

**UNFAIR DISMISSAL  
COMPENSATORY AWARDS:**

Impact assessment

SEPTEMBER 2012

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<b>Title:</b> <b>Unfair Dismissal Compensatory Awards</b> IA No: BIS0356 <b>Lead department or agency:</b> BIS <b>Other departments or agencies:</b> HM Courts and Tribunals Service	<b>Impact Assessment (IA)</b> Date: 01/06/2012 Stage: Consultation Source of intervention: Domestic Type of measure: Primary legislation Contact for enquiries: Simon Rowley
<b>Summary: Intervention and Options</b>	
<b>RPC: RPC Opinion Status</b>	

Cost of Preferred (or more likely) Option					
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, One-Out?	Measure qualifies as	
£m	£m	£0m	No	NA	

**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.

**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.

<b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 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.		<b>Micro No</b>	<b>&lt; 20 No</b>	<b>Small No</b>	<b>Medium No</b>	<b>Large No</b>
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			<b>Traded:</b> N/A		<b>Non-traded:</b> 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.*

*cb Quinlan*

Signed by the responsible SELECT SIGNATORY:

Date: 10/09/2012

# Summary: Analysis & Evidence

# Policy Option 1

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

## FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m) N/Q		
			Low: Optional	High: Optional	Best Estimate:
<b>COSTS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>	<b>Total Cost (Present Value)</b>	
Low					
High					
Best Estimate					
<b>Description and scale of key monetised costs by 'main affected groups'</b>					
<p><b>Other key non-monetised costs by 'main affected groups'</b></p> <p>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.</p>					
<b>BENEFITS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>	<b>Total Benefit (Present Value)</b>	
Low	Optional		Optional	<b>Optional</b>	
High	Optional		Optional	<b>Optional</b>	
Best Estimate					
<b>Description and scale of key monetised benefits by 'main affected groups'</b>					
<p><b>Description and scale of key non-monetised benefits by 'main affected groups'</b></p> <p>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.</p>					
<b>Key assumptions/sensitivities/risks</b>				<b>Discount rate (%)</b>	
<p>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.</p>					

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs:	Benefits:	Net:	No	N/A

# Summary: Analysis & Evidence

# Policy Option 2

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

## FULL ECONOMIC ASSESSMENT

Price Base Year	PV Base Year	Time Period Years	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate:
<b>COSTS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Cost (Present Value)</b>
Low	Optional		Optional		<b>Optional</b>
High	Optional		Optional		<b>Optional</b>
Best Estimate					
<b>Description and scale of key monetised costs by 'main affected groups'</b> Maximum of 5 lines					
<b>Other key non-monetised costs by 'main affected groups'</b> 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 less claimants than Option 1.					
<b>BENEFITS (£m)</b>	<b>Total Transition (Constant Price) Years</b>		<b>Average Annual (excl. Transition) (Constant Price)</b>		<b>Total Benefit (Present Value)</b>
Low	Optional		Optional		<b>Optional</b>
High	Optional		Optional		<b>Optional</b>
Best Estimate					
<b>Description and scale of key monetised benefits by 'main affected groups'</b> Maximum of 5 lines					
<b>Other key non-monetised benefits by 'main affected groups'</b> 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.					
<b>Key assumptions/sensitivities/risks</b>					<b>Discount rate (%)</b>
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)

<b>Direct impact on business (Equivalent Annual) £m:</b>			<b>In scope of OIOO?</b>	<b>Measure qualifies as</b>
<b>Costs:</b>	<b>Benefits:</b>	<b>Net:</b>	No	N/A

# 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.

It accompanies public consultation which seeks to understand the potential impacts of a possible reduction (or change in nature) of the award cap.

## 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<sup>1</sup> 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 218,100 employment tribunal claims between 1 April 2010 and 31 March 2011 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 2010/2011 was 382,400.<sup>2</sup> The number of employment tribunal claims for the last 3 financial years available are shown in Table 1 below.

**Table 1: Number of Unfair Dismissal Claims accepted, Employment Tribunals and EAT Statistics, 2010-11**

<b>Claims accepted</b>	<b>2008-09</b>	<b>2009-10</b>	<b>2010-11</b>
Unfair Dismissal claims	52,700	57,400 <sup>3</sup>	47,900
All ET claims accepted	151,000	236,100	218,100
Total jurisdictional claims	266,500	392,800	382,400

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

<sup>1</sup> Unless the tribunal considers that it was not reasonably practicable for the claimant to have filed the claim within 3 months.

<sup>2</sup> See HMCTS Employment Tribunal and EAT Statistics 2010/2011 for more detail (<http://www.justice.gov.uk/statistics/tribunals/employment-tribunal-and-eat-statistics-gb>)

<sup>3</sup> 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 2010/2011 are shown in Table 2 below.

**Table 2: Outcomes of tribunal claims disposed of in 2010/2011**

<b>Outcome</b>	<b>Number</b>	<b>Percentage</b>
Total	49,600 <sup>4</sup>	100%
Withdrawn	12,300	25%
Acas conciliated settlements	20,500	41%
Struck out not at a hearing	5,400	11%
Successful at tribunal	4,200	8%
Dismissed at a preliminary hearing	1,400	3%
Unsuccessful at hearing	4,800	10%
Default judgement	1,200	2%

So up to 5400 claims (11%) were successful at tribunal (1200 default judgments + 4200 successful at tribunal) in 2010/2011. In 2010/2011 2608 claimants were awarded compensatory awards (ETS & EAT annual publication). The total value of awards awarded to claimants for unfair dismissal in 2010/2011 was approximately £23.4 million.

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). 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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<sup>4</sup> Please note that this is the number of claims disposed of by HMCTS. It is different from the number of claims accepted in 2010/2011 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 consultation 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. In addition, as part of the Resolving Workplace Disputes consultation, BIS has introduced clearer information on tribunal awards data such that median awards will be published on employment tribunal claim form cover sheets and in guidance.

We are already committed to changing the up-rating formula for tribunal award limits and statutory redundancy pay to curb future increases. 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.

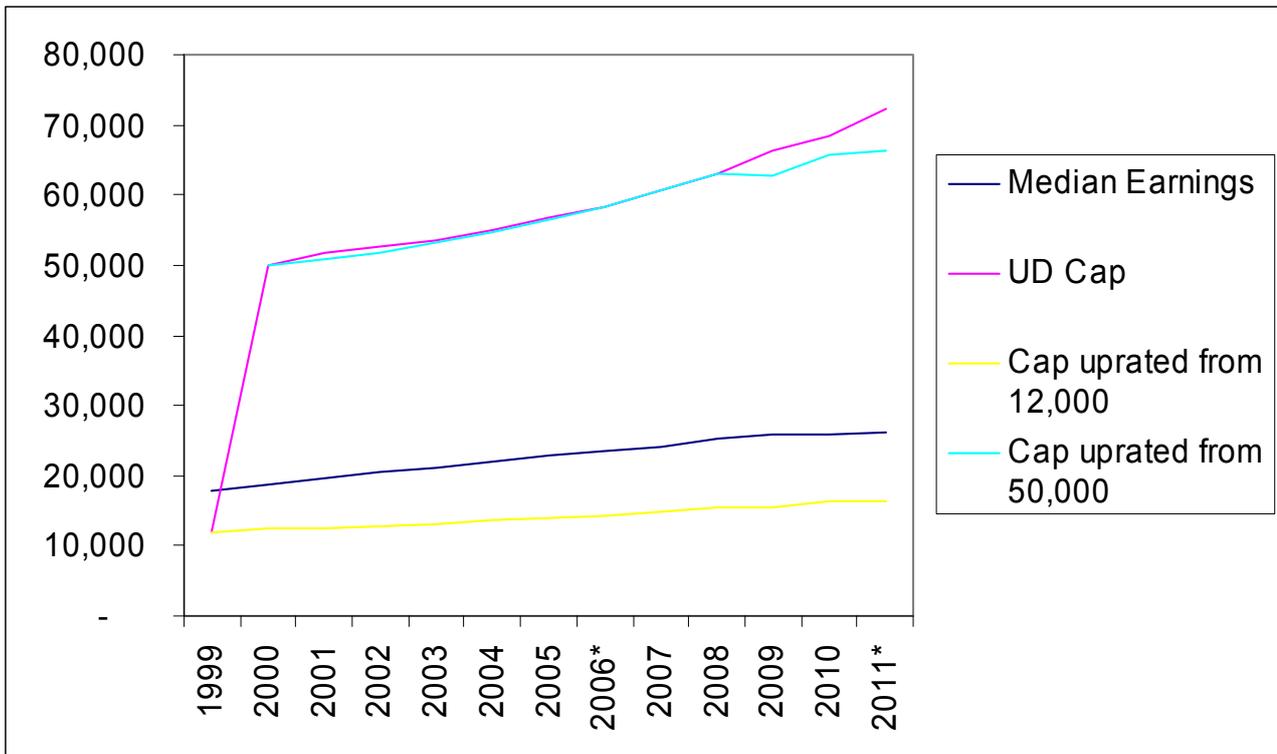
The current level of the cap on the compensatory award may lead to unrealistic expectations among both employees and employers as to the likely level of a tribunal award. The median unfair dismissal award is around £5000, and has been around £4000 - £5000 for the last 6 years (see Figure 2). The median 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 2010/2011<sup>5</sup> was under £5000 – less than 7% of the value of the cap on the compensatory award and less than 20% of the annual median wage of £25,882. 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. Which includes the introduction of median awards on claim form cover sheets and in guidance.

A literature review for BIS on understanding the behaviour of employees in workplace conflicts<sup>6</sup> suggests that expectations of the outcome of a 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 is helpful. This is already taking place in forthcoming changes to ET1 forms (these will in future display the median awards)"

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<sup>5</sup> Most recent published figure from Employment Tribunal and EAT statistics. Available at <http://www.justice.gov.uk/statistics/tribunals/employment-tribunal-and-eat-statistics-gb>.

<sup>6</sup> as reported in <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/u/11-918-understanding-behaviour-employees-conflicts-at-work>

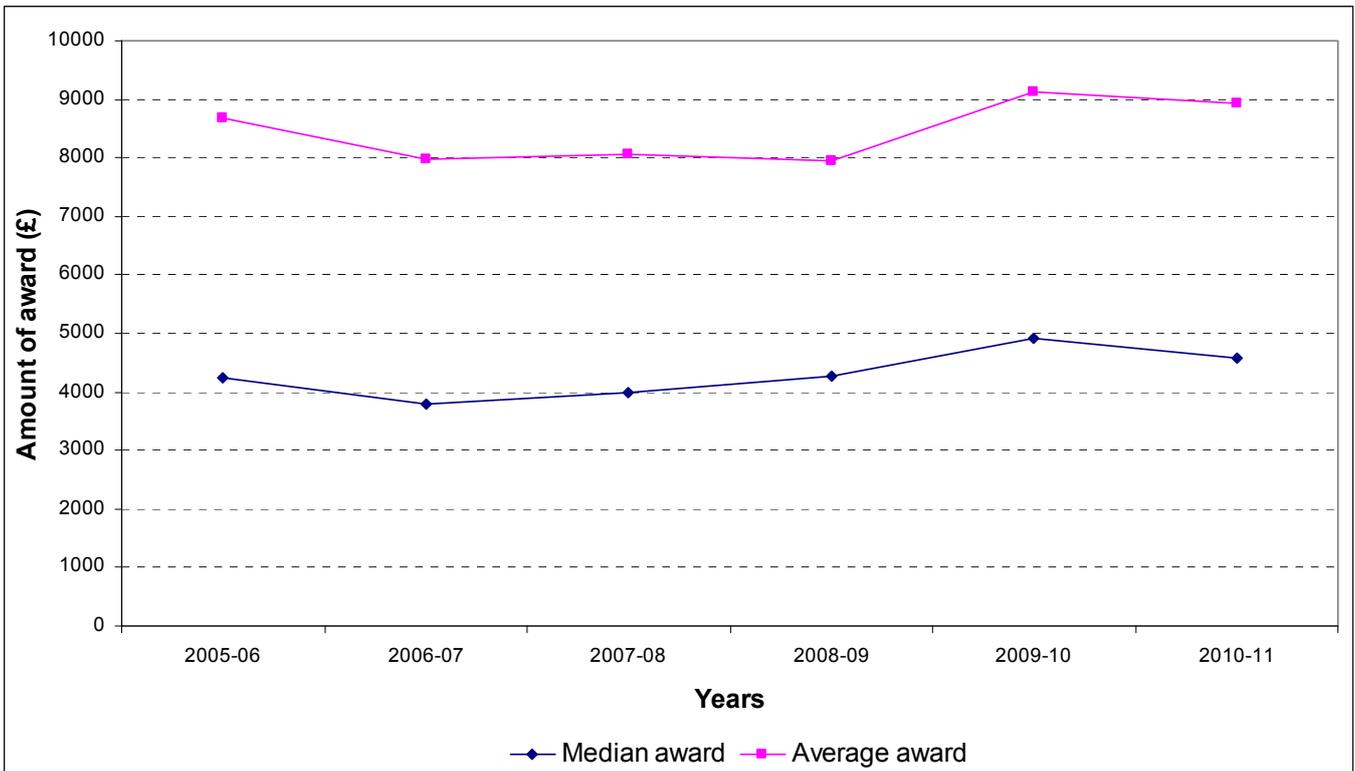


**Figure 1: The unfair dismissal compensatory award cap compared to median earnings and previous cap levels up-rated to 2011 values.**

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 2.77 times median annual salary (based on 2011 provisional figure of £26,093<sup>7</sup>), 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 £25,882)<sup>8</sup> and three times gross full time annual median earnings (currently £77,646).

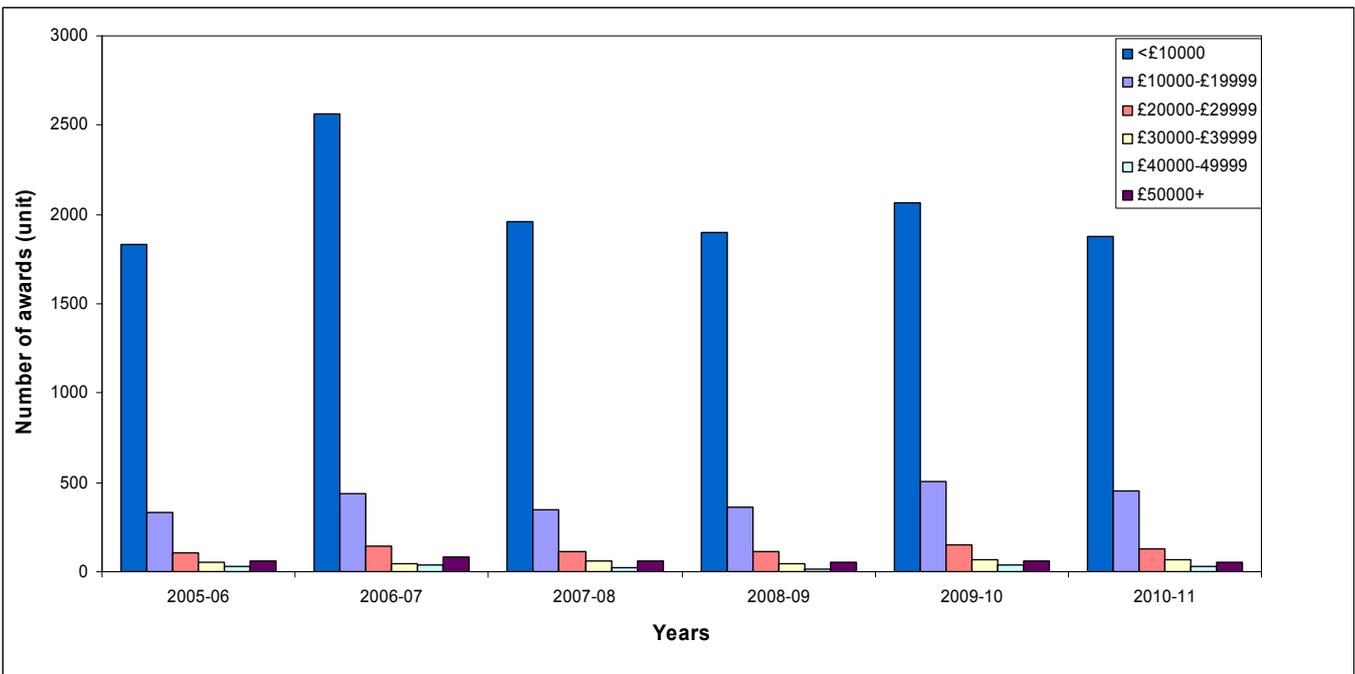
<sup>7</sup> Source: ASHE 2011 provisional estimates.

<sup>8</sup> Source: ASHE 2010 revised figures.



**Figure 2: Median and mean awards at employment tribunal for unfair dismissal, 2005/2006 to 2010/2011. \* Source ET/EAT statistics annual report.**

The distribution of awards is shown in Figure 3. The majority of awards are well below the current cap.<sup>9</sup> For example 94% of awards were below £30,000 and 98% of awards were below £50,000 in financial year 2010/2011 (similar figures for 2009/2010). There were 2608 awards made for unfair dismissal in total in 2010/2011.<sup>10</sup>



**Figure 3: Numbers of awards given by employment tribunals from 2005/2006 to 2010/2011 by the level of award.<sup>11</sup>**

<sup>9</sup> 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.

<sup>10</sup> 2886 awards were made for unfair dismissal in 2009/2010 and there were 2490 in 2008/2009.

<sup>11</sup> Data shown is for 2010/2011, distributions were similar for years 2006/2007 to 2009/2010 as well.

The cap is also high compared to annual earnings (loss of earnings is a major component of the unfair dismissal compensatory award). The 90<sup>th</sup> 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 5%<sup>12</sup>). Earnings data are shown in Table 3.

**Table 3: Distribution of Annual Full-Time Gross Pay 2010**

Percentile	10	20	30	40	50	60	70	80	90
Pay (£)	14,009	17,000	19,756	22,606	25,882	29,575	33,976	39,916	51,666

\* Source ASHE, ONS 2011 (2010 revised results)<sup>13</sup>

## 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. We also want to consider whether evidence points to changes that would improve the efficiency of the existing Government intervention.

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).

## 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.
- 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.

## Description of proposals being considered

### (A) Do nothing

<sup>12</sup> BIS estimate based on ASHE 2010 data.

<sup>13</sup> <http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2010-revised-results/index.html>

The cap will remain unchanged (but the formula by which it is up-rated will be amended in this 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. We intend to implement the new formula in 2013.

As discussed on page 2, the Resolving Workplace Disputes proposals mean that Employment Tribunal forms will soon 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 but we would welcome views on what stakeholders consider to be an appropriate level for a flat rate cap.

*The basic award would be unaffected by all of the above options. Options 2 and 3 could be implemented either separately or in combination. Any change would also not affect certain unfair dismissal claims where compensation is uncapped, i.e. health and safety and 'whistleblowing' claims.*

## **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).**

### **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.

We are seeking evidence through consultation as to whether this would also lead to more realistic expectations of the levels of awards and therefore help encourage the settlement of disputes outside the tribunal. Table 4 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<sup>14</sup>.

**Table 4: Percentage of employees and Unfair Dismissal Claimants earning less than £30,000, £40,000 and £50,000**

	Employees (including part-time employees) earning less than level <sup>15</sup>	UD claimants in SETA earning less than level <sup>16</sup>
£72,300	95%	99%
£50,000	91%	96%
£40,000	85%	90%
£30,000	71%	80%

### 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 (£25,882)).

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 (90 – 96% based on ASHE 2010 and SETA 2008 data, see Table 4) 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 71% 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 £25,882.

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

There is no expected cost to the exchequer of either Option 1 or Option 2.

<sup>14</sup> Both SETA 2008 and ASHE 2010 revised figures are shown because SETA 2008 figures are now slightly out of date.

<sup>15</sup> From ASHE 2010 revised figures (ONS 2011)

<sup>16</sup> From SETA 2008. Rounded to the nearest per cent.

## 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 £26000 for full-time employees, around £21,000 for all employees including part-time employees). In fact median awards are below the 10<sup>th</sup> percentile of earnings of all employees (including part-time employees) which is £6,476 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 cap. The percentage of claimants who received an award which that were awarded above £30,000 compensation for unfair dismissal has been 5 – 6% for the past 6 years (around 0.3% 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 who were awarded above £50,000 has been between 2 and 3 percent for the last 6 years (about 0.1% 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 5: Number of awards over £30,000, £40,000 and £50,000 from 2005-2006 to 2010-2011**

2005-06		2006-07		2007-08		2008-09		2009-10		2010-11	
No	%										

All	2410	100	3309	100	2552	100	2490	100	2886	100	2608	100
over £30K	141	6	167	5	137	5	113	5	169	5	153	6
over £40K	92	4	119	4	80	3	65	3	100	3	82	3
over £50K	62	3	84	3	60	2	49	2	62	2	51	2

\*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 (and 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 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 1.75 jurisdictional claims per case in 2010/2011 (ETS annual report 2010/2011).

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.

## 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)

If a change were made to the unfair dismissal award cap, this 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.**

Government is consulting 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. Government will also consider the introduction of a cap on individual awards related to a multiple of earnings, which would not be less than 52 weeks' pay. At this stage there is not a preferred option, Government needs to consider evidence from stakeholders in coming to a decision.

## 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<sup>17</sup>. 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<sup>18</sup>. There were 2608 awards for unfair dismissal in financial year 2010/2011, about 5% of unfair dismissal claims<sup>19</sup>.

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<sup>17</sup> <http://www.bis.gov.uk/assets/biscore/employment-matters/docs/10-756-findings-from-seta-2008>

<sup>18</sup> Based on LFS data.

<sup>19</sup> Employment Tribunal and EAT statistics 2010/2011.

## 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).

## 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<sup>20</sup> 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%).<sup>21</sup> 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<sup>22</sup>.

Average earnings are highest between 30 – 50 (30-39 year olds had a median salary of £28,203 and mean of £33,880 and 40 – 49 years a median salary of £28,892 and £36,476).

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<sup>20</sup> ONS redundancy figures 2012, based on ONS analysis of LFS data.  
(<http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=Redundancies+by+Region>)

<sup>21</sup> This trend is present in previous quarters and years where there is data available.

<sup>22</sup> 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.

See table below.<sup>23</sup>

**Table A1: Median and mean salaries by age**

Description	Median	Mean
All employees	25,882	32,204
18-21	13,623	14,324
22-29	20,884	23,282
30-39	28,203	33,880
40-49	28,892	36,476
50-59	27,152	34,122
60+	23,585	29,668

## 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

<sup>23</sup> Source: ASHE 2010 figures.

not think that the reduction of the cap would lead to a disparate impact on employees in that age bracket.

## 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.

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## Background

Personal characteristics of employment tribunal claimants were collected in Survey of Employment Tribunal Applications (SETA) 2008<sup>24</sup>. 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. It is not possible to look at characteristics of unfair dismissal claimants receiving awards above their annual earning or at the illustrative levels used in the economic impact assessment as sample sizes in SETA were too small for this breakdown to be reliable.

## 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 the overall 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).

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Any enquiries regarding this publication should be sent to:

Department for Business, Innovation and Skills  
1 Victoria Street  
London SW1H 0ET  
Tel: 020 7215 5000

If you require this publication in an alternative format, email [enquiries@bis.gsi.gov.uk](mailto:enquiries@bis.gsi.gov.uk), or call 020 7215 5000.

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