
<th>Small No</th>
<th>Medium No</th>
<th>Large No</th>
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What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)
Traded: N/A
Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Date:
**Summary: Analysis & Evidence**

**Policy Option 1**

**Description:** Introduce a cap on individual awards in unfair dismissal cases of 12 months' pay

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**FULL ECONOMIC ASSESSMENT**

<table>
<thead>
<tr>
<th>Price Base</th>
<th>PV Base</th>
<th>Time Period</th>
<th>Net Benefit (Present Value (PV)) (£m) N/Q</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td>Low:</td>
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</table>

<table>
<thead>
<tr>
<th>COSTS (£m)</th>
<th>Total Transition (Constant Price)</th>
<th>Average Annual (excl. Transition) (Constant Price)</th>
<th>Total Cost (Present Value)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
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<tr>
<td>Best Estimate</td>
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</tbody>
</table>

Description and scale of key monetised costs by ‘main affected groups’

Other key non-monetised costs by ‘main affected groups’

Employers and Exchequer: no costs incurred; Employment Tribunal claimants: the majority will be unaffected, a very small number will receive lower awards in the future than they would receive now. Option 1 would be likely to have higher costs to claimants than Option 2.

<table>
<thead>
<tr>
<th>BENEFITS (£m)</th>
<th>Total Transition (Constant Price)</th>
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Description and scale of key monetised benefits by ‘main affected groups’

Description and scale of key non-monetised benefits by ‘main affected groups’

Employers: some increase in certainty about the scale of awards they could face. Small reduction in money spent on awards. Employment tribunal claimants/employees: clearer expectations. Option 1 would be likely to have more of an effect on expectations than Option 2.

**Key assumptions/sensitivities/risks**

Discount rate (%)

The impacts of this measure cannot be fully quantified beyond assessing the likely number of people affected by the change. There is a small risk of claims switching to other jurisdictions, but even if realised it would affect only a very small number of cases.

**BUSINESS ASSESSMENT (Option 1)**

<table>
<thead>
<tr>
<th>Direct impact on business (Equivalent Annual) £m:</th>
<th>In scope of OIOO?</th>
<th>Measure qualifies as</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs: Benefits: Net:</td>
<td>No</td>
<td>N/A</td>
</tr>
</tbody>
</table>
**Policy Option 2**

**Summary: Analysis & Evidence**

**Description:** Reduce the cap on the compensatory award to a lower flat rate than currently.

### FULL ECONOMIC ASSESSMENT

<table>
<thead>
<tr>
<th>Price Base Year</th>
<th>PV Base Year</th>
<th>Time Period Years</th>
<th>Net Benefit (Present Value (PV)) (£m)</th>
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<tr>
<td></td>
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**COSTS (£m)**

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**Description and scale of key monetised costs by ‘main affected groups’**

**Other key non-monetised costs by ‘main affected groups’**

Employers and Exchequer: no costs incurred; Employment Tribunal claimants: the majority will be unaffected, a very small number will receive lower awards in the future than they would receive now. Option 2 is likely to affect fewer claimants than Option 1.

### BENEFITS (£m)

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<td></td>
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**Description and scale of key monetised benefits by ‘main affected groups’**

**Other key non-monetised benefits by ‘main affected groups’**

Employers: some increase in certainty about the scale of awards they could face. Small reduction in money spent on awards. Employment tribunal claimants/ employees: clearer expectations. The benefits of Option 2 are similar to Option 1 but are likely to be smaller because the limit on awards will be higher for the majority of claimants with Option 2 than with Option 1.

**Key assumptions/sensitivities/risks**

Discount rate (%)

The impacts of this measure cannot be fully quantified at this stage beyond assessing the likely number of people affected by the change. There is a small risk of claims switching to other jurisdictions, but even if realised it would affect only a very small number of cases.

### BUSINESS ASSESSMENT (Option 1)

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<td></td>
</tr>
<tr>
<td>Net:</td>
<td></td>
<td></td>
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</tbody>
</table>
Unfair Dismissal Awards IA Evidence Base

Issue

Since the introduction of unfair dismissal rights in 1971, the compensation paid to workers who make a successful tribunal claim has always been subject to a statutory limit.

Where compensation is paid, the award consists of 2 elements: the 'basic award' and the 'compensatory award'. The Government is not proposing to change the 'basic award' but considers that the current level of the cap on the 'compensatory award' may lead to unrealistic perceptions among employees and employers. This impact assessment therefore considers whether this cap should be reduced and if so, how.

This impact assessment accompanies the Government Response to the “Ending the Employment Relationship” (ETER) consultation.

Background

Enforcement of employment law is primarily through individuals making claims to employment tribunals. If an individual feels that they have been unfairly dismissed they can make a claim to an employment tribunal. This must be within 3 months\(^1\) of the alleged unfair dismissal taking place.

Individuals bring unfair dismissal claims where they believe that they have been dismissed for an unfair reason or where they believe that their employer’s decision to dismiss them for one of the potentially fair reasons was unreasonable. Fair reasons for dismissal include conduct, capability, redundancy, because of a statutory restriction (e.g. a taxi driver who is legally disqualified from driving) or some other substantial reason. Individuals can also claim for unfair dismissal when they have resigned due to a fundamental breach of their employment contract. This is known as constructive dismissal.

HM Courts and Tribunals Service received an overall total of 186,300 employment tribunal claims between 1 April 2011 and 31 March 2012 including almost 50,000 unfair dismissal claims. Each claimant may make a claim on a number of grounds, known as jurisdictional complaints. The total number of jurisdictional complaints in 2011/2012 was 321,800.\(^2\) The number of employment tribunal claims for the last 3 financial years available is shown in Table 1 below.

| Table 1: Number of Unfair Dismissal Claims accepted, Employment Tribunals and EAT Statistics, 2009-12 |
|---|---|---|---|
| Claims accepted | 2009-10 | 2010-11 | 2011-12 |
| Unfair Dismissal claims | 57,400\(^3\) | 47,900 | 46,300 |
| All ET claims accepted | 236,100 | 218,100 | 186,300 |
| Total jurisdictional claims | 392,800 | 382,400 | 321,800 |

Many claims do not reach an employment tribunal hearing for a variety of reasons which include conciliation, private settlements and rejection on technical reasons (e.g. the claim was not made within the appropriate timeframe). If a claim gets as far as an employment tribunal hearing and is successful the tribunal can, where appropriate, award compensation to the claimant. The

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\(^1\) Unless the tribunal considers that it was not reasonably practicable for the claimant to have filed the claim within 3 months.


\(^3\) The number of claims may have gone up due to the recession.
outcomes of unfair dismissal employment tribunal claims which were disposed of in financial year 2011/2012 are shown in Table 2 below.

Table 2: Outcomes of tribunal claims disposed of in 2011/2012

<table>
<thead>
<tr>
<th>Outcome</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>46,100</td>
<td>100%</td>
</tr>
<tr>
<td>Withdrawed</td>
<td>11,300</td>
<td>24%</td>
</tr>
<tr>
<td>Acas conciliated settlements</td>
<td>19,500</td>
<td>42%</td>
</tr>
<tr>
<td>Struck out not at a hearing</td>
<td>4,000</td>
<td>9%</td>
</tr>
<tr>
<td>Successful at tribunal</td>
<td>3,900</td>
<td>8%</td>
</tr>
<tr>
<td>Dismissed at a preliminary hearing</td>
<td>1,300</td>
<td>3%</td>
</tr>
<tr>
<td>Unsuccessful at hearing</td>
<td>4,800</td>
<td>10%</td>
</tr>
<tr>
<td>Default judgement</td>
<td>1,200</td>
<td>3%</td>
</tr>
</tbody>
</table>

So up to 5100 claims (11%) were successful at tribunal (1200 default judgments + 3900 successful at tribunal) in 2011/2012. In 2011/2012 2309 claimants were awarded compensatory awards (ETS & EAT annual publication). The total value of awards awarded to claimants for unfair dismissal in 2011/2012 was approximately £21.1million.

Where compensation is awarded the compensation is made up of two elements:

1. A basic award
2. A compensatory award

The **basic award** has a maximum of £12,900 and is calculated using the same formula as statutory redundancy payments. This is based on the employee’s age, length of service and weekly pay. In certain cases there is a minimum amount of basic award.

*The Government is not proposing to make any changes to the basic award.*

The **compensatory award** is an amount which the tribunal considers just and equitable for the loss which the employee has suffered because of the dismissal, insofar as the employer is responsible. It is subject to a statutory maximum (currently £72,300 and due to be raised to £74,200 in February 2013). It can be higher in cases where the reason for dismissal is that the employee made a protected disclosure under the Public Interest Disclosure Act 1998, or took action relating to health and safety. The maximum is up-rated annually using RPI.

To decide on the appropriate amount for the compensatory award, Employment Tribunals consider the following losses:

- Loss of earnings (past and future)
- Loss of bonus or commission
- Loss of other benefits (e.g. company car)
- Loss of pension
- Expenses incurred as a result of the dismissal (e.g. travel costs looking for a new job)
- Loss of statutory rights (Employment Tribunals sometimes award a nominal amount to compensate for the fact the claimant will have to start afresh building up qualifying service for UD and redundancy)

If in taking into account all of the above considerations the award that is decided on is above the cap level then the cap is applied.

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Please note that this is the number of claims disposed of by HMCTS. It is different from the number of claims accepted in 2011/2012 as claims are disposed of over different time periods, thus in a given year claims accepted and disposed will not be the same.
When considering the proposals in this IA there are other factors which should be taken into account.

The Resolving Workplace Disputes consultation announced Government’s intention to introduce fees in employment tribunals, and set out the policy rationale for this decision. The Ministry of Justice (MoJ) has consulted on this and in the Government response announced its intention to introduce the new fee charging structure during summer 2013. In addition, as part of the Resolving Workplace Disputes consultation, BIS has increased access to tribunal awards data by publishing the median awards made at tribunal in the major jurisdictions on employment tribunal claim form and response cover sheets and in guidance.

We are already in the process of changing the up-rating formula for tribunal award limits and statutory redundancy pay to curb future increases as part of the Enterprise and Regulatory Reform Bill, currently before Parliament. The formula is currently linked to RPI and this will remain unchanged but will no longer be rounded up to the next hundred pounds as this has led to increases above the rate of inflation.

**Problem under consideration**

The cap on the compensatory element of unfair dismissal awards has increased rapidly in recent years. The cap was subject to a large one-off increase in 1999, from £12000 to £50000 and subsequently up-rated using a formula that has resulted in above-inflation increases in compensation in most years. The cap currently stands at £72,300 and in February 2013 will be £74,200.

The current level of the cap on the compensatory award may lead to unrealistic expectations among both employees and employers as to the likely level of a tribunal award. The median unfair dismissal award has been around £4000 - £5000 for the last 6 years (see Figure 2). The median is generally used because the mean is skewed by a small number of high awards (some of which may be exempt from the cap and therefore unaffected by these changes). The median award in financial year 2011/2012\(^5\) was under £4560 – less than 7% of the value of the cap on the compensatory award and less than 20% of the annual median wage of £26,224\(^6\). Reducing the cap would be in line with the other measures being implemented as a result of Resolving Workplace Disputes consultation (publishing median awards on claim form cover sheets and guidance) to give claimants and businesses more realistic expectations about the level of awards in employment tribunal cases.

A literature review for BIS on understanding the behaviour of employees in workplace conflicts\(^7\) suggests that expectations of the outcome of an employment tribunal claim can be unrealistic. In particular, optimistic overconfidence suggests that disputants may be overconfident both about their likelihood of success and the potential value of a claim. Expectations are likely to drive behaviour, so the provision of more information to help align expectations with reality is helpful. This is already taking place in the form of recent changes to tribunal claim and response forms. As of April 2012, HM Courts and Tribunals Service have included details of the median award on the cover sheet accompanying the ET1, and in the ET3 guidance.

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\(^6\) ASHE 2011 figure.
\(^7\) As reported in http://www.bis.gov.uk/assets/biscore/employment-matters/docs/u/11-918-understanding-behaviour-employees-conflicts-at-work
Figure 1 shows that the cap on compensation is currently much higher than it was prior to the one-off increase in 1999. During the period 1999 - 2011, the RPI increased by 42% and average (median) earnings increased by 47%. In contrast, the cap on unfair dismissal compensation increased by 503%, however this includes the increase from £12,000 in 1999 to £50,000 in 2000. From 2000 to 2011 the cap has increased by 45% (median earnings and RPI both increased by around 38% over this period).

The cap is currently 2.73 times median annual salary (based on 2012 provisional figure of £26,462⁸), in 2000 it was 2.65 times median annual salary and in 1999 it was 0.67 times median annual salary. We therefore want to consider whether the current cap is set at an appropriate level to provide reasonable, but not excessive, compensation for unfair dismissal or whether the level of the cap should be decreased. The power in the Enterprise and Regulatory Reform Bill would allow the cap to varied within a range of gross full time annual median earnings based on revised figures (currently £26,095⁹) and three times gross full time annual median earnings (currently £78,672).

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⁸ Source: ASHE 2012 provisional estimates.
⁹ Source: ASHE 2011 revised figures.
The distribution of awards is shown in Figure 3. The majority of awards are well below the current cap. For example, 94% of awards were below £30,000 and 98% of awards were below £50,000 in financial year 2011/2012 (similar figures for 2010/2011). There were 2309 awards made for unfair dismissal in total in 2011/2012.

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**Figure 2:** Median and mean awards at employment tribunal for unfair dismissal, 2005/2006 to 2011/2012. *Source ET/EAT statistics annual report.*

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**Figure 3:** Numbers of awards given by employment tribunals from 2005/2006 to 2011/2012 by the level of award. *Source ET/EAT statistics annual report.*

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10 Please note that the figures in Figure 2 and Figure 3 are based on total award and include both the basic and compensatory awards elements.

11 2608 awards were made for unfair dismissal in 2010/2011 and there were 2886 in 2009/2010.
The cap is also high compared to annual earnings (loss of earnings is a major component of the unfair dismissal compensatory award). The 90th percentile for full time earnings is £51,666 so less than 10% of employees earn more than £72,300 or above annually (we estimate around 4%). Earnings data are shown in Table 3: Distribution of Annual Full-Time Gross Pay 2012.

<table>
<thead>
<tr>
<th>Percentile</th>
<th>10</th>
<th>20</th>
<th>30</th>
<th>40</th>
<th>50</th>
<th>60</th>
<th>70</th>
<th>80</th>
<th>90</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pay (£)</td>
<td>14,422</td>
<td>17,448</td>
<td>20,198</td>
<td>23,123</td>
<td>26,462</td>
<td>30,188</td>
<td>34,728</td>
<td>40,815</td>
<td>52,684</td>
</tr>
</tbody>
</table>

* Source ASHE provisional results, ONS 2012.

Table 3: Distribution of Annual Full-Time Gross Pay 2012

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* Source ASHE provisional results, ONS 2012.

**Rationale for Intervention**

Government intervenes in the labour market via employment regulation for a variety of efficiency and equity reasons. The enforcement of this regulation is mostly through employment tribunals, for which there are policies in place for how cases are dealt with. These include factors that an employment tribunal will take into account in setting a compensatory award, and the limit (cap) for that award.

The Government considers that the combination of changes through the one-off increase in 1999 and subsequent up-rating may have resulted in a cap that goes beyond the level of compensation necessary to provide adequate redress to unfairly dismissed workers. Our recently concluded Ending the Employment Relationship consultation looked at this issue in depth, including the implications of Options 1 and 2.

We are looking at the level of the UD cap in the context of a wider suite of reforms, including measures to facilitate the use of settlement agreements and the measures we are implementing following our consultation on *Resolving Workplace Disputes*. The RWD package of measures also aims to encourage the earlier resolution of disputes and to streamline and improve the efficiency of the employment tribunal system. Addressing the level of the cap will complement these wider measures, including the aim of ensuring realistic perceptions about the likely level of tribunal awards. We have already taken steps to include the median average value of awards on the coversheet and guidance for employment tribunal claim forms (ET1).

The *Enterprise and Regulatory Reform* bill, currently before Parliament includes a clause which gives the Secretary of State the power to adjust the cap on the compensatory award for unfair dismissal claims. Clause 13 permits adjustment in two ways: either the introduction of a salary cap of no less than 12 months’ pay, or simply changing the current overall cap. This overall cap would be retained if an earnings’ based cap were introduced, with the lower of the two being the applicable cap.

**Policy Objective**

The intention of these proposals is to:

- Set an appropriate cap on unfair dismissal compensation, taking into consideration the large one-off increase and subsequent above inflation increases which have increased the current cap to a historically high level.

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12 BIS estimate based on ASHE 2012 data.
• Improve certainty of the amount of award that businesses will pay and make expectations of awards more realistic among claimants and employers, whilst retaining adequate levels of compensation for claimants who have been unfairly dismissed.

Description of proposals being considered

(A) Do nothing

The cap will remain unchanged (but the formula by which it is up-rated is likely to be amended through a measure currently before the Houses of Parliament in the Enterprise and Regulatory Reform Bill). The formula will remain linked to RPI but will no longer be rounded up to the next hundred pounds as this has led to increases above the rate of inflation. The annual uprating will take place under the provisions of this new formula from 2014 on.

As discussed on page 2, the Resolving Workplace Disputes proposals mean that Employment Tribunal forms now display median awards in an attempt to better inform Tribunal claimants. This should help to improve information and expectations for both parties.

(B) Reduce the cap

Option 1

Introduce a cap on individual awards of 12 months’ pay (where this was less than the overall cap).

Option 2

Reduce the cap on the compensatory award to a lower flat rate. £30,000, £40,000 and £50,000 are used throughout the IA as illustrative examples. The consultation sought views on what an appropriate level would be, but no consensus emerged.

Government Response to Consultation on Appropriate level of Unfair Dismissal Cap

The Government recently consulted on whether there is a need to reduce the unfair dismissal cap to supplement the other reforms to the employment tribunals systems, and if so to what level. The Ending the Employment Relationship consultation considered the introduction of a cap on individual awards related to a multiple of earnings, which would not be less than 52 weeks’ pay and changing the overall specified cap, which stands at £72,300. An overall cap would be retained if an earnings’ based cap were introduced.

Many respondents favoured the introduction of an earnings’ based cap. Of those who were not in favour, 36% were opposed, and the remaining 14% were unsure. Businesses, business representatives, and trade associations felt that it should be introduced, while trade unions felt it should not, and legal representatives were split. Those in favour felt it would help correct perceptions that an unfair dismissal award is often very high. In reality, the median award is £4,560, which less than 7% of the current statutory cap. Claimants, with widely varying circumstances, are all subject to the same cap of £72,300, setting expectations high when in reality actual 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 other claims being brought. Given that there is no bar on multiple claims being brought together, and that most unfair dismissal claims are already brought alongside additional claims, the Government is not convinced that this consequence is likely.
Most respondents felt employers would have greater certainty over costs, particularly given the variables a tribunal takes into account when making an award determination. Respondents were split on whether the impact on employers and employees would be positive, though even some trade unions against noted that in reality few employees would be impacted at all.

Many trade unions and a number of legal representatives felt there would be a discriminatory impact on certain groups of claimants on introducing a pay based cap. As the Equality Impact Assessment in Annex 1 notes, there is no evidence that supports this argument.

Changing the overall cap, on the other hand, was a more contentious proposition. There was no agreement amongst respondents on how the cap should be changed, and little evidentiary support for any proposed figures.

The Costs and Benefits of Reducing the Cap

The costs and benefits of reducing the cap are assessed against a do nothing approach.

Benefits

Reducing the cap would rebalance the level of the cap following the large recent increases. It would also give businesses more certainty about how much can be awarded; this would particularly be the case when the cap is tied to annual salary. It could make expectations of likely awards more realistic among claimants. The majority of awards would be unlikely to be affected by the individual cap, discussed in the costs section below. The number of awards affected by reducing the overall level of the cap is dependent on the level that it would be reduced to this is also discussed in more detail in the costs section.

Benefits of Option 1: Introduce a cap on individual awards of 12 months’ pay (where this was less than the overall cap).

Introducing a cap based on individual pay would bring the cap more in line with average earnings and typical awards, providing a more tailored approach to award caps than a single specified number. The compensatory award is intended to compensate a claimant for financial loss, "in so far as that loss is attributable to action taken by the employer," and does not include injury to feelings. Therefore the calculation is strongly linked to earnings. An earnings' based cap would make that link clearer and provide more certainty to both employers and employees as to what award might realistically be expected. A flat overall rate does not as accurately reflect what might be expected in a given situation, which could range from a part-time employee earning £2,000 a year to someone earning £50,000 per year.

Benefits to businesses of Option 1

The advantage of introducing an individual cap based on annual earnings is that a business facing an employment tribunal would have certainty that the award would not exceed this level. This would be of benefit to businesses where the individual earns less than the overall cap.

Table 3 shows the percentage of employees in the UK who earn less than the existing cap level of £72,300 and the percentage who earn less than £50,000, £40,000 and £30,000. In addition it
shows the percentage of unfair dismissal claimants from SETA 2008 who earned less than these levels\textsuperscript{14}.

Table 3: Percentage of employees and Unfair Dismissal Claimants earning less than £30,000, £40,000 and £50,000

<table>
<thead>
<tr>
<th>Employees (including part-time employees) earning less than level\textsuperscript{15}</th>
<th>UD claimants in SETA earning less than level\textsuperscript{16}</th>
</tr>
</thead>
<tbody>
<tr>
<td>£72,300 96%</td>
<td>99%</td>
</tr>
<tr>
<td>£50,000 92%</td>
<td>96%</td>
</tr>
<tr>
<td>£40,000 85%</td>
<td>90%</td>
</tr>
<tr>
<td>£30,000 73%</td>
<td>80%</td>
</tr>
</tbody>
</table>

Benefits of Option 2: Reducing the compensatory award to a lower flat rate

Reducing the overall cap would bring it more in line with average earnings and typical awards.

Benefits to businesses of Option 2

Lowering the overall cap on the compensatory award would mean that businesses would have certainty that the award would be lower than it potentially could be with the current cap. The extent of this benefit would depend on what the cap would be reduced to. A lower cap would be more in line with the majority of awards and with median salary which means that it would be more realistic, although the majority of awards are likely to be lower than even the minimum award could be reduced to (the lowest the award can be reduced to is median gross annual full-time salary (£26,095)).

How it would compare to the individual cap also depends on the level of the overall cap. For example if the overall cap was reduced to £50,000 then for the majority of cases (92 – 96% based on ASHE 2012 and SETA 2008 data, see Table 3) this would be higher than an individual cap (and therefore giving a less realistic guide to the likely level of award), although for the remaining cases the overall cap would be the same or lower than an individual cap and therefore would mean that businesses could be certain that the award would be lower than with the individual cap (around 3% of unfair dismissal claimants in SETA 2008 earned between £50,000 and £72,300). If the overall cap was reduced to £30,000 then 73% of employees earn less than this (and 80% of unfair dismissal claimants in SETA 2008) so a limit based on their annual salary would be lower than an overall cap of £30,000. The lowest amount that the overall cap could be reduced to is median gross annual full-time earnings, which is currently £26,095.

If the cap is reduced (either to an individual cap or to a lower overall level) there would be a small financial benefit to non-compliant businesses. The magnitude of this would be dependent on the level of the cap, however it would be very small (median awards have been under £5000 for the last 3 years, mean awards have been under £10,000) and would be a transfer from claimants to non-compliant businesses. In addition as the tribunal awards come under fines and penalties there would be no regulatory ‘OUT’.

Costs

Exchequer costs

\textsuperscript{14} Both SETA 2008 and ASHE 2012 provisional figures are shown because SETA 2008 figures are now slightly out of date.

\textsuperscript{15} From ASHE 2012 provisional figures.

\textsuperscript{16} From SETA 2008. Rounded to the nearest per cent.
There is no expected cost to the exchequer of either Option 1 or Option 2.

Costs to Businesses

There are no expected costs to businesses of either Option 1 or Option 2.

Costs to claimants

There is likely to be some cost to claimants of Options 1 and 2 but only a very small number of claimants would be likely to be affected by either option. The costs to claimants of both options are discussed below.

Costs of Option 1: Introduce a cap on individual awards of 12 months’ pay

The majority of people would not be affected by the introduction of an individual cap based on annual earnings as the award is based on loss of earnings. The tribunal statistics do not contain any annual earnings information however our estimate based on SETA (Survey of Employment Tribunal Applicants) 2008 is that around 5% of claimants who receive an award would be affected by the individual cap (so around 0.3 per cent of all claims disposed of). There are too few respondents in SETA to be able to give a reliable estimate of how much the loss to individuals would be or any more information on their characteristics. The people that would be most likely to be affected would be people who are out of work for a long time or are not likely to find another job or another job with similar remuneration so that their losses would be greater than 1 year (the impacts of this are discussed further in the EQIA). Other evidence which supports that the majority of claimants would not be affected is that the median award of around £5000 is so far below median annual earnings (around £26500 for full-time employees, around £21,000 for all employees including part-time employees). In fact median awards are below the 10th percentile of earnings of all employees (including part-time employees) which is £6,482 so the limit would be above the median award for 90% of individuals if they were to make a claim. The median awards published by HMCTS are totals and also include the basic award element which will be unaffected by the cap.

Cost of Option 2: Reducing the compensatory award to a lower flat rate

A reduction in overall level of the cap would mean that there would be some cost to unfair dismissal claimants who would have received an award above the cap. The extent of this impact would be dependent on the level that the cap was reduced to. For example more claimants would be likely to be affected if the cap was reduced to a £30000 cap than to £50,000. The percentage of claimants who received an award which were awarded above £30,000 compensation for unfair dismissal has been 5 – 6% for the past 6 years (around 0.1% of all claims disposed of in 2010/2011). If the cap was reduced to £30,000 a claimant who would have received the previous maximum of £72,300 would now be awarded £30,000 for the compensatory award i.e. the maximum potential loss to the individual would be £42,300 so although very few people would be affected by the change the loss to the individual could be significant. The percentage of claimants who received an award which were awarded above £50,000 has been between 2 and 3 percent for the last 6 years (less than 0.05% of all claims disposed of in 2010/2011). If the cap was £50,000 anyone who would have received the maximum compensatory award would now receive £50,000 so the maximum potential loss to an individual would be £22,300. The vast majority of successful claims are awarded amounts well below the proposed caps (the median award has been around £4000- £5000 for the past 6 years).
Table 4: Number of awards over £30,000, £40,000 and £50,000 from 2005-2006 to 2011-2012

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
<td>No</td>
<td>%</td>
</tr>
<tr>
<td>All</td>
<td>3309</td>
<td>100</td>
<td>2552</td>
<td>100</td>
<td>2490</td>
<td>100</td>
</tr>
<tr>
<td>over £30K</td>
<td>167</td>
<td>5</td>
<td>137</td>
<td>5</td>
<td>113</td>
<td>5</td>
</tr>
<tr>
<td>over £40K</td>
<td>119</td>
<td>4</td>
<td>80</td>
<td>3</td>
<td>65</td>
<td>3</td>
</tr>
<tr>
<td>over £50K</td>
<td>84</td>
<td>3</td>
<td>60</td>
<td>2</td>
<td>49</td>
<td>2</td>
</tr>
</tbody>
</table>

*These include basic awards which would not be affected by the cap so are indicative only and likely to be an overestimate.

Risks

There is a small risk that there would be a reduction in the deterrent effect resulting from lowering the cap (as it is non-compliant businesses who will benefit financially from this). We believe this is highly unlikely given that median and mean awards are much lower than the cap and are already published (this has been introduced into employment tribunal guidance). In addition the process of dealing with an ET claim is a deterrent in itself, especially including the costs and reputational risk to employers of an employment tribunal claim.

If the cap is reduced then there is a risk, which a number of trade unions and legal representative respondents to the ETER consultation raised, that some claims will move into other, uncapped jurisdictions, such as discrimination or unfair dismissal claims where compensation is uncapped, i.e. health and safety and whistle-blowing, however as there are so few claims that are likely to be near the cap anyway, and as unfair dismissal is already capped this is likely to be limited to a small number of cases. Many claimants already claim under more than one jurisdiction already. There were on average 1.73 jurisdictional claims per case in 2011/2012 (ETS annual report 2011/2012).

There is a risk that some claimants may take a breach of contract claim to the civil courts rather than go to employment tribunal if they believe that they are owed more than they would be likely to be awarded at employment tribunal. This would only apply to claimants who believe they may receive an award which is above or near the cap and who have the grounds to bring a breach of contract claim. The number of claimants who are awarded an amount above or near the proposed cap levels is as illustrated above very small. There are disincentives to claimants to pursue claims in the civil courts. The risk to the claimant is greater in the civil courts as they are more likely to order the claimant to pay the employer’s costs if they lose than employment tribunals, and costs are capped in employment tribunals but are not in the Civil Courts.

Including a limit of individuals’ annual salary to the cap risks adding an element of increased complexity to the cap. The Ending the Employment Relationship consultation, however, did not indicate that this was a concern. The definition of ‘week’s pay’ that would be used to calculate the cap is well-established.
Rationale and evidence that justify the level of analysis used in the IA

There are a relatively small number of employment tribunal claims, compared to the number of employees in the UK. Only a very small proportion of these end up in tribunal and are awarded compensation. The vast majority of the awards that are made are far beneath the cap and so would not be affected by a reduction of the cap to any of the proposed levels.

Direct costs and benefits to business (following OIOO methodology)

The proposed changes to the award cap would only affect the awards made where claimants are successful at employment tribunal. As such this would be out of scope for one-in-one-out purposes.

Wider impacts

We are unable to determine whether a reduction of the cap or the introduction of a limit linked to earnings would have a disparate impact on any particular group which shares a protected characteristic. An Equalities Impact Assessment is included at Annex A.

The proposal does not impose costs on any business, and therefore there is no risk of disproportionate costs to small businesses. As a result a micro-business exemption is not considered.

Summary

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.

On balance, however, the benefits and support for the introduction of an earnings based cap outweigh the possible risks and disadvantages. Therefore, subject to Parliamentary process, the Government intends to introduce an earnings’ based cap on the compensatory award for unfair dismissal.
Annex A: Equality impact assessment

Equalities

The Department for Business, Innovation and Skills (BIS) is subject to the public sector duties set out in the Equality Act 2010. Equality Impact Assessments are an important mechanism for ensuring that we gather data to enable us to identify the likely positive and negative impacts that policy proposals may have on certain groups and to estimate whether such impacts disproportionately affect such groups. In developing policy the Government is legally required by the Equality Act 2010 to consider the impact on individuals with protected characteristics: age, disability, gender, pregnancy and maternity, race and nationality, religion or belief, transgender and sexual orientation.

Scope of the EQIA

This Equality Impact Assessment accompanies the Economic Impact Assessment looking at the level of the cap on unfair dismissal compensatory awards. The measure aims to bring the cap more in line with average earnings.

The unfair dismissal protections have a two year qualification period. So any change to the cap could potentially affect anyone who has been in employment for at least two years or anyone with a claim for automatically unfair dismissal. However, it is important to note that the majority of claims are unlikely to be affected as the majority of awards are well below the lowest level the cap could be reduced to, and well below typical annual salaries.

Background

The personal characteristics of employment tribunal claimants were collected in the Survey of Employment Tribunal Applications (SETA) 2008\(^1\). Results from SETA are compared to the Labour Force Survey employee results to see how the characteristics of employment tribunal claimants, and specifically unfair dismissal claimants differ to the general population of employees.

However, it is not possible to identify and assess the characteristics of those claimants who received compensatory awards above their annual earnings or above the illustrative levels of cap used in the economic impact assessment. The sample sizes in SETA are too small for this breakdown to be reliable and there is no other data which records the protected characteristics of those receiving compensatory awards (or the value of those awards) in unfair dismissal cases.

To put into context the following information there have recently been around 50,000 unfair dismissal claims per year. This works out as about 0.2% of all those in employment\(^2\). There were 2309 awards for unfair dismissal in financial year 2010/2011, about 5% of unfair dismissal claims\(^3\).

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1 http://www.bis.gov.uk/assets/biscore/employment-matters/docs/10-756-findings-from-seta-2008
2 Based on LFS data.
Gender

60% of employment tribunal claimants and 65% of UD claimants in SETA 2008 were male. This is higher than the proportion in the workforce as a whole (51 per cent), as given in the LFS.

Men are also more likely to earn higher annual salaries than women so they may be more likely to be affected by a reduction in the cap, for example 13% of men earn over £50,000 a year compared to only 6% of women (based on gross full-time annual salary data from ASHE 2012).

Ethnicity

91% of UD claimants in SETA were white. This is the same as the workforce in general in 2008 where 91% of LFS respondents reported being white, 4% of UD claimants were black, compared to 1% in the workforce, 3% Asian compared to 5% in the workforce and 1% mixed race compared to 2% in the workforce. Eighty-six per cent of employment tribunal claimants across all jurisdictions were white, 5% black, 5% Asian, 2% mixed race and 2% other.

Disability

In SETA 2008 twenty per cent of unfair dismissal claimants and 22% of employment tribunal claimants overall had a long-standing illness, disability or infirmity at the time of their employment claim, which is very close to the proportion among employees in general (22 per cent) Twelve per cent had a long-standing illness, disability or infirmity that limited their activities in some way, again similar to the workforce as a whole (10 per cent) and slightly lower than employment tribunal claimants overall (15 per cent).

Age

47% of respondents on the SETA (2008) claimant survey were 45+, compared to 38% of respondents to the Labour Force Survey and this was higher still for claimants whose primary jurisdiction was unfair dismissal at 52%.

This may be because older people are less likely to find another job quickly after leaving one. ONS redundancy figures show that in 2012 Q4 the re-employment rate for individuals aged 50+ was 21.9% 3 months after being made redundant, 11% lower than for all aged 16+ (32.9%). If re-employment rates are still lower for individuals aged 50+ one year after leaving a job then they may be adversely affected by a cap based on annual salary as their losses may be greater than for one year. However this analysis is not possible due to the methodology used in LFS.

Average earnings are highest between 30 – 50 (30-39 year olds had a median salary of £28,568 and mean of £33,550 and 40 – 49 years a median salary of £29,791 and £36,922). See table below.

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4 ONS redundancy figures 2012, based on ONS analysis of LFS data. (http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=Redundancies+by+Region)
5 This trend is present in previous quarters and years where there is data available.
6 LFS is a rotating panel survey based on 5 quarters and lot of people would have ‘rotated out’ of the panel 1 year after having been made redundant.
7 Source: ASHE 2012 provisional figures.
Table A1: Median and mean salaries by age

<table>
<thead>
<tr>
<th>Description</th>
<th>Median</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>All employees</td>
<td>25,882</td>
<td>32,204</td>
</tr>
<tr>
<td>18-21</td>
<td>13,532</td>
<td>14,398</td>
</tr>
<tr>
<td>22-29</td>
<td>20,901</td>
<td>23,227</td>
</tr>
<tr>
<td>30-39</td>
<td>28,568</td>
<td>33,550</td>
</tr>
<tr>
<td>40-49</td>
<td>29,791</td>
<td>36,922</td>
</tr>
<tr>
<td>50-59</td>
<td>27,744</td>
<td>35,331</td>
</tr>
<tr>
<td>60+</td>
<td>24,715</td>
<td>31,382</td>
</tr>
</tbody>
</table>

Religion/belief

SETA 2008 results showed that 46 per cent of claimants regarded themselves as belonging to a religion. Forty per cent of all claimants regarded themselves as Christian. Six per cent of all claimants regarded themselves as belonging to a religion other than Christianity (Muslim 2.4%, Hindu 1.2%, Sikh, Jewish, Buddhist and other answers were all under 1%). Similar figures were found for Unfair Dismissal claimants where 44% regarded themselves as belonging to a religion, 40% Christianity, 4% other and 54% no religion, 1% refused to answer. Comparisons with LFS cannot be made because of the difference in phrasing of the questions about religion/religious beliefs between the two surveys.

It is not possible to look at employment tribunal claimant characteristics in terms of gender reassignment, marriage and civil partnership, pregnancy and maternity, and sexual orientation because the data is not available to make comparisons.

Summary

The data indicates that certain groups who share a protected characteristic are more likely to bring an unfair dismissal claim than other groups (e.g. men more likely to bring a claim than women, those over 45 years old more likely to bring a claim than those under 45 years). However, the data does not tell us the protected characteristics of those claimants who were successful at the Employment Tribunal. Similarly, the data does not tell us what protected characteristics were present in those claimants who received certain levels of award (e.g. we do not know how many of the compensatory awards above £30,000, £40,000, or £50,000 were awarded to men and how many to women). As a result, we are unable to determine whether a reduction of the cap or the introduction of a limit linked to earnings would have a disparate impact on any particular group which shares a protected characteristic. However, as the Economic Impact Assessment notes, the vast majority of awards currently made are below the proposed levels for a reduced cap and therefore the impact on claimants will be slight in any event.

The Government recognises that those aged between 30 and 50 years old are likely to earn more than those who are of a different age. It could be considered that this suggests that individuals in that age group are more likely to receive higher compensatory awards for unfair dismissal claims – as a large element of any compensatory award is loss of earnings – but there is no evidence to show that that is the case or that individuals in that age group are likely (or more likely than those in other groups) to receive compensatory awards in excess of the illustrative caps set out in the Economic Impact Assessment. As a result, the Government does not think that the reduction of the cap would lead to a disparate impact on employees in that age bracket.
Several responses, from trade unions and legal representatives, to the consultation highlighted that certain groups, including older and younger workers and the disabled, may be systematically more likely to take longer than 12 months to find a new job following an unfair dismissal, in which case a 12 months’ salary cap may have a disproportionate negative impact. However, it should be stressed that awards can often be much lower than lost earnings, and that therefore the cap may not come into play even where a claimant has not been in employment for over 12 months. 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’ earnings, 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.