

EXPLANATORY MEMORANDUM TO
THE UNFAIR DISMISSAL (VARIATION OF THE LIMIT OF
COMPENSATORY AWARD) ORDER 2013

2013 No. 1949

1. This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This Order introduces an additional cap on the compensatory award for unfair dismissal claims. This cap is based on 12 months of an individual's pay and would exist alongside the current overall cap. The applicable cap in an individual case would be the lower of the two.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Legislative Context

4.1 This instrument is the first use of the power under section 15(1) of the Enterprise and Regulatory Reform Act 2013 ("ERR Act"), which allows the Secretary of State to vary the limit on the compensatory award for unfair dismissal in two ways.

4.2 The first way is to change the level of the overall cap, currently £74,200. The overall cap cannot be changed to a level that is less than median annual earnings, or more than three times median annual earnings. Median annual earnings is determined by the most recent figure published by the Statistics Board (see sections 15(4) and 15(9) of the ERR Act). At this time, that figure is £26,095 (see <http://www.ons.gov.uk/ons/rel/ashes/annual-survey-of-hours-and-earnings/2011-provisional-results--soc-2010-/stb---ashes-results-2011--soc-2010-.html>).

4.3 The specified amount of £74,200 inserted by the Order (new section 124(1ZA)(a) of the Employment Rights Act 1996) complies with this restriction as it is greater than £26,095 but below £78,285 (3 x 26,095).

4.4 The second way is to introduce a cap based on a multiple of an individual's weekly pay. This variation is also limited, in that this multiple cannot be less than 52 (see section 15(5) of the ERR Act). The Order also complies with this requirement, as the cap is based on 52 weeks of pay (new section 124(1ZA)(b) of the Employment Rights Act 1996).

4.5 Concerns were raised during the ERR Bill's passage through Parliament about the impact of introducing a cap based on pay (see, for example Enterprise and Regulatory Reform Bill Deb, 3 July 2012, c329 - c347). These concerns included introducing a separate cap for small businesses or, a pay based cap without a specified overall cap. There was explicit reassurance that neither of these uses was intended and that use of the power would be developed following a consultation (Enterprise and Regulatory Reform Bill Deb, 3 July 2012, c361). Section 8 of this Memorandum discusses objections to the pay based cap in more detail, as those concerns mirrors those raised in Parliament.

5. Territorial Extent and Application

5.1 This instrument applies to Great Britain.

6. European Convention on Human Rights

The Parliamentary Under Secretary of State for Employment Relations and Consumer Affairs, *Name*, has made the following statement regarding Human Rights:

In my view the provisions of the Unfair Dismissal (Variation of the Limit of Compensatory Award) Order 2013 are compatible with the Convention rights.

7. Policy background

7.1 This Government committed, through the Employment Law Review, to undertake a Parliament-long review of employment law, with the goal of ensuring the United Kingdom's labour market is fair, flexible, and effective. Part 2 of the Enterprise and Regulatory Reform Act 2013 was developed to address several issues identified by this review. Section 15 gives the Secretary of State the power to vary the limit on awards for unfair dismissal.

7.2 The Order is being used to introduce a pay based cap. This additional cap is intended to address unrealistic perceptions of the level of award that can be expected in unfair dismissal claims. The existing cap was subject to a large increase in 1999 and has risen by more than inflation since. At £74,200, it is greatly in excess of the median award, which has been around £5,000 for the last 7 years.

7.3 Claimants, with widely varying circumstances, may expect £74,200 at tribunal when in reality awards are rarely anywhere near this amount. The perception created by this gap means employers are less likely to take on staff, for fear of being liable for huge sums.

7.4 The Government has concluded, after public consultation and considering various options, that changing the legislation is the most effective means of addressing this issue. Simply publicising the information about average levels of award does not impact on perception and expectation as long as the legislation still permits for a very high level of award. This legislative

change strikes the appropriate balance between providing a fair compensation to employees and creating an environment which gives businesses the confidence to take on staff.

8. Consultation outcome

8.1 The *Ending the Employment Relationship* Public Consultation, issued on 14 September, sought views on the appropriateness of the current level of the cap and the introduction of a pay based cap. The consultation closed on 23 November and received over 170 responses.

8.2 The Government Response to the consultation was published on 17 January 2013 and can be found at - <https://www.gov.uk/government/consultations/ending-the-employment-relationship>. There was broad support for introducing a pay based cap.

8.3 Of the 119 respondents who answered, 48% were in favour of the introduction of a cap based on 52 weeks' pay, 45% were opposed and 7% were not sure. Three of the respondents did not favour the proposal, however, based on that fact that 52 weeks was too long. If these respondents were considered as in favour of this cap (but just concerned about the number of weeks' chosen), then overall 50% of all respondents would have favoured the introduction of a pay cap; comprising of 95% of all of the business respondents. Trade unions opposed the notion of any cap on awards based on principle (including the overall cap), while around 2/3 of legal representatives opposed it.

8.4 Those opposed, both in Parliamentary debates and consultation responses, raised several concerns. The first is that perceptions are not unrealistic. The Government, however, is convinced by the balance of the evidence that they are. For example, in the most recent Survey of Employment Tribunal Applications, 38% of unfair dismissal claimants surveyed expected to receive at least £10,000, and of those, 37% expected at least £25,000 (14% overall).

8.5 There have also been concerns that introducing a pay based cap would mean individuals are not adequately compensated for their losses when making an unfair dismissal claim. All Governments have agreed that a cap on unfair dismissal is necessary since its introduction in 1971. Inevitably, such a cap risks negatively impacting some claimants who would have received more. The pay based cap is intended to strike the balance between minimising the number of claimants negatively impacted and ensuring that the cap is fair and provides enough certainty for employers. Using previous award levels, the Government has estimated that only about 5% of successful unfair dismissal claims would be affected by a 52 weeks pay cap.

8.6 Individuals who opposed a 52 weeks' pay cap also felt that lowering the cap might lead to more claims in other jurisdictions being brought, such as discrimination claims which are uncapped. There is no specific evidence which indicates this would happen; moreover, the majority of unfair dismissal

claims are already brought with other claims, so it would appear that the current system of cap does not prevent or discourage individuals from taking uncapped claims alongside unfair dismissal claims.

8.7 On balance, the Government takes the view that the benefits and support for the introduction of a pay based cap, set at 52 weeks pay, outweigh the possible risks and disadvantages which respondents, MPs, and Lords raised.

9. Guidance

9.1 This instrument does not require stakeholders to fulfil a new obligation. The change will be communicated widely so that all who may be affected are aware of it. BIS will use appropriate communication channels and press avenues to publicise the change.

10. Impact

10.1 The impact on business, charities or voluntary bodies is nil in cost, and the only possible impact is being liable for a smaller amount if an unfair dismissal claim is brought against them.

10.2 The impact on the public sector is the same as 10.1.

10.3 An Impact Assessment of this pay based cap was published on 17 January 2013 as part of the Government Response to the Ending the Employment Relationship Consultation and is attached to this memorandum. It will be published alongside the Explanatory Memorandum on the OPSI website.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 This instrument does not impose additional burdens on businesses, therefore there is no need to minimise the impact of the requirements on firms employing up to 20 people.

12. Monitoring & review

12.1 We are developing an overarching monitoring and review plan for the measures in the Enterprise and Regulatory Reform Act, including evaluating the impact of this measure.

13. Contact

Kara Allen at the Department for Business, Innovation and Skills Tel: +44 (0) 20 7215 6590 or email: kara.allen@bis.gsi.gov.uk can answer any queries regarding the instrument.