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|--|---|--|--|--|--|--|
| <b>Title:</b><br>The Equality Act 2010 (Equal Pay Audits) Regulations 2014<br><b>IA No:</b><br><b>Lead department or agency:</b><br>Government Equalities Office, Department for Culture Media and Sport<br><b>Other departments or agencies:</b><br>Business Innovation & Skills, Ministry of Justice | <b>Impact Assessment (IA)</b>                 |  |  |  |  |  |
|  | <b>Date:</b> 28/01/2014                       |  |  |  |  |  |
|  | <b>Stage:</b> Final (Fast track)              |  |  |  |  |  |
|  | <b>Source of intervention:</b> Domestic       |  |  |  |  |  |
|  | <b>Type of measure:</b> Secondary legislation |  |  |  |  |  |
| <b>Contact for enquiries:</b><br>Yemi Atiku / Evelyne Doh<br>Tel: 0207 211 6967 / 6388   |   |  |  |  |  |  |

|  |                           |
|--|---------------------------|
| <b>Summary: Intervention and Options</b> | <b>RPC Opinion: GREEN</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, Two-Out? Measure qualifies as |
| £-0.13M                                   | £-3.25M                    | £0.34M   | No   N/A  |

**What is the problem under consideration? Why is government intervention necessary?**  
Women continue to experience substantial differences in pay compared to their male colleagues doing like work, equivalent work or work of the same value. Despite a legal framework on equal pay being in force since 1975, some employers are either still not familiar with the law, or are deliberately choosing to flout it by paying their female employees less. The effects of such inequality include the restriction of women's contribution to economic growth, and to some extent, the on-going gender pay gap. The 2013 ONS statistics estimated that women working full-time were still paid on average 10% less than their male counterparts. The Government aims to address this by introducing regulations under powers contained in the Equality Act 2010 ("the 2010 Act") which will be applicable only where an employer is found by an Employment Tribunal to have committed an equal pay breach (i.e. a breach of equal pay law and/or sex discrimination law relating to pay)


**What are the policy objectives and the intended effects?**  
The overall objective of the regulations is to ensure that in the very rare cases where a tribunal makes a finding of an equal pay breach, employers will be required to fully consider their pay policies and structures and draw up an action plan to rectify any discriminatory pay differences that may exist. This will result in fewer future breaches and will consequently reduce the number of equal pay claims brought against employers. These regulations will supplement the voluntary business-led approach to gender equality reporting as outlined in the *Think, Act, Report*<sup>1</sup> initiative which seeks to promote greater transparency on key issues in the workplace such as recruitment, retention, promotion and pay.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**  
The Government has introduced the voluntary Think, Act, Report initiative, but believes that it is right that those few employers who are found to have committed an equal pay breach should be required to undertake mandatory equal pay audits, subject to a number of specified circumstances.  
**Option 1: Do nothing:**  
**Option 2: (Preferred): Require an employment tribunal to require an employer to carry out an equal pay audit except in particular circumstances specified in the primary legislation:** This would target intervention only in cases where there is shown to be a need for corrective action after an employer has been found to be in breach of equal pay law.

|  |  |                    |                       |                       |                           |
|--|--|--------------------|-----------------------|-----------------------|---------------------------|
| <b>Will the policy be reviewed?</b> It will be reviewed. <b>If applicable, set review date:</b> 2019                   |  |                    |                       |                       |                           |
| 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</b><br>No | <b>&lt; 20</b><br>Yes | <b>Small</b><br>Yes   | <b>Medium</b><br>Yes      |
| What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent) |  |                    |                       | <b>Traded:</b><br>N/A | <b>Non-traded:</b><br>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.**

<sup>1</sup> <https://www.gov.uk/government/policies/creating-a-fairer-and-more-equal-society/supporting-pages/think-act-report>

Signed by the responsible SELECT SIGNATORY:  Date: 19 June 2014

# Summary: Analysis & Evidence

# Policy Option 2

**Description:** Require an Employment Tribunal to require an employer to carry out an equal pay audit only where an equal pay breach is established and an exception does not apply.

## FULL ECONOMIC ASSESSMENT

| Price Base<br>Year 2013 | PV Base<br>Year 2013 | Time Period<br>Years 10 | Net Benefit (Present Value (PV)) (£m) |             |                      |
|-------------------------|----------------------|-------------------------|---------------------------------------|-------------|----------------------|
|                         |                      |                         | Low: -0.17                            | High: -0.08 | Best Estimate: -0.13 |

| COSTS (£m)    | Total Transition<br>(Constant Price) Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Cost<br>(Present Value) |
|---------------|--|---|-------------------------------|
| Low           | 0.1  | 0.4   | 3.5                           |
| High          | 0.1  | 0.4   | 3.5                           |
| Best Estimate | 0.1  | 0.4   | 3.5                           |

### Description and scale of key monetised costs by 'main affected groups'

A small transitional cost to the Tribunals Service of implementing these proposals has been estimated as at most £100,000. Annually recurring costs to private and voluntary sector employers whose settlement behaviour is affected by the increase in the expected cost of proceeding to a hearing of £375-379,000. The annually recurring cost of remedy hearings to the Exchequer is estimated at £16-19,000. The increased costs to employers are incurred only by those choosing to settle an equal pay case, and are therefore the result of implied non-compliance with equal pay law. Hence, this measure is out of scope for the purposes of OITO.

### Other key non-monetised costs by 'main affected groups'

Cost of required equal pay audits or remedy hearings to employers are not included as these would only be incurred by those found to have committed an equal pay breach and which were unable to rely on an exception.

| BENEFITS (£m) | Total Transition<br>(Constant Price) Years | Average Annual<br>(excl. Transition) (Constant Price) | Total Benefit<br>(Present Value) |
|---------------|--|---|----------------------------------|
| Low           | N/A  | 0.4   | 3.3                              |
| High          | N/A  | 0.4   | 3.5                              |
| Best Estimate | N/A  | 0.4   | 3.4                              |

### Description and scale of key monetised benefits by 'main affected groups'

As a result of the impact on employer settlement behaviour, both in terms of higher settlement payments and a reduction in the number of claims progressing to a hearing, there will be benefits to the following groups:

Individuals: Annually recurring - £375-379,000 from settlements

Exchequer: Annually recurring - £8-21,000 from fewer tribunal hearings.

### Other key non-monetised benefits by 'main affected groups'

The principal benefits of this measure are where the requirement to carry out an equal pay audit identifies discriminatory pay differentials, which will require an action plan to be drawn up to address them. This would provide a benefit both to the employee and the employer, since where equal pay audits identify widespread pay inequality that was not previously known of or expected this will help employers avoid future equal pay claims, where appropriate remedial action is taken, and will ensure that male and female employees are all paid equally for like work.

### Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The possibility of an equal pay audit being required following a finding of an equal pay breach increases the ability of the claimant to negotiate a higher settlement award from an employer.

There will be a reduction in the number of claims proceeding to a hearing by 10-25% as a result of the increase in incentive for employers to reach settlement.

Due to the exceptions provided in the legislation, no more than 25% of equal pay claims that are successful at tribunal against private or voluntary sector employers will result in an equal pay audit being required.

## BUSINESS ASSESSMENT (Option 1)

| Direct impact on business (Equivalent Annual) £m: |     |           |   | In scope of OITO? | Measure qualifies as |
|---|-----|-----------|---|-------------------|----------------------|
| Costs:  | 0.3 | Benefits: | 0 |                   |                      |
|   |     |           |   | No                | N/A                  |

## Evidence Base (for summary sheets)

- **Introduction**

The proposals to promote gender equality and transparency in pay matters have been the subject of two public consultations. The first consultation, the *Modern Workplaces: Equal Pay Consultation* (<http://webarchive.nationalarchives.gov.uk/+http://www.bis.gov.uk/Consultations/modern-workplaces>) was launched in 2011 and received 116 responses. Respondents to this consultation agreed with the fundamental principle that equal pay audits were an effective method of improving transparency following a tribunal finding of an equal pay breach. However, respondents had doubts about the effectiveness of the proposals because they felt that the possibility of a mandatory equal pay audit would rather drive employers to settle cases than face a hearing and possible further legal action. The Government response to that consultation was published in June 2012 (<https://www.gov.uk/government/publications/modern-workplaces-consultation-government-response>) and agreed to a provisional second consultation on the proposed content of an equal pay audit and on publication and disclosure requirements.

The second consultation *Equal Pay Audits – A Further Consultation* launched in May 2013 and focused on the proposed content of implementing regulations, including the detail of equal pay audits, as well as other issues raised by the first consultation - <https://www.gov.uk/government/consultations/equal-pay-audits-a-further-consultation>. This received 43 responses which broadly supported Government action to introduce regulations that set out the detail of the equal pay audit process. The Government response is due to be published in Spring 2014.

- **Summary of adjustments made to the Impact Assessment resulting from the two public consultations**

This validation impact assessment takes into account a number of key points raised during the *Modern Workplaces: Equal Pay Consultation* and *Equal Pay Audits: A Further Consultation*. These include:

- Respondents suggested that previous estimated average costs of an equal pay audit were too low. To reflect those comments we increased the estimated average expected cost to £13,236 by altering assumptions, while recognising that the range of costs would be significant.
- Financial penalties were clearly the favoured option for enforcement of the equal pay audit proposal. During scrutiny of the primary legislation, the Delegated Powers and Regulatory Reform Committee which has the role of examining bills before the House of Lords recommended the provision of financial penalties for failure to comply with an equal pay audit order. This suggestion was taken on board, and specific provision has now been made in the primary legislation.

In addition, specific queries were raised by the Government's Regulatory Policy Committee during its evaluation of the previous Regulatory Triage Assessment (RPC12-FT-GEO-1671). These were:

- Consideration of the scale of impact on businesses which choose to settle cases before they reach the employment tribunal final hearing;
- Consideration of the impact on compliant businesses of undertaking voluntary equal pay audits in order to avoid the risk of being taken to a tribunal; and
- Consideration of the estimated number of audits likely to be ordered per year (currently estimated at 2).

These impacts were tested through the second consultation process. No new information was provided to challenge the original assumptions, and the direction of impacts was broadly confirmed by the responses. The estimated number of employers which choose to settle cases before they reach the employment tribunal final hearing on liability has been revised downwards, but this has been driven by updated data on the total number of claims, the proportion of claims that reach tribunal, and the assumed proportion that are for private or voluntary sector employers, rather than changes to the underlying assumptions.

This impact assessment takes account of the above listed issues and accordingly re-evaluated the costs/benefits analysis.

- **Problem under consideration**

The issue under consideration is the same as set out in the original impact assessment – that despite the legal framework around equal pay being in force since 1975, there is still a significant gender pay gap, and continuing evidence of non-compliance with the law. The 2013 ONS statistics estimated that women working full-time were still paid on average 10.0% less than their male counterparts. A comparison of the gender pay difference of all male and female employees, (i.e. those working full-time and part-time, but excluding overtime) currently stands at 19.7%. Research published by the Government Equalities Office (GEO) in February 2010 found that one-third of the gender pay gap in the United Kingdom could not be explained by any observable factors<sup>2</sup>.

[http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=3&ved=0CEUQFjAC&url=http%3A%2F%2Fwebarchive.nationalarchives.gov.uk%2F20100505211508%2Fhttp%3A%2Fwww.equalities.gov.uk%2Fpdf%2FGPAYGAP\\_gpg\\_summary\\_FINAL.pdf&ei=p3IJUsngl4arhQeo2YCoDA&usq=AFQjCNG9hSwt6RkmEYXyH0NtlfsG\\_T4r2Q&sig2=k226YCwDm22geQ865DnEPw&bvm=bv.53217764.d.Yms\).](http://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=3&ved=0CEUQFjAC&url=http%3A%2F%2Fwebarchive.nationalarchives.gov.uk%2F20100505211508%2Fhttp%3A%2Fwww.equalities.gov.uk%2Fpdf%2FGPAYGAP_gpg_summary_FINAL.pdf&ei=p3IJUsngl4arhQeo2YCoDA&usq=AFQjCNG9hSwt6RkmEYXyH0NtlfsG_T4r2Q&sig2=k226YCwDm22geQ865DnEPw&bvm=bv.53217764.d.Yms).)

A survey of 550 senior HR professionals working in predominantly larger enterprises in 2010, representing around two million employees, found that 16% could not state that there was no material gender inequality of pay in their organisation – 12% thought there was significant gender inequality of pay and 4% stated that they had no way of measuring this

Recent Employment Tribunal Statistics indicate that there is still a large number of equal pay claims estimated at 23,638 per annum for 2012/13. Although the vast majority of these will not reach a remedy hearing (the final stage of a claim) due to consolidation into multiple claims, compromise agreements, withdrawals and dismissals, these claims, particularly those relating to work of equal value and those involving a large number of claimants with similar claims (referred to here as “multiples”) can be complex and take considerable time and effort to resolve. Moreover, it is difficult to differentiate between individual claims and multiple claims as evidence shows that a large number of equal pay claims fall within the multiple claim category. It is likely that the number of claims will continue to take up a significant proportion of the resource available to the Tribunal Service; it is also likely that full use may not be being made of the considerable volume of information that has been gathered during a tribunal hearing, and the effort put into that tribunal by all parties. While the immediate claimants have their pay corrected (anyone with a successful equal pay claim can claim back pay for up to 6 years), other employees who may be disadvantaged may still have to raise a claim to have this happen. Steps to prevent these further claims being necessary are therefore desirable.

However, individually enforceable rights such as the right to equal pay do not always enable employees to challenge wider or systemic unfairness in pay and reward by their employer, because the resolution of a single case does not necessarily rectify all the other gender-related pay inequalities within the workforce. Therefore robust changes are needed to the enforcement regime so that those who are disadvantaged in this way can bring a claim if the employer does not correct the situation himself. Analysis of a number of judgments in equal pay cases has shown that private sector employers who lose equal pay cases often have no transparency in their pay systems, and indeed are not able to show any clear rationale at all for the pay rates that they offer individuals. Of a sample of 41 successful equal pay judgments over the last decade, primarily involving private sector employers, less than a quarter appeared to have a transparent salary structure<sup>3</sup>. Furthermore, the survey of senior HR professionals indicated that only 58% of organisations had taken steps or made plans to assess or monitor gender inequality of pay.

The Government is however committed to supporting voluntary action by employers on gender pay. On 14<sup>th</sup> September 2011, the Government launched a business-led voluntary approach to gender equality reporting, *Think, Act, Report*. The Government believes that employers who give the necessary thought to their own position through this voluntary approach are less likely to lose equal pay cases – but where employers do not give thought to their own pay structures, and so are more likely to lose cases at the

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<sup>2</sup> Olsen W, Heuvelman H, Gash V & Vandecasteele L. (2010). The Gender Pay Gap in the UK 1995-2007, Government Equalities Office

<sup>3</sup> Legal analysis of equal pay case judgments, Government Equalities Office

Employment Tribunal, the Government considers intervention to require them to give thorough consideration to their pay systems is justified.

The Government has noted concerns raised during both consultations, particularly in relation to the Employment Tribunal having the discretion to set out specific elements of an equal pay audit, issues raised about the proportionality of equal pay audit requirements, and the potential effect on the settlement behaviour of employers. We acknowledge that while some of those employers who settle cases will go on to correct pay inequalities within their systems on a voluntary basis in order to avoid future cases, for other cases, the requirement to carry out an equal pay audit will be of real benefit both to the employer and to its workforce. The Government remains convinced that these measures are needed to ensure that where equal pay breaches are found by an Employment Tribunal to have taken place, Employment Tribunals are given the most appropriate and cost-effective tools to address any wider pay inequalities and therefore mitigate the likelihood of future equal pay claims.

#### • **Rationale for intervention**

Government intervention is considered necessary where an employer has been shown to have committed an equal pay breach.

The aims of addressing such non-compliance are to:

- tackle the inequality of pay between men and women in the workplace, which in turn will contribute to reducing the gender pay gap in the UK;
- remove a continuing barrier to women's progress in the workplace and promote economic growth by maximising the contribution of women to the economy; and
- reduce the chances of future equal pay claims by requiring employers found to have committed an equal pay breach to carry out an equal pay audit.

It is right that those employers who have been found by an Employment Tribunal to have committed an equal pay breach should be required to take steps to ensure that their pay practices are lawful.

Failure by an employer to correct the factors which might have led to a successful equal pay claim against them following an Employment Tribunal hearing may leave them vulnerable to future equal pay claims. Exposing and dealing with any remaining pay inequalities will enable them to resolve those issues by negotiation without resort to the Employment Tribunal process. Employers must however bear in mind that a claimant with a successful equal pay claim can claim back pay for up to 6 years.

A systematic equal pay audit is an established way by which an employer can ensure lawful treatment of its employees. Although there is currently no common agreed form of equal pay audit, the general principles are well established (covered in guidance provided by the Equality and Human Rights Commission) and can be related to the requirements of the law. However, there is currently no obligation on employers to conduct such equal pay audits. A mandatory requirement imposed on employers in the limited circumstances where they have been found to have breached the law will support the voluntary approach to gender equality reporting, including in relation to pay information, which is contained within the framework of the *Think, Act, Report* (TAR). This will also supplement the increased transparency which is intended to result from section 77 of the 2010 Act, which makes pay secrecy clauses unenforceable where discussions may expose pay inequalities.

With this in mind, it is right to limit the requirement to carry out an equal pay audit following an Employment Tribunal finding **only** to those cases where an audit would have the desired effects. This means the Employment Tribunal that is charged with ordering an equal pay audit must also have the capability not to require an equal pay audit in certain defined circumstances. This will ensure that the order is proportionate.

#### • **Policy objective**

The overall objective of the equal pay audit measures is to ensure that an employer who has committed an equal pay breach identifies and sets out an action plan for removing any remaining pay inequalities so as to ensure its pay structure is free from gender bias. This will supplement the voluntary business-

led approach to gender equality reporting *Think, Act, Report* which the Government developed with business organisations.

Equally, the intention is to avoid unnecessary burden on business so that employers who have already taken steps to ensure that their pay structures are robust and compliant by undertaking an equal pay audit voluntarily, should not be subject to a requirement to carry out an audit. Similarly, there may be some businesses, particularly small businesses for which the disadvantages of an equal pay audit might outweigh the benefits.

- **Description of options considered (including do nothing)**

The options that were considered include:

1. **Option 1: Do nothing** - This option relied on employers taking voluntary and suitable further action following an Employment Tribunal finding, with no legal compulsion, such as a voluntary pay audit.
2. **Option 2: Preferred** - Require an Employment Tribunal to impose equal pay audits except in particular circumstances specified in the primary legislation, namely:
  - a. the employer has conducted an audit in the previous 3 years which meets requirements prescribed for this purpose;
  - b. it is clear without an audit whether action is required to avoid equal pay breaches occurring or continuing;
  - c. the breach found gives no reason to think that there may be other breaches; or
  - d. the disadvantages of an equal pay audit would outweigh its benefits.

Employment Tribunals will be able to consider the facts of each particular case to determine if any of the factors outlined above are applicable before making a decision on whether or not to order an equal pay audit.

The Government also considered a number of non-regulatory or voluntary alternatives to ensure equal pay for women. These include:

- encouraging employers to improve gender equality reporting in their workplace which subsequently resulted in the introduction of the *Think, Act, Report* initiative;
- signposting employers who breach equal pay law to information sources and good practice with regard to equal pay - <http://www.equalityhumanrights.com/advice-and-guidance/tools-equal-pay/>;
- increasing boardroom diversity by encouraging more women to reach board level positions which consequently led to the Women on Boards programme - <https://www.gov.uk/government/publications/women-on-boards-2013-second-annual-review>; and
- maximising women's contribution to economic growth which led to the introduction of the Women's Business Council programme. The Women's Business Council published its report in June 2013 and made a number of recommendations including investment in the futures of girls and young women by creating a culture change in careers provision for young people and adults; creating effective talent management programmes such as leadership coaching, networking and formal training; and supporting more women to set up their own businesses. Work is currently in progress to align the Women's Business Council agenda to the *Think Act Report* initiative as a positive example of transparency and a voluntary-led approach - <https://www.gov.uk/government/publications/womens-business-council-report-maximising-womens-contribution-to-future-economic-growth>.

The Government strongly believes that the only definitive way of approaching employers who fail to pay men and women equally for doing equal work is to have in place a robust legislative remedy to tackle any systemic pay inequality. This chosen option will complement the Government's non-legislative approach by ensuring that action is targeted only at those employers who have been found to have



committed an equal pay breach and that any action ordered to be taken is proportionate to the scale of the problem.

- **Monetised and non-monetised costs and benefits of each option (including administrative burden)**

### **Option 1: Do nothing**

Under this option, a number of non-legislative measures for supporting employers (as outlined under the sub-heading 'Description of options considered') to achieve transparency in employers' pay systems were also taken into account. However, these non-legislative measures have not been costed because it is considered that they would not materially mitigate the risk of future equal pay claims. It is unlikely that an employer who has been taken through the whole judicial process to a final hearing in an equal pay case and has not up to that point been able to resolve the claim or corrected their pay systems, will find additional signposting or generic guidance of any benefit. Annex 1 sets out the current and estimated future volume of equal pay claims without intervention.

### **Option 2: Require an Employment Tribunal to impose equal pay audits except in particular circumstances specified in legislation (Preferred)**

*All benefits and costs discussed for option 2 are additional to the 'Do Nothing' option, and are direct impacts of the policy options. Annex 3 sets out in more detail the approach taken to monetise the costs to individuals, employers and the exchequer of this government intervention with regards altering incentives to pursue equal pay claims to hearing.*

#### Non-Monetised Benefits of equal pay to individuals and others

The main benefits are of businesses and other organisations changing their pay practices to comply with equal pay requirements. These however are difficult to quantify and have not been monetised in this assessment. This is because the scale of benefits to individuals will depend on the extent to which they are currently underpaid and the benefits to firms will depend on the amount of gender discrimination still present in their pay systems, and the extent to which they are able to reduce their exposure to fresh cases by negotiating compliant pay systems. However, there is some evidence that employers already use equal pay audits, implying that for those who are concerned about unequal pay in their organisation, they can be beneficial. For example, the equal pay reviews survey carried out in 2008 by IFF research stated that 87% of employers who conducted a pay audit did so because they saw it as good business sense.<sup>4</sup> Furthermore, 82% of those who conducted audits did so because they wanted to be seen as good practice employers. Clearly the majority of those who do undertake equal pay audits believe there are economic benefits from ensuring equal pay throughout an organisation; for example, in demonstrating commitment to staff and to fairness, in ensuring that they are making maximum use of their employees' capacity and in protecting themselves from the cost of legal action.

The results from the survey of senior HR professionals highlights a difference between the fraction of organisations who stress that they have no material gender inequality of pay, and the fraction who actually assess or monitor this. The survey shows that many organisations must believe they have no gender pay inequality without having taken steps to actually check this out. As noted above, employers who lose cases appear to often do so because they are amongst those that have not considered their pay structures. Employers who have lost cases will be less vulnerable to future claims if they are required to look systematically at what they pay and why.

More recently, the *Think, Act, Report: Two Years On* progress report published in December 2013 (<https://www.gov.uk/government/publications/think-act-report-two-years-on>) stated that a survey of employer organisations signed up to the initiative indicates that many employers are carrying out equal pay audits in a bid to become more transparent about the position of women in their workforces.

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<sup>4</sup> Equal pay review survey, 2008, IFF Research; Equality and Human Rights Commission: [http://www.equality-ne.co.uk/downloads/349\\_Equalpay.pdf](http://www.equality-ne.co.uk/downloads/349_Equalpay.pdf)



It has not been possible to quantify the reduction in the number of cases reaching the Employment Tribunal which will result from the requirement to conduct equal pay audits – this is because to do so would require an estimate of the remaining gender inequality within the pay structures of non-compliant employers and this would be very speculative.

There will also be benefits for individuals in the wider workforce of an employer because the discipline of conducting the equal pay audit will put the employer in a position where it will have to recognise and correct any remaining gender inequality in its pay structures. It will enable the employer by acting before fresh cases are raised to negotiate arrangements without legal action. This will promote equal pay in the workforce where it is required without unfairly burdening good compliant employers.

Due to the difficulty in robustly quantifying any monetised benefits to individuals and employers from moving closer towards equal pay in the workplace, we have included these real benefits only in the non-monetised summary. It should nevertheless be noted that in fair and flexible labour markets, for work of equal value the demand and supply of labour ought to be the sole factor in determining an equal rate of pay for men and women and that anything else is evidence of market inefficiencies. Therefore, there must also be real benefits in ensuring equal pay for which equal pay audits are useful in identifying the issue and promoting action.

#### *The impact of an Employment Tribunal being able to require an employer to carry out an equal pay audit on employer and claimant settlement behaviour*

Some respondents to the two consultations (including employers and their representatives) suggested that incentives to settle an equal pay claim will increase as a result of the requirement to carry out an equal pay audit only where an equal pay breach has been found) due to the increase in the expected cost of such a finding. One approach that could be used to assess this impact is as follows:

1. By understanding the factors which affect the expected cost of an equal pay audit to the employer at the point a claim is brought against them;
2. By estimating the increase in the average expected cost of a hearing for an employer from an Employment Tribunal being able to impose an equal pay audit and equating this to the increase in the maximum amount an employer would be willing to settle a case;
3. Approximating how claimants will respond to this when negotiating a settlement with an employer;
4. By estimating the impact that an increase in the expected cost of a claim for the employer will have on the likelihood of that claim proceeding to a hearing.

We have used this approach in Annex 3 to estimate this impact of government intervention, and monetise costs and benefits to employers, individuals and the exchequer. This approach was tested through the consultation process and was not contested, and no more robust data was provided. The estimated impacts are summarised as:

- £463 extra cost of settling for 806 claims per year against private and voluntary employers, a total extra cost of **£373,000** per annum. This is a transfer to the claimants involved who will benefit by the same amount.
- An increase of 5-12 claims that would have gone to tribunal settling instead because of the higher expected cost of going to tribunal, at an additional cost of **£2-6,000** for employers per annum.
- The Exchequer will make savings if fewer cases proceed to hearing, estimated at **£8-21,000** per annum.

The consultation also explored how likely employers would be to carry out voluntary equal pay audits currently and how likely they would be to carry out voluntary audits when regulations are brought in, so that they do not find themselves in a position where they are compelled to carry out an audit after being found to be in breach of equal pay law.. There was no notable difference between the responses under the two scenarios and no new evidence was given as to the likelihood of this occurring.

#### *Non-monetised costs*

Where earlier settlement takes place, the policy would not result in added transparency about pay, and **might** to a limited extent, reduce the opportunity for an increase in transparency that would follow from a finding at Tribunal. However, if the finding was not accompanied by a requirement to conduct an equal

pay audit, it only brings limited transparency gains anyway. In the absence of a requirement to carry out an equal pay audit, no real benefit accrues directly to others in the workforce unless they themselves bring and win a case. However, an employer who settles **may** take some corrective action. It is not possible to quantify this reduction in transparency, and it may offset any overall gains in pay transparency where equal pay audits are imposed. This impact will be monitored as part of the overall evaluation of the measure.

### Familiarisation costs

Employers will need to be aware of the fact that an equal pay audit may be imposed if they are found by an employment tribunal to have committed an equal pay breach. This is expected to be a minimal familiarisation cost on employers, which will be incurred alongside the requirements on employers to become familiar with the wider changes to the Tribunals Service process (including new rules on financial penalties on employers who lose at Employment Tribunals, early conciliation, and the flexibility at work provisions) expected to be implemented by April 2014.

Furthermore, familiarisation with specific guidance on the specification of and method of conducting an equal pay audit would only be required of an employer where an audit was required. Hence, this has been accounted for in the overall average cost of an audit (see Annex 2).

Therefore, there will be no significant familiarisation costs as an impact of this policy.

### Transitional costs to the Tribunals Service

It is understood that there will be transitional costs to the Tribunals Service associated with training staff, providing guidance and generally ensuring this measure is enforced effectively. It is expected that these costs would be at most **£100,000**.

### Increased costs to the Tribunals Service from remedy hearings

Where an equal pay claim is successful, there may be an increased cost to the Tribunals Service from increased length of remedy hearings to decide whether or not an equal pay audit should be required and if so what the scope of the audit should be. This will arise because Tribunals will need to consider issues around the scope of the audit, evidence as to what has already been done, and whether any of the exceptions are applicable. In Annex 3 we estimate that 49 claims against private or voluntary sector employers reach a tribunal every year, of which 26 are successful (52% of claims reaching a tribunal are successful). Due to expected changes in settlement behaviour we estimate a reduction of 5-12 claims per year reaching tribunal of which 3-6 would have been successful. Therefore there would be an estimated average of 20-23 successful claims against private or voluntary sectors employers each year, equivalent to 5-6 employers (based on an average of 3.7 claimants per case), where the tribunal would have to consider imposing a pay audit. It is assumed that on average, remedy hearings would cost the Exchequer half the amount for a full hearing, and lead to a total increased cost of **£16-19,000** per annum.<sup>1</sup>

This is based on GEO's own estimate of the burden.

**Note: We do not consider any extra burden to the employer of the remedy hearing because this would only be as a result of proven non-compliance with existing equal pay law.**

### New equal pay claims

As a result of this measure, there could be an increase in the number of equal pay claims being made against employers. This could arise as a result of activists, trade unions and some advisers seeking to encourage and support claims with a view to increasing the chance of challenge to the employer's systems. Individuals who might settle on their own account may be persuaded to maintain their challenge through the tribunal process in order that an audit will be imposed, and other employees will

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<sup>1</sup> [5,6] x £6,250 x 50%

be saved from the risk of similar disadvantage. Some new claims of less merit may be raised if employees anticipate that employers will settle more readily as a result of fear of having to undertake an audit. The specific nature of equal pay rights, depending as they do primarily on a factual comparison of work, should keep this effect relatively small. Responses to the consultation did not provide a clear view on whether there would be an overall increase in the number of equal pay claims brought, though employer's representative bodies in particular thought that increased settlement rates could generate some new weak cases to take advantage of perceived unwillingness by employers to fight them. Most responses indicated that the much more probable impact was on settlement behaviour.

The cost of pay audits where they are imposed following the claimant being successful at a hearing

It is estimated overall that with no impact on the rate of settlement, there will be on average 517 claims successful at hearing each year (1.7% of the estimated 31,000 claims accepted annually). Of the equal pay cases where the claimant is successful at hearing, a small fraction will have been made against private and voluntary sector employers; 26 claims (1.7% of 1,534). We do not consider claims brought against public sector employers here as the majority made in recent years have followed large scale pay harmonisation exercises, which have been intended to equalise pay.

As stated above, changes to settlement behaviour are expected to reduce the number of successful claims following tribunal to an estimated average of 20-23 per year, equivalent to 5-6 individual employers. No more than 25% of claims successful at hearing against private or voluntary employers are expected to result in a pay audit, resulting in approximately 2 pay audits being imposed annually. The total direct cost of conducting these pay audits to private and voluntary sector employers, using an average cost per audit of approximately £13,236 (see Annex 2 for derivation of audit cost), would be approximately **£26,500 per annum**.

**Note: As equal pay audits would only be required of employers who have been found to be non-compliant with equal pay legislation, these costs have not been included as an impact of the policy.**

Summary of Costs and Benefits of Option 2

The overall impact of option 2 is a net present value over 10 years of **£-0.17million to £-0.08million**.

**Table 1 – Summary of Costs and Benefits of Option 2 (£000s)**

|  | Costs        |                    |            | Benefits           |            | Net Present Value<br>(10 Years) |            |
|--|--------------|--------------------|------------|--------------------|------------|---------------------------------|------------|
|  | Transitional | Annually Recurring |            | Annually Recurring |            |                                 |            |
|  |              | Low                | High       | Low                | High       | Low                             | High       |
| Private and voluntary sector employers | 0            | 375                | 379        | 0                  | 0          | -3,228                          | -3,262     |
| Exchequer                              | 100          | 16                 | 19         | 8                  | 21         | -169                            | -83        |
| Individuals                            | 0            | 0                  | 0          | 375                | 379        | 3,228                           | 3,262      |
| <b>Total</b>                           | <b>100</b>   | <b>391</b>         | <b>398</b> | <b>383</b>         | <b>400</b> | <b>-169</b>                     | <b>-83</b> |

Source: GEO estimates, SETA 2008, Employment Tribunal Statistics, ASHE 2012

Note: Low and High represent the low and high settlement impacts

• **Risks and assumptions of option 2 (preferred)**

There is a degree of risk and uncertainty around the impact of option 2. Firstly, when considering this measure in isolation, as discussed, there is a need to understand the impact on the behaviour of employers. For example, this measure may lead to an increase in employer incentives for and subsequently the rate of, settlement in equal pay claims. The methodology used to assess the cost of government intervention on employers, through the increase in the amount they are willing to pay to

settle a case, relies primarily on an assumption that claimants typically have more control over settlement negotiations and are able to negotiate the maximum settlement payment the respondent is willing to pay. This is a strong assumption and therefore the monetised impacts should be treated with caution.

The wider non-monetised benefits to individuals of ensuring employers correct gender inequalities in pay systems would be less likely to occur if, to avoid the possibility of conducting an audit where a claim is successful, an employer elects to settle instead. Any change in behaviour may result in monetised benefits to individuals and the Exchequer where a claim does not proceed to hearing. There would however also be costs of this. These costs are less easy to monetise, and they relate to the potential equality in pay achieved for individuals, and the groups they represent within organisations, not being achieved if claims are stopped from proceeding to a hearing.

This measure will potentially be implemented alongside thirteen other measures with a direct impact on the Tribunals Service, on which consultation has been held,<sup>2</sup> and which are dealt with in a separate assessment. Interaction with these measures could ultimately affect the number of pay audits expected to be imposed as a result of this policy.

Of the thirteen concurrent proposals which will impact on the Tribunals Service, a new measure requiring all claims to be submitted to The Advisory Conciliation and Arbitration Service (ACAS) in the first instance, to increase the frequency of pre-claim conciliation, could have a significant impact on what constitutes the typical number of equal pay claims entering the tribunal process. However, responses to the consultation suggested that this would have a minimal impact on equal pay cases because they generally involve relatively complex examination of facts, argument about identification of the appropriate comparator, and argument about circumstances which might justify a difference in pay. It seems unlikely that the relevant facts could be fully established, agreed between parties and considered during a relatively short pre-claim period.

Furthermore, proposals which are intended to deter vexatious or unmeritorious claims, could also impact on the number of claims reaching the Tribunals Service and raise settlement and success rates (though we might expect the overall number or level of settled and successful claims to be largely unaffected).

If we assume that some fraction of those claims which make up the typical caseload (31,000 claims) will now be pre-claim conciliated, then this consequently reduces the number of claims which might be successful at hearing, and therefore, would potentially reduce the number of instances in which equal pay audits are imposed.

As also mentioned previously, there is no definite expectation of how many successful equal pay claims at hearing will result in an equal pay audit being imposed. We have assumed this might be 25% of successful claims against private and voluntary sector employers, which is likely to be a high estimate, and was not challenged during the consultation.

- **Direct costs and benefits to business calculations (following OITO methodology)**

The power to order an equal pay audit is not within the scope of OITO as there are no direct costs/upfront impact to business or indeed to voluntary sector organisations which are compliant with the law. Costs will only be incurred:

- a) where an employer has been found to have breached equal pay law, and is consequently ordered to carry out such an audit, or
- b) where because of the strength of the case against them, an employer opts to settle the case before it gets to a final hearing.

With regard to the costs incurred as a result of employers opting to settle cases rather than go to an Employment Tribunal, this is a personal choice they make. The Government believes that if an employer is faced with a single equal pay claim which it settles, there is a greater likelihood that pay inequalities

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<sup>2</sup> Resolving workplace disputes: A consultation (January 2011), BIS; <https://www.gov.uk/government/consultations/resolving-workplace-disputes-public-consultation>

may be widespread throughout the organisation's pay structure and may lead to a floodgate of other equal pay claims which would no doubt end up costing the employer more than if he does not settle, is found to have committed an equal pay breach and is ordered to carry out an equal pay audit. The benefit of an equal pay audit is that it provides the employer with the opportunity to examine its pay structures, to justify any pay inequalities where they are found, and to put in place an action plan to eliminate any inequalities that cannot be justified.

### Enforcement

We intend to support this measure with enforcement by way of a financial penalty regime. Financial penalties were favoured by respondents to the consultation as well as by the Delegated Powers and Regulatory Reform Committee. Using financial penalties for failure to comply with an equal pay audit order would be effective in ensuring that employers examine their pay systems or face repeated penalties until they comply with the order.

### Impacts on Small and Micro Businesses

The impact of the proposed measures is expected to fall mainly on large employers who have been found to have broken equal pay law committed an equal pay breach. The measures will apply to small businesses (other than start-ups and micro-businesses), charities and voluntary bodies, but the impact on these is expected to be minimal and overall the measure will be low cost (i.e. less than a £1m per year). The measures will however not apply to microbusinesses in line with the Government's current exemption to limit regulatory burdens for these types of businesses. The Government is clear that the measures will only impact those few employers who are found by an Employment Tribunal to have discriminated because of gender in matters relating to pay. As the measure qualifies for the fast track as a low cost measure the new small and micro business assessment does not apply.

## Annex 1. Volume of Equal Pay Claims

The estimated average number of equal pay claims per annum is 31,000. This has been calculated by taking an average over the past 10 years (from 2003/04 to 2012/13) to account for the surge in the late 2000s. There were only 4,400 equal pay claims accepted in 2003/2004, rising to 62,700 in 2007/2008, and decreasing to 23,600 in 2012/2013. Whilst surges in Employment Tribunal claims do occur across all jurisdictions, it would not be correct to assume that the surge in equal pay claims might be persistent. That was mainly due to public sector pay restructuring exercises which exposed historic pay inequalities (see Table 3), which are unlikely to be replicated elsewhere in the economy. Therefore taking a 10 year historical average is deemed to be a reasonable estimate for the underlying baseline. This provides the best estimate of the expected number of claims per annum going forward, from which we have considered the number of claims which occur against private, public and voluntary sector employers.

Similarly, the average outcomes of equal pay claims disposed of as listed in table 2 below have been calculated as an average over the past 10 years. This method in part accounts for anomalous outcome rates in individual accounting periods. However, in 2005/2006, 33% of equal pay claims disposed of were successful at hearing, which can be linked to a small number of very large multiple claims against NHS employers and so this particular period has been excluded from the average to avoid misrepresenting what is typical.

**Table 2 – Percentage of equal pay claims disposed reaching stated outcome**

|   | Percentage reaching outcome |
|---|-----------------------------|
| <b>Total that reach hearing</b>           | <b>3.2%</b>                 |
| <i>Of which...</i>                        |                             |
| <i>Successful at tribunal (claimant)</i>  | 1.7%                        |
| <i>Unsuccessful at hearing (claimant)</i> | 1.6%                        |
| <b>Total that settle</b>                  | <b>52.5%</b>                |
| <i>Of which...</i>                        |                             |
| <i>Privately settled</i>                  | 30.9%                       |
| <i>ACAS conciliated</i>                   | 21.7%                       |
| <b>Other Outcomes</b>                     | <b>44.4%</b>                |
| <i>Withdrawn</i>                          | 24.4%                       |
| <i>Struck out (Not at Hearing)</i>        | 19.7%                       |
| <i>Dismissed at a preliminary hearing</i> | 0.3%                        |
| <i>Default judgement</i>                  | 0.0%                        |

Source: Employment Tribunal Service annual reports and statistics 2003/2004-2012/2013 (excluding 2005/06), adjusted to account for private settlements using SETA 2008

Over recent years, the vast majority of equal pay claims have been against public sector employers as indicated in table 3 below. Of the claims submitted to the Employment Tribunal service (as opposed to the number which are accepted or disposed of in any given accounting period) in 2008/2009, 99% were against NHS and Local Authority employers.

**Table 3 – Breakdown of origin of equal pay claims at tribunal, 2008/2009**

|                  | Number of equal pay claims | Percentage of total claims |
|------------------|----------------------------|----------------------------|
| NHS              | 28,511                     | 24.4%                      |
| Local Government | 86,668                     | 74.2%                      |
| Other            | 1,574                      | 1.3%                       |
| <b>Total</b>     | <b>116,753</b>             |                            |

Note: other comprises central government and private sector employers

Source: Tribunals Service

However, this underestimates the exposure of other sectors to equal pay claims as recent statistics show that a large number of the claims still with the Employment Tribunals relate to large multiple claims. Therefore the estimated breakdown of new claims by sector going forward, as stated in table 4, corrects for the fact that recent statistics have been affected by a specific caseload surge from NHS and Local Authority employers.

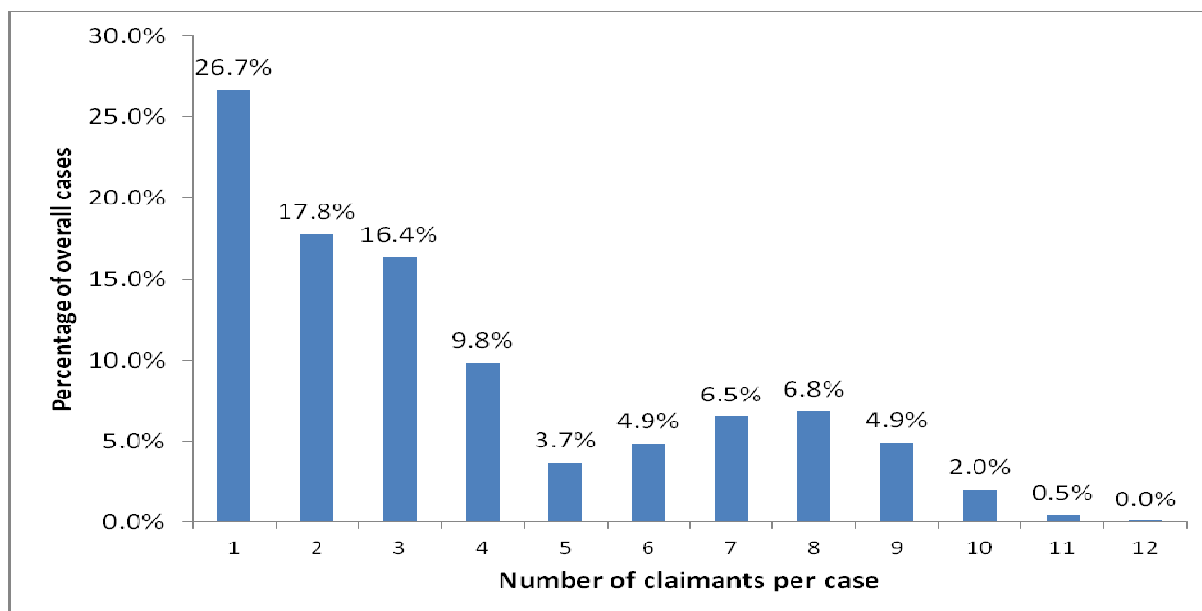
**Table 4 – Equal pay claims by economy sector**

|                  | Percentage of equal pay claims | Estimated Annual Number of Claims |
|------------------|--------------------------------|-----------------------------------|
| Public Sector    | 95%                            | 29,144                            |
| Private Sector   | 4%                             | 1,227                             |
| Voluntary Sector | 1%                             | 307                               |

Source: GEO estimates, Tribunals Service

Equal pay claims are commonly brought to Employment Tribunals as multiple claims - that is more than one claimant against the same employer. This is particularly the case for public sector claims, but also true to some extent for claims originating in the private and voluntary sectors. The Government Equalities Office has used the Tribunals Service administrative data covering all cases from 1996-2010 to derive an estimate of the average number of claimants per case (employer)<sup>3</sup>. This was done by looking at equal pay judgment case numbers and then comparing the number of unique cases against 1 million unique claimant judgments. Using this methodology there are approximately 3.7 claimants to each case or employer. It should be noted also that some of these multiple claims may themselves be sub-multiples in larger cases against the same employer, indicating that this may be a minimum value.

**Figure 1 – Distribution of Equal Pay Cases by number of individual claimants, 1996-2010**



Source: GEO analysis of Tribunal Service administrative data 1996-2010



## Annex 2. Unit Costs

Unless stated otherwise, all monetary figures have been inflated to 2013 prices using HM Treasury GDP deflator series consistent with 5 December Autumn Statement 2013

### Exchequer

The average cost of an employment tribunal claim is given by Ministry of Justice's 2012 impact assessment regarding *Introducing a fee charging regime into Employment Tribunals and the Employment Appeal Tribunal*.<sup>4</sup> Equal pay cases are termed as 'Open Track' cases for the purposes of administration by the tribunal service. The average cost of receipt and allocation of an open track claim is £440, and the average cost of a hearing is £6,250 (including interlocutory hearings). These are the core mandatory stages in the employment tribunal process.

### Employers

#### Time and Legal Advice

The average costs to employers of an equal pay case are calculated using SETA 2008. The costs for cases where discrimination is the primary jurisdiction have been used to estimate the costs for equal pay cases specifically. The issues within a discrimination claim are generally no less complex than those in an equal pay claim. This is calculated as the cost of advice and representation, time spent by corporate managers and senior officials, and time spent by other employees, namely dedicated personnel, training and industrial relations managers, on the case. Responses to the consultation suggested that the cost to the employer had previously been underestimated. It was suggested that unlike in discrimination cases more widely, employers would pay for some form of legal advice or representation in virtually all cases where equal pay claims were brought against them due to the nature of the issues in consideration. The costs here have been amended to reflect this using SETA data. The median hourly wage has been estimated using the Annual Survey of Hours and Earnings as £50.52<sup>5</sup> for corporate managers and senior officials and £28.89<sup>6</sup> for personnel, training and industrial relations managers. The median average amount of time spent on a case is estimated from SETA 2008 data as 6 days for directors and senior staff and 3 days for other staff. The overall average cost to an employer of an equal pay case is £6,566, including £3,838 for advice and representation estimated from SETA 2008.

**Table 5 – Cost of an equal pay case to the employer**

|  |               |
|--|---------------|
| Time spent on case by directors & senior staff | £2,122        |
| Time spent on case by other staff              | £607          |
| Cost for advice and representation             | £3,838        |
| <b>Total</b>                                   | <b>£6,566</b> |

Source: SETA 2008, ASHE 2012

Note: Assumes a 7 hour day

Note, this cost per employer applies to the average per case, which could consist of multiple or single claimants. It was estimated in the costs and benefits section that there are approximately 3.7 claimants to each case on average, meaning the cost of time spent and legal advice *per claim* is £1,775<sup>7</sup>.

#### Compensation

The average compensation awarded in discrimination between 2007/08 and 2012/13 in successful discrimination employment tribunal claims is approximately £19,000 in 2012/13 prices. This is considered here to be a proxy for compensation in equal pay cases, which typically consists of up to 6 years back-pay, accounting for the level of inequality in pay discovered.

<sup>5</sup> ASHE, Nov 2012 –111 incl. 21% uplift for non-wage labour costs

<sup>6</sup> ASHE, Nov 2012 –1135, incl. 21% uplift for non-wage labour costs

<sup>7</sup> £1,775 = £6,566 / 3.7

## The Cost of an Equal Pay Audit

We are aware of no widely-shared understanding of what it would cost to complete an equal pay audit. Clearly costs to a particular employer would vary depending on how much of the required information had already been gathered and suitably stored, how many employees there were, how complex or varied the work undertaken was, and other factors. The estimates below are therefore based on assumptions that most of the company pay data is already held electronically and can be reasonably easily accessed, and that the mix of tasks undertaken is not unusually complex. We make no allowance for one-off costs to develop systems. Although they are clearly different tasks, we have assumed the same daily charge for external advice as we have assumed would be made by an equal value assessor in an equal pay case.

- Internal time required 8 weeks
- Carried out by a “personnel, training, and industrial relations manager” or equivalent with wage cost of £1,029 per week<sup>8</sup>
- External time – 5 days
- Cost per day of external advice, £1,000

Responses to the consultation suggested that the previous estimated average cost of a pay audit was too low. In particular, it should be acknowledged that for smaller and medium organisations, who may not have well defined pay systems or records, they would likely need to put these in some degree of order before an audit could be carried out. To reflect these comments; the assumed length of internal time has been increased here from four to eight weeks.

Given the revised assumptions, the typical cost of an audit would be approximately £13,236<sup>9</sup> to the employer. As consultation responses noted however, it is important to acknowledge that for large employers this figure is likely to be far higher, whilst for some small employers, it could be an overestimate.

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<sup>8</sup> ASHE, Nov 2012 Code 1135, median weekly earnings, incl. 21% uplift for non-wage labour costs; £1,029.47

<sup>9</sup> 13,236 = (8 x £1,029.47) + (5 x £1,000)

## Annex 3.

### Factors which affect the expected cost of a pay audit to the employer

After an equal pay claim is brought, an employer will seek to settle the case as soon as possible if they believe the expected costs of proceeding with the case to a hearing outweigh the costs of negotiating and making a settlement now. The expected future cost to the employer currently would be calculated using several factors:

- The expected cost of the employer's time from proceeding with the case to a final hearing
- The expected cost of any legal advice and representation needed
- The employer's current understanding of the likelihood of losing the case, including whether or not the employer is risk averse
- If the employer loses the case, the expected amount of compensation it believes it would have to pay
- The cost of any other non-financial negative effects that might be expected from defending the case - e.g. Reputational damage [Note: this cost may be negative, in so far as the expected benefit from proving that an employer's pay systems are compliant at a hearing, may be greater than the cost of the implied non-compliance from settling a case]
- The extent to which the employer discounts future costs relative to more immediate costs

As a result of the Government intervention now proposed, some additional costs would be factored in by the employer:

- If the employer loses the case, the employer's current understanding of the probability that an equal pay audit would be imposed (and not successfully overturned at appeal)
- If imposed, the expected cost of carrying out an equal pay audit.

### **An increase in the average expected cost of a hearing for an employer and the maximum amount an employer would be willing to settle a case for**

The impact therefore of government intervention is to raise the expected cost to the employer of defending a case where there is a real chance it will reach a final hearing. This will increase the maximum amount the employer is willing to pledge in a settlement offer. To estimate this increase, we calculate the average expected cost to an employer of proceeding to a final hearing before and after the government intervention.

#### *Before Intervention*

The cost of an employer's time and the cost of any legal advice and representation for a case that progresses from initial acceptance by the employment tribunal to a final hearing is estimated at £6,566 per case or £1,775 per claim (see Annex 2). Using table 2, the average success rate of a claimant at hearing in equal pay cases over the last 10 years is 52%. The average compensation awarded for a single claim is £19,000 (see Annex 2). Using this, we can estimate that the average, expected cost of proceeding to a final hearing for an employer, in a case which has a real chance of doing so, is **£11,602**.<sup>1</sup> This expected cost is considered to be the maximum amount that an employer is willing to settle for at the start of an equal pay case. This estimated cost does not include some of the non-financial factors mentioned above as it was not possible to find appropriate data or evidence.

#### *After Intervention*

After government intervention, the expected cost should also include the cost of carrying out an equal pay audit. The average cost of carrying out an equal pay audit is estimated at £13,236 (See Annex 1). It is expected that only a small percentage of those claims which are successful at hearing will result in a requirement to carry out an equal pay audit, since in many cases one of the exceptions will apply - for example, a tribunal would not be able to order an equal pay audit where the employer was a micro or

<sup>1</sup> £11,602 = £19,000 x 52% + £1,775<sup>2</sup> £1,712 = £13,236 x 52% x 25%

new business or where it was shown that there would be no benefit because any systemic disadvantages have already been exposed and corrected. Therefore, initially, we estimate that no more than 25% of claims successful at hearing against private and voluntary sector employers would lead to the imposition of an equal pay audit.

With 52% of claims being successful and only 25% of those resulting in a mandatory audit judgement, the average expected additional cost per case would be £1,712<sup>2</sup>, or **£463**<sup>3</sup> per claim (accounting for multiple claims). This is an indication of the increase an employer might be prepared to make to the maximum amount he is willing to pay to settle the case. Whilst the estimates here did not include some of the non-financial factors an employer would take into consideration, these would be largely constant with or without the government intervention and so it is not felt this would affect the derived figure greatly.

### **How claimants will respond when negotiating a settlement**

On average, over the last 10 years, 52.5% of equal pay cases reach either private settlement or ACAS conciliation. We assume that the ability of the tribunal to impose an equal pay audit will not alter claimant behaviour in so far as it will not increase the benefits they might receive as a result of a successful judgement. The equal pay audit would potentially benefit other employees as opposed to the claimant, as their pay would be corrected and any further pay inequalities would be identified in the equal pay audit as a result of the tribunal judgement anyway. Therefore, for those claims that already settle, the claimant may now be able to negotiate a higher settlement as the maximum the employer is willing to pay has increased.

We consider that generally claimants have less incentive to begin negotiating or reach a settlement position than an employer as their expected costs are far lower, and they are generally very optimistic about both the chances of winning the case and also the size of compensation awarded. Furthermore, following the government intervention, an employer's incentives to settle will increase, which will be known to the claimant and may be used to negotiate a higher settlement. In fact, the claimant should be able to negotiate the majority, if not all the **£463** increase from the employer, even based on partial information about the likelihood or cost of an equal pay audit requirement in the case.

Given the fact that the majority of equal pay claims against public sector employers have resulted from large scale pay evaluation exercises, it is highly unlikely that for example a Local or NHS authority's incentives to settle cases against them would be impacted by this proposal. It is expected that a pay audit would not be imposed on these organisations even where there was a finding of an equal pay breach as it would serve no further purpose, since they have recently conducted audits. Therefore, the settlement behaviour of public sector employers will be unaffected by these proposals.

It is therefore estimated that the cost of settlement will therefore increase by £463 for 806 (52.5% of 1,534) claims brought against private and voluntary sector employers each year (see Table 4). This is an annually recurring cost from government intervention of **£373,000**.

Furthermore, as a result of the increase in the expected cost of a hearing for the employer, it is probable that the rate of settlement of equal pay claims will increase. This was suggested by most business representatives who responded to the consultation. This might be because of the process costs of conducting the audit, or because of fear that conducting an audit would, instead of enabling them to negotiate any changes to their pay structures that are still needed, simply raise new cases against them. Therefore, this measure will increase the expected impact of the case on the employer, affecting the decision of an employer on whether or not to settle the case or risk a judgement. Whereas previously an employer may have chosen to risk an adverse judgment, the potential for increased cost will increase the amount they are willing to pay in order to settle the case, thus increasing the likelihood of an agreement being reached with the employee. As per above, the increase in the expected cost of an adverse judgement is used to represent this increase in the maximum an employer is willing to settle for, and therefore the additional impact of the government intervention.

Responses to the two consultations generally supported the notion that requiring a tribunal to impose an equal pay audit would increase settlement incentives for employers. Some respondents suggested that

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<sup>3</sup> £463 = £1,712 / 3.7

since the cost of an equal pay audit in many instances would likely be greater than the compensation awarded, this would actually become the principal driver in determining employer settlement behaviour. However, no responses to the consultation suggested any specific estimate of the magnitude of this effect, and therefore here we rely on a range of percentages to reflect this uncertainty about the actual size of the impact. We assume that the number of claims that would be settled by the parties without proceeding to a final hearing would increase by 10-25%.

Using the figures presented in tables 2 and 4, it is estimated that 49 (3.2% of the 1,534 assumed annual equal pay claims brought against private and voluntary sector employers accepted) would reach a final tribunal hearing. A 10 – 25% reduction in this number, on account of the expected increase in the number of claims settling, will result in an additional 5-12 claims that are settled annually. This represents an additional cost to private and voluntary sector employers of **£2-6,000** per annum.

The Exchequer will make savings if fewer cases proceed to a final hearing. The average cost of an equal pay hearing is £6,250, and given that there are on average 3.7 claims per case, these savings are estimated at **£8-21,000** per annum.

The increase in the settlement payment brought about by the increase in the expected cost of a judgement at hearing to the employer is transferred to the claimant. Therefore, claimants will receive benefits from the government intervention of **£375-379,000** per annum. However, if this were the case, it is recognised that there would be other significant non-monetised costs to individual claimants, and the groups they represent within organisations, from not achieving formal recognition that the employer was in breach of the law.