



dti

**NATIONAL MINIMUM WAGE
AND EMPLOYMENT AGENCY
STANDARDS ENFORCEMENT**

Consultation Document

MAY 2007

CONSULTATION ON NATIONAL MINIMUM WAGE AND EMPLOYMENT AGENCY STANDARDS ENFORCEMENT

<u>Contents</u>	<u>Page(s)</u>
Foreword	2 – 3
Executive summary	4 – 6
Details of the consultation	7 – 9
Part I: National Minimum Wage arrears	10 – 15
Part II: National Minimum Wage penalties	16 – 24
Part III: Employment Agency penalties	25 – 29
What happens next?	30
Initial Regulatory Impact Assessment	31 – 48
Annex A: The Consultation Code of Practice	49
Annex B: Response form	50 – 57
Annex C: List of consultees	58 – 59

FOREWORD

Since 1997, our approach to the UK labour market has been based on combining social justice with economic prosperity so that businesses grow and employment expands, delivering opportunity for all. Last year's Success at Work strategy paper set out the next stage of our approach. In particular, it emphasised the need for a stable and proportionate regulatory framework: one in which complying with the law is simple and straightforward and where individuals get the rights to which they are entitled, supported by an effective enforcement and penalties regime. This consultation document is about two key elements of the regulatory framework – the national minimum wage and the Employment Agency Standards Inspectorate – focussing on measures to promote compliance and improve fairness for workers and compliant businesses.



The national minimum wage (NMW) has benefited an estimated 1 million workers each year since its introduction in April 1999. The vast majority of employers comply with NMW legislation. But nearly a decade on from the National Minimum Wage Act ("the NMW Act"), some unscrupulous employers continue to underpay their workers. This is both unfair to the compliant businesses who are undercut, and unfair to the workers who are underpaid.

We are proposing a new strategy to deal with these cases, based on a fairer way of dealing with NMW arrears, and a simpler, more effective penalty regime to deter non compliance.

We have always made every effort to ensure that workers who are underpaid are repaid what they are owed. In 2005/06 we recovered over £3.2 million for over 25,000 workers. But if arrears have lost purchasing power since the underpayment happened, there is a risk that workers remain worse off in real terms. This document seeks views on how we can remedy that by calculating fairer arrears.

We also seek views on our proposals for a simpler penalty regime, which follow on from consideration of the 2007 Low Pay Commission (LPC) recommendation that we introduce a new penalty for underpayment of the NMW. The proposals are designed to simplify our existing penalty regime, creating a clearer deterrent to non compliance.

These proposals, underpinned by our success in restoring arrears to workers and our existing strategy to prosecute the most serious cases of non compliance, remove all the potential profits of underpayment of the NMW. This is a strong message which will change the behaviour of potentially non compliant employers.

We are also taking this opportunity to consult on the penalties regime for offences committed against employment agency legislation. We would also

welcome your views on our proposals for clearer investigative powers for the Employment Agency Standards Inspectorate.

In making sure that we have the simple, clear and effective incentives in place to encourage employers and agencies to comply at the right time, we can do more than ever before to make sure that workers are not underpaid in the first place, and that agencies comply with their responsibilities. In consulting on these measures, we are keen that we hear the views of all those affected – from the individual to the employer to any other interested parties. We look forward to hearing your views.

A handwritten signature in black ink, appearing to read 'Jim Fitzpatrick', with a stylized, cursive script.

Jim Fitzpatrick

Parliamentary Under-Secretary of State for Employment Relations
and Postal Services

EXECUTIVE SUMMARY

1. This consultation addresses three issues:
 - Ensuring that workers who are underpaid the NMW receive fair arrears which are calculated so that workers do not lose out in real terms as a result of that initial underpayment
 - Ensuring that a simple, effective penalty regime is in place to encourage employers to pay the NMW where it is due from the outset
 - Ensuring that an effective enforcement regime is in place for dealing with the minority of employment agencies that do not comply with agency legislation

Coverage of NMW proposals

2. Almost all workers in the UK are entitled to the NMW. Her Majesty's Revenue & Customs (HMRC) enforce NMW legislation on the government's behalf in the United Kingdom. The Department of the Environment, Food and Rural Affairs (DEFRA) and the agricultural agencies in Scotland and Northern Ireland undertake enforcement of the minimum wage in the agricultural sector. These agencies are also responsible for enforcement of the agricultural minimum wage (AMW).
3. Common enforcement procedures currently apply in respect of both the AMW and NMW. DEFRA ministers and devolved agricultural agencies will take into account views expressed during this consultation and the impact of any shift in the emphasis of enforcement procedures [see *Effects of a new penalty*] when considering whether the AMW will be enforced using fair arrears and a new penalty. In this document we refer mainly to the NMW, but views are welcome on both the enforcement of the NMW and the AMW.
4. Workers can resolve NMW complaints with their employer, ask for the help of an enforcement agency, or make a complaint direct to an Employment Tribunal or civil court. We propose that everybody should be entitled to fair arrears, whichever route they take. Our proposal on a penalty is focussed on simplifying the current enforcement regime, so looking at the tools which are used by HMRC in the enforcement of the NMW, with a view to penalising all employers found to be underpaying the NMW.

Introducing fair arrears

5. If a worker who qualifies for the NMW is remunerated by his employer at a rate which is less than the NMW, the worker is entitled to arrears. Arrears are the difference between the remuneration received by the worker and the NMW rate which applied at the time that they should have been paid.
6. This calculation does not take into account that arrears may have lost purchasing power since they were incurred. Part I of this consultation

document asks for views on a fairer way of calculating NMW arrears for all workers and suggests options for how this might be achieved.

Introducing a simpler, more effective penalty

7. Currently employers who are brought to HMRC's attention as underpaying the NMW are able to repay arrears without attracting a penalty, either by repaying arrears during the course of an investigation or repaying arrears in full on receipt of an enforcement notice. A penalty can only be applied if the employer does not comply with an enforcement notice. It can therefore be argued that the current penalty regime does not provide an incentive for employers to comply at the right time, and does not do enough to prevent arrears from arising in the first place.
8. In addition, it is not necessarily clear to employers when underpayment might result in a penalty. If a penalty is issued, is it calculated to a statutory formula which is not straightforward. This means it is difficult for non compliant employers to see up front the penalty they face.
9. A simple new deterrent is therefore needed which makes clear that underpayment is unacceptable, and what the consequences of underpayment will be. A penalty which makes this obvious will have stronger deterrent effect. It will also better protect workers from exploitation and better protect compliant businesses from unfair competition.
10. Part II of this consultation document asks for views on the proposal to introduce a penalty for all employers who are found to be underpaying the NMW. It asks what form the penalty should take, gives options, and asks what level the penalty should be.

Employment Agency enforcement regime

11. At present, under section 5(2) of the Employment Agencies Act 1973, any breach of the regulations governing employment agencies (the Conduct of Employment Agencies and Employment Businesses Regulations 2003) is a criminal offence, triable as a summary offence in a magistrate's court. Our experience has been that, while the present approach has proved effective for the great majority of agencies that wish to comply, it has not proved effective for those (relatively few) who seek to avoid their legal responsibilities and obstruct investigations by the Employment Agency Standards (EAS) Inspectorate. In particular there are difficulties related to the limitations of prosecuting for summary offences, both in terms of adequacy of penalties and the relative lack of investigative and prosecution powers where criminal offences are summary only.
12. The most significant problem in terms of adequacy of penalties occurs where an individual who has been prohibited from running an agency (because of their unsuitability on account of misconduct) ignores the ban. The maximum penalty for breach of a prohibition order is a fine of £5,000. This may not be an effective deterrent where the agency is highly profitable.

13. When investigating serious complaints, the EAS needs to find out what payments have been made to rogue agencies that have been seeking illegal payments (or otherwise breaching the regulations to their financial advantage to identify the scale of the problem). At present the EAS does not have the power to obtain “production orders” to get financial information from third parties where agencies are suspected of obtaining money unlawfully.
14. In addition, there is no scope for the EAS to prosecute for “attempting” to commit offences under the legislation. This means that the EAS needs to identify witnesses prepared to give evidence against the agency. Some victims fear that they may not get future work from agencies if they give such evidence.
15. We are therefore considering amending the Employment Agencies Act so that these offences can be either indictable (ie tried in a Crown Court) or summary (tried in a magistrates court).
16. This consultation seeks views on whether the offences should be capable of being tried in a Crown Court as part of ensuring an effective enforcement regime, and whether the EAS should be given clearer investigative powers (in order to obtain financial information regarding those suspected of offences under the Employment Agencies Act). These changes should not add burdens to legitimate agencies since they are targeted at the small number of rogue agencies who seek to mistreat workers and ignore their legal obligations. By making it more difficult for rogue agencies to cut corners at the expense of the reputable side of the industry, these changes should in fact benefit most agencies.

Who is being consulted

17. Views on these proposals are sought from individuals, businesses, trade unions, representative bodies and other interested parties.

DETAILS OF THE CONSULTATION

How to respond

This consultation commenced on 16 May and will close on 8 August 2007. Responses may be submitted as follows:

Online: <http://www.surveymonkey.com/s.asp?u=618263708421>

or

By letter, fax or email to:

Maria Gonzalez-Rey
Employment Relations Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Tel: 0207 215 5944
Fax: 0207 215 6414
maria.gonzalez-rey@sti.gsi.gov.uk

When responding please state whether you are responding as an individual or on behalf of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were taken into account.

Additional copies and contact details

You may make copies of this document without seeking permission. Further printed copies can be obtained from:

DTI Publications Orderline
ADMAIL 528
London SW1W 8YT
Tel: 0845 015 0010
Fax: 0845 015 0020
Minicom: 0845 015 0030
www.dti.gov.uk/publications

The Department will also be able to arrange for other languages or copies in Braille to be provided if required. Further copies of the electronic consultation document and the response form can be obtained from the DTI website at www.dti.gov.uk/consultations

Confidentiality and data protection

Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the

access to information regimes (primarily the Freedom of Information Act 2000, the Data Protection Act 1998 and the Environmental Information Regulations 2004). If you want other information that you provide to be treated as confidential, please be aware that, under the Freedom of Information Act, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard any information that you wish to be treated as confidential should be so treated. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that your request for confidentiality would be complied with in all circumstances. An automatic confidentiality disclaimer generated by your information technology system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the Data Protection Act and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Help with queries

Questions about the policy issues raised in this document related to NMW arrears and penalties can be addressed to

Helen Dwyer
Department of Trade and Industry
Tel: 0207 215 3484
Fax: 0207 215 6414
Email: helen.dwyer@dti.gsi.gov.uk

Questions about the policy issues raised in this document related to Employment Agencies enforcement regime can be addressed to

John Thorpe
Department of Trade and Industry
Tel: 0207 215 5708
Fax: 0207 215 6414
Email: john.thorpe@dti.gsi.gov.uk

If you have any comments or complaints about the way this consultation has been conducted, please address them to:

Stephen Childerstone
Better Regulation Team
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Tel: 0207 215 0354
Fax: 0207 215 2235
Email: stephen.childerstone@dti.gsi.gov.uk

A copy of the Code of Practice on Consultation is at [Annex A](#).

PART I: NATIONAL MINIMUM WAGE ARREARS

The government is committed to ensuring the fairest outcome for workers who have been underpaid.

Introduction

1. The NMW Act entitles almost all UK workers to the NMW. The government has always made every effort to protect this entitlement and to restore arrears to workers who have been underpaid, helping helped tens of thousands of workers recover £22.6 million in unpaid wages since 1999. 16 compliance teams around the country work to this end, and earlier this year the Chancellor announced that we are increasing the enforcement budget by £2.9 million.
2. However, the independent Low Pay Commission (LPC) has expressed its concern that, even when arrears are restored to workers, they can still be worse off in real terms as a consequence of underpayment. It has urged the government to consider how this should be tackled.
3. If a worker who qualifies for the NMW is remunerated by his employer at a rate which is less than the NMW, the worker is entitled to arrears. Arrears are currently calculated as the difference between the remuneration received by the worker and the NMW rate which applied at the time that they should have been paid¹.
4. The government recognises that arrears may have lost purchasing power since they were incurred placing the worker at a disadvantage in real terms compared to a worker who was paid correctly from the outset. We are seeking views on whether arrears could be calculated in a fairer way to remedy this. This is referred to throughout as “fair arrears”.
5. Fair arrears would aim to restore to the worker what they had lost in real terms. The government is not seeking to introduce a punitive element on employers through fair arrears. These proposals are separate from the simple, effective penalty on which we seek views in Part II of this consultation.

Coverage

6. All workers have a right to fairness, whether working their complaint out themselves, using a third party such as HMRC, or going to an Employment Tribunal. We are therefore proposing that fair arrears should apply wherever an underpayment has occurred, irrespective of the means used to secure payment.
7. Under this proposal, if fair arrears were not paid to a worker, they would have the same rights as currently to seek repayment for the full amount. They could approach their employer, make a complaint to HMRC, or to an employment tribunal or civil court. Under the proposals in Part II of this document, if an

¹ National Minimum Wage Act, Section 17 (2)

employer were found by HMRC to be underpaying fair arrears, they may face a penalty.

Simplicity

8. It is important that under fair arrears, an employer who proactively identifies an underpayment is able to calculate and restore the correct amount. The worker should be able to easily establish that they have received their entitlement. The government is therefore seeking a clear, straightforward and uniform approach, to be applied wherever underpayment has occurred. This is particularly important in enabling the efficient calculation and resolution of outstanding arrears.

Awareness and guidance

9. For the minimum wage to remain truly successful it needs to be widely known about and willingly complied with. If introduced, the government will continue to take steps to ensure that workers are aware of their entitlement and employers understand how to comply with the law. Again, this is particularly important for those employers who have identified an underpayment and need to calculate and restore fair arrears to their worker.
10. We will issue clear guidance to employers and workers to facilitate this process, and advice and help will continue to be available from Business Link and the NMW helpline. We are interested in any other views on how to promote awareness and understanding of fair arrears.

Options

11. We have included four options- one being to make no change, and three further options for a straightforward, generic mechanism to calculate fair arrears. We are interested in hearing views on these. The options as they appear are:

Option A: Take no action

Option B: Interest on arrears

Option C: Charging all arrears at the current rate of NMW

Option D: Charging standard arrears plus an adjustment

Option A: Take no action

12. Arrears are currently calculated as the difference between the remuneration received by the worker and the NMW rate which applied at the time that they should have been paid². Calculating arrears which stretch back over a number of NMW rates is not always simple, but it is nonetheless a straightforward concept for employers and workers to understand. Where complaints are made to HMRC and arrears are found to be due, the government makes every effort to restore arrears to workers. However, under the present calculation, arrears may have lost purchasing power since they were incurred, placing the worker at a disadvantage compared to one who was correctly paid from the outset.

² National Minimum Wage Act, Section 17 (2)

13. In a recent sample of closed NMW cases, 13% of cases included arrears that stretched back over 5 years³. The longer arrears stretch back, the greater the chance that the worker may lose out in real terms on receipt of their arrears under the present calculation. Taking no action does not address this. We are now looking for a fairer way to calculate arrears to make sure that workers who have been underpaid do not remain disadvantaged, even when they have been repaid their arrears.

Option B: Interest on arrears

14. This option would apply interest could be applied to NMW arrears to mitigate against any loss of purchasing power.

15. Interest can come close to reflecting the value of lost investment on a sum. Compound interest would do this most accurately. However, calculating compound interest would not meet the need for a straightforward system which enables employers and workers to understand what is due. Simplicity is most needed to facilitate the effective resolution of underpayment where it happens without the intervention of HMRC.

16. A straightforward precedent for simple, rather than compound, interest exists in the interest which can be awarded by an employment tribunal on certain awards in discrimination cases⁴. It is calculated to a set government interest rate currently running at 6%⁵. Interest is applied from the mid point of underpayment, reflecting that the total sum was not owing for the whole period, and a daily rate of simple interest is then applied for that period. At the current interest rate the following calculation would give the interest owed:

$$\text{(Half the total days underpaid / 365) x 0.06 x total owed = interest}$$

17. This calculation is most accurate where the worker is underpaid by equal instalments over a period. This is not always the case with NMW, and workers who were initially underpaid by larger amounts may lose out. However, a more accurate calculation would inevitably lose simplicity, becoming more difficult for employers and workers to apply.

18. Once calculated, interest on NMW arrears would be taxable as interest in the hands of the worker- unlike arrears of pay, PAYE would not be operated by the employer on the payment. As such, there are practical implications in how tax would be collected on the interest, which would create complexities for the low paid workers involved. This makes interest less attractive as a way of remedying the disadvantage underpaid workers face.

³ Source: HMRC

⁴ The Industrial Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996

⁵ Special Investment Account Rate under rule 27(1) of the Court Fund Rules 1987 and, in Scotland, the rate fixed, for the time being, by the Act of Sederunt (Interest in Sheriff Court Decrees or Extracts) 1975: regulation 3(2).

19. We are seeking views on whether interest should be applied to arrears to calculate them more fairly. If respondents think that interest on arrears is the best option, we are interested in what the method of calculation should be.

Option C: All arrears charged at the current rate

20. This option would use the current NMW rate, rather than an interest rate, to calculate fair arrears. When workers are repaid, they currently receive arrears calculated against the rate under which their underpayment was incurred. Underpayments stretching over a longer period may have been incurred under more than one NMW rate, as can be seen from the table showing historic adult NMW rates, below.

Figure 1

	1 Apr 1999	1 Oct 2000	1 Oct 2001	1 Oct 2002	1 Oct 2003	1 Oct 2004	1 Oct 2005	1 Oct 2006	1 Oct 2007
Adult Rate (for workers aged 22+)	£3.60	£3.70	£4.10	£4.20	£4.50	£4.85	£5.05	£5.35	£5.52

21. NMW rates are recommended by the LPC, based on their assessment of economic circumstances and evidence at the time. Whilst there is no guarantee that the LPC will recommend a rate rise, historically, previous rates have always been lower than current rates, as this table shows.
22. Using the current rate for all arrears would mean that all arrears restored to workers would accurately reflect what the appropriate national minimum is considered to be in today's economic circumstances. There is, however, no guarantee of how the NMW rate may have changed since the underpayment happened.
23. Under the current trend, workers who had been underpaid at old rates would benefit. Workers who were underpaid within the current NMW rate would not see any increase, as the NMW rate they were underpaid under is still considered to be the appropriate rate of NMW given the evidence and economic circumstances.
24. When the NMW rate changes, the new rate usually takes effect from 1st October of a given year. Charging all arrears at the current rate means that a worker who is underpaid into a new rate period, even if just by a couple of weeks, will benefit significantly more than one who has been underpaid for almost a year, but whose underpayment stops just shy of a new rate.
25. However, this is a simple system which is easy for employers and workers to understand. An employer would no longer need to work out each period of arrears to a different historical rate, and could instead calculate arrears by

comparing what was paid to the worker for the entire period of arrears to one (current) NMW rate. It also offers an incentive to employers to resolve underpayments swiftly, before any rate change.

26. We are seeking views on charging all arrears using the current rate of NMW.

Option D: Adjusted arrears

27. In this option, arrears would be calculated in the present way⁶ then adjusted to create an uplift payable to the worker from the employer. Adjusting the earnings owed would mitigate against the loss of purchasing power.

28. The adjustment would be based on how much the worker had been underpaid, and would be prescribed by legislation. It could be determined by:

a) a fixed percentage of arrears, or

b) the “band” of arrears the underpayment falls into. For instance, arrears of £0 - £100 could see a fixed sum going back to the worker. Arrears of £100+ could see a higher fixed sum going back to the worker.

29. Both systems allow an employer to quickly work out the adjustment and apply the uplift that is due to their worker. They also allow the worker to quickly ascertain whether they have been repaid correctly.

30. Whether adjusting arrears by percentage or by banded arrears, the amount of time that money has been owing is not taken into account. This may affect the accuracy with which the adjustment can reflect any loss of purchasing power. However, adjusting by percentage does mean that the uplift is strictly in proportion to the amount underpaid. Banding arrears can be slightly less proportionate, particularly for those on the upper or lower margins of a band. Those on the upper margins could even consider “holding out” before they tried to resolve their arrears, to secure a higher uplift.

31. We are seeking views on arrears plus an adjustment, how the adjustment should be calculated and what level it should be set at.

Summary of questions

The government is interested in introducing a new way to calculate fair arrears for all workers. Do you have any comments on this?

Please indicate which of the following options you prefer:

A. Take no action

B. Interest on arrears

C. Charge all arrears at the current rate

⁶ National Minimum Wage Act Section 17 (2)

D. Arrears plus additional sum

Please comment on the options in more detail.

A. Take no action

Do you have any comments on this?

B. Interest on arrears

How should this be calculated?

Do you have any other comments on this?

C. Charging all arrears at the current rate

Do you have any other comments on this?

D. Adjusted arrears

How should the adjustment be calculated?

If the adjustment is calculated by percentage, what should the percentage be?

If the adjustment is calculated by adding a sum determined by the band of arrears incurred,

i) what should the bands be and

ii) what should the sum be?

Do you have any other comments on this proposal?

Do you have any other comments or suggestions on how fair arrears could be calculated?

If the government introduces fair arrears, do you have any comments on how to awareness and guidance could be made available to workers and employers?

PART II: NATIONAL MINIMUM WAGE PENALTIES

The government is committed to simple, effective NMW enforcement which supports workers and businesses by deterring non compliant employers from underpaying their workers, eradicating the unfair competitive advantage that underpayment can bring.

Introduction

32. Part I of this document addressed how arrears can be restored to workers more fairly. Part II is concerned with the separate matter of how to create a simpler penalty system able to penalise employers who are found to be underpaying the NMW, with the aim of preventing arrears from arising in the first place.
33. The government is committed to ensuring that those who are entitled to the NMW receive their entitlement. Enforcement action is geared to this aim, by increasing the number of employers paying the minimum wage who should be paying it and increasing the number of workers receiving the minimum wage who are entitled to receive it. In 2005/06, our enforcement teams helped over 25,000 workers recover more than £3 million in unpaid wages. However, the best protection we can offer workers and compliant businesses is to strive to ensure that arrears do not arise in the first place.
34. At present, employers who are found to be underpaying their workers can repay what they owe without attracting a penalty notice. Because of this, 95% of the non compliant employers we identify do not pay a penalty. Nearly a decade on from the NMW Act, it is timely to consider whether we have the right deterrent, or whether there is more we could do to change the behaviour of non compliant employers. That is why we agreed to actively consider the 2007 LPC recommendation that “as a deterrent to non-compliance, the government introduce a penalty to apply to any employer found to have underpaid the minimum wage”.
35. The 2005 Hampton Review⁷ highlighted that effective enforcement can support compliance across the board. Our efforts are targeted at non compliant businesses. There are no inspections without a reason, and advice and guidance is available to employers. Finding the right deterrent to underpayment will do more than ever before to protect workers from exploitation and better protect compliant businesses from unfair competition.
36. This is also an opportunity to simplify and clarify the existing penalty regime to create an easily understood deterrent which makes clear that underpayment is unacceptable, and what the consequences of underpayment will be. The proposals in this consultation are for a penalty which would replace the existing penalty notice. We will also consider how the penalty can be streamlined alongside enforcement notices to create a clearer, more transparent regime.

⁷ Philip Hampton (2005) *Reducing administrative burdens: effective inspection and enforcement*

Coverage

37. Almost all workers in the UK are entitled to the NMW. HMRC enforce NMW legislation on the government's behalf in the United Kingdom. DEFRA and the agricultural agencies in Scotland and Northern Ireland undertake enforcement of the minimum wage in the agricultural sector. These agencies were responsible for enforcement of the agricultural minimum wage (AMW)⁸ prior to the introduction of the NMW.
38. Common enforcement procedures currently apply in respect of both the AMW and NMW. DEFRA ministers and the devolved agricultural agencies will take into account views expressed during this consultation and the impact of any shift in the emphasis of enforcement procedures (see Effects of a new penalty) when considering whether the AMW will be enforced using fair arrears and a new penalty. Views are welcome both on enforcement of the NMW and AMW.

Figure 2

What is the existing enforcement process?

HMRC respond to enquiries and complaints from workers, employers and third parties to help ensure that employers comply with the NMW. Using risk assessment they also select and visit a sample of employers to check that they are meeting their obligations under the minimum wage legislation.

Presently, employers who are underpaying can pay arrears during the course of the investigation. If they do not, they are issued with an enforcement notice⁹ - an official demand that the arrears should be paid. If the arrears outlined on the notice are paid in full in the time specified, there is no penalty.

If the enforcement notice is not complied with in full, employers are issued with a penalty notice. This penalises the employer for non compliance with the enforcement notice¹⁰ and is calculated by a statutory formula:

twice the hourly amount of the NMW (as in force at the date of the penalty notice) in respect of each worker to whom the failure to comply relates for each day during which the failure to comply has continued in respect of the worker .

The minimum penalty is £224.70, for an employer who has underpaid one worker. Penalties are paid centrally to government and held in the Consolidated Fund. An employer can appeal an enforcement notice if they believe it is incorrect. They can also appeal a penalty notice if they believe it is incorrect¹¹. Both appeals are initially to an employment tribunal.

⁸ No agricultural worker may be paid less than the NMW. Some agricultural workers must be paid more than the NMW because there is a higher agricultural minimum wage. For further details see DTI (2004) *A detailed guide to the National Minimum Wage*, DTI URN 04/1253

⁹ National Minimum Wage Act, Section 19

¹⁰ See DTI *National minimum wage penalty notice policy* at <http://www.dti.gov.uk/files/file36381.pdf> and the National Minimum Wage Act, Section 21. If an enforcement notice has not been complied with, an officer acting on behalf of a worker may also present a complaint to an Employment Tribunal or start civil proceedings in the County (Sheriff's) Court to regain arrears.

¹¹ National Minimum Wage Act, Sections 19(4) to (10) and Section 22

The most serious cases of non-compliance with NMW legislation may be criminally prosecuted.

A simpler penalty regime

39. In 2005 the LPC reported on research into the ways in which small firms in the restaurant and clothing sectors operate in the informal economy. This revealed uncertainty amongst employers as to what action would be taken against them if they underpaid the NMW and the penalties for non-compliance they would face¹². Common perceptions of the consequences of detection ranged from uncertain notions of penalties to sanctions which would close the business, or automatic arrest¹³.
40. In January 2007, the Government published its penalty notice policy to help make clear that non compliance with an enforcement notice will result in a penalty, and how that penalty is calculated. However, we accept that it is not inherently obvious under the current penalty notice regime when an underpaying employer will be penalised, and what the penalty will be. This probably weakens the deterrent effect of our current measures.
41. In seeking views on penalty options which are simpler than the current penalty notice, we will also consider the interaction of penalties and enforcement notices¹⁴, and if there is any scope to streamline these processes whilst retaining the underpinning rights to appeal.

Grounds for a penalty

42. The LPC have previously noted that most employers who do not pay the minimum wage and have enforcement action taken against them are no worse off than if they had paid the minimum wage at the outset. This is because, under our current regime, it is non compliance with an enforcement notice, rather than underpayment itself, which is penalised. We want to replace our current penalty with a penalty for underpayment.
43. This would focus more formal action on non-compliant businesses, and would deter businesses from underpaying their employees to achieve lower costs, and the unfair competitive advantage that brings. It would effectively create an automatic penalty for any employer found to be underpaying the NMW. This makes it easier than at present for non-compliant employers to understand whether they will be penalised- if you are caught underpaying, you will face a penalty.
44. In proposing underpayment as grounds for a new penalty, we recognise that there is an enforcement cost associated with penalising employers who have

¹² Low Pay Commission (2005) *National Minimum Wage: Low Pay Commission Report 2005* URN 05/849

¹³ M. Ram *et al* (2004), *Informal employment, small firms and the National Minimum Wage*.

¹⁴ National Minimum Wage Act 1998, Sections 19 - 22

underpaid. Since there is no further benefit to the worker in those cases where employers have underpaid in the past, but since been proactive and repaid arrears in full before the intervention of HMRC, we are only seeking to apply the penalty in cases where arrears are outstanding.

45. This would mean that if a case came to the attention of HMRC where a worker had been underpaid but the employer had resolved the situation by repaying arrears in full (including the “fair arrears” described in Part I), we would not envisage that a penalty would be applied. However, where a complaint is made and arrears were found to be outstanding, we envisage that a penalty would apply.
46. A penalty for underpayment would apply to employers found to be underpaying the NMW whatever the motivation for the underpayment. Whether caused by ignorance of the law or by deliberate non-compliance, underpayment means that the law has been broken and a competitive advantage has been gained at the expense of the worker. An automatic penalty encourages all employers to take care to comply with the law, and, if in doubt as to how the law applies to them, to use the sources of advice and guidance that are available [see *Awareness and guidance*].
47. We are not therefore proposing a penalty process which assesses the motivation of the employer who underpays. This would prolong and complicate the procedure. The underpinning right for an employer to appeal an invalid demand for arrears or penalty is valuable to ensure a fair system, and would continue.
48. We are interested in whether there are any circumstances in which you think that an automatic penalty should not apply.

Escalation

49. The existing penalty notice has merit in persuading employers who have not been inclined to repay arrears during the course of an investigation to do so at enforcement notice stage.
50. It is important to retain an incentive for employers to return arrears to workers as quickly as possible, to dissuade the minority of employers who may be inclined to prevaricate further once HMRC has established that arrears are owing. We particularly recognise that some employers may be less willing to work with HMRC and repay arrears if they are facing an automatic penalty for underpayment.
51. We are therefore proposing a penalty which escalates if arrears remain unpaid or the penalty is ignored, encouraging employers to pay arrears early, rather than delay. This would mean a penalty which is set at an initial level, but has the capacity to increase to a higher level if not acted upon- for instance if arrears are not repaid within a specified time. This would mirror the current penalty notice which is applied when an employer ignores or doesn't pay in full an enforcement notice. For each option, we ask what the initial level of the penalty should be, and what the penalty should escalate to.

Level of the penalty

52. For each of the options we are consulting on, we are interested in views on what the level of the penalty should be both when underpayment is identified, and, if arrears continue to be ignored, what the penalty should escalate to. The minimum for a current penalty notice is £224.70. This is imposed at a late stage in the enforcement process, for an employer who has failed to comply with an enforcement notice (who has been made aware of arrears and not repaid them). We are interested in whether, when a penalty has escalated, it should reach a level broadly equivalent to this, or more.
53. For all the options, the government will consider whether a minimum and maximum limit to the penalty should be applied, to ensure an appropriate response which does not become unduly punitive. We are interested in views on this, and what the minimum and maximum should be.

Awareness and guidance

54. An automatic penalty highlights the importance of ensuring that employers are aware of their obligations. Once employers are found to be underpaying NMW, they will not simply be provided with information and advice to move back into compliance- they will also be liable for a penalty.
55. The NMW Act is an established feature of the UK labour market, nearly a decade old, and surveys show that awareness is high. Nonetheless, a new penalty places a premium on employers knowing their obligations at the right time, and it is important that employers continue to have access to “without prejudice” information to understand and meet their regulatory requirements more easily.
56. Therefore, under the new policy for fair arrears and penalties, we envisage that employers would continue have access to existing sources of advice such as the NMW helpline, Business Link and the DTI’s website, without enquiries in themselves triggering enforcement action.

Effects of a new penalty

57. Potentially, the 95% of non compliant employers who currently settle arrears informally during the course of an investigation would be penalised by creating an automatic penalty for those found to be underpaying their workers. It is therefore likely that the new penalty will be applied more often than the current penalty notice. Issuing and collecting more penalties has resource implications.
58. Informally settling arrears during the course of an investigation can be a quick route to restore arrears to workers without further action or investigation being taken. To gather the level of evidence necessary to penalise, greater input and investigation may be needed by HMRC and in some cases it could take longer to return arrears to workers.

59. Ultimately, these considerations could affect the throughput of cases. This must be weighed against the deterrent effect that a new penalty would have. The increase in the penalties issued will depend on the incentive that a clearer, simpler penalty will create for employers to pay the right amount at the right time, and the proposals here acknowledge that the best protection we can offer workers and compliant businesses is to strive to ensure that arrears do not arise in the first place.
60. These proposals underline our commitment to increasing the number of employers paying the minimum wage who should be paying it and increasing the number of workers receiving the minimum wage who are entitled to receive it.

Claims taken direct to a tribunal

61. As well as having recourse to HMRC, the NMW Act allows workers to take their claim directly to an Employment Tribunal or civil court. We would envisage that this would include cases where fair arrears, as described in Part I, had not been paid. Claims to a tribunal are initially referred to Acas, who have a statutory duty to promote the settlement of claims without the need for them to be determined by a hearing. If conciliation cannot be reached, the claim proceeds to a tribunal.
62. It could be argued that, as these cases may result in an underpayment being identified, a new penalty should also be created for such cases. If the level of the penalty amounted to an additional deterrent over and above the cost and inconvenience to an employer of defending a tribunal claim, it could be argued that this might encourage employers to settle through conciliation.
63. In 2005/06 fewer than 400 cases involving NMW were passed to Acas for conciliation. In around 80% of these, the minimum wage was only one of the issues complained of. This makes the likelihood of resolution of the whole case through the deterrent effect of the NMW penalty less likely. Given that NMW cases represent well under 1% of all the cases Acas receive, the effect a new penalty could have in avoiding tribunal action would be minimal.
64. Our overall aim is to simplify and strengthen the enforcement regime operated by HMRC through the NMW Act. The options we are consulting on do not therefore include proposals for new civil penalties for cases where a claim is made directly to a tribunal or civil court or referred for resolution to Acas.

Options

65. Below are the options for consultation including those for a simpler, more effective penalty for employers found to be underpaying the NMW.

Option A: Take no action

66. The current regime enables 95% of non compliant employers to settle their arrears without attracting a penalty. This allows informal resolution of the majority of claims, which can see arrears being quickly restored to workers.

67. If an employer does not settle arrears during the course of an investigation an enforcement notice is issued. If the employer does not fully comply with an enforcement notice in the specified time, in almost all cases a penalty notice will be issued. This encourages employers to comply with the enforcement notice. However, the penalty calculation is complex and the penalty does not have the simple, up front deterrent effect of an automatic penalty for underpayment.
68. We now want to make sure that we have the right incentives in place to make sure that employers comply with the law at the right time, discouraging arrears from arising in the first place. The existing regime has worked well, but nearly a decade on the NMW Act is an established feature of the UK labour market. It is timely to consider whether we have the right deterrent, or whether there is more we could do to change the behaviour of non compliant employers through introducing a simpler, clearer penalty regime.

Option B: Fixed penalty

69. This option would introduce a fixed penalty which could be applied to any employer who was found to be underpaying the NMW.
70. The penalty would be the same amount regardless of the number of workers who were underpaid, or the level of underpayment. All breaches would attract the same penalty. This means that a business underpaying one worker would be fined as much as a business underpaying 500 workers. It may be felt that this lacks proportionality.
71. However, such a penalty is both simple to publicise and understand. It is also simple to apply, as the only criteria to establish is that there is an underpayment.
72. We are seeking views on this penalty, including at what level it should be set, and to what level it should escalate if the arrears remain unpaid or the penalty notice is ignored.

Option C: Fixed penalty per worker

73. This option would introduce a penalty which could be applied to any employer found to be underpaying the NMW, and calculated by a fixed sum per worker underpaid.
74. This is not strictly in proportion to the size of the employer, but it is in proportion to the number of the workforce who have suffered an underpayment. It is not, however, in proportion to the amount of underpayment, so the penalty for 10 workers who were underpaid by £5 each may be greater than the penalty for underpaying 1 worker by £500.
75. This penalty also means that the number of workers being underpaid has to be established correctly. Enforcement teams will already strive for this information to issue a demand for arrears but it does require operational effort and introduce a risk of challenge not on whether underpayment took place, but how many people were underpaid.

76. We are seeking views on this penalty, including at what level it should be set, and to what level it should escalate if the arrears remain unpaid or the penalty is ignored.

Option D: Penalty which is a multiple of arrears

77. This option would introduce a fixed multiplier in legislation, which would be applied to the level of arrears outstanding to create the penalty amount. This could be applied to any employer found to be underpaying the NMW.

78. This makes the penalty in proportion to the amount of arrears underpaid, but is regardless of how many workers have been underpaid. A large amount of arrears could be spread across many workers, or just suffered in total by one worker. The penalty would be the same.

79. This necessitates an exact calculation of arrears and may be an incentive for the employer to argue that arrears are less.

80. We are seeking views on this penalty, including at what level the multiplier should be set, how the multiplier or penalty should escalate if the arrears remain unpaid or the penalty is ignored.

Option E: Banded fixed penalty

81. This option would introduce a fixed penalty which is determined by what “band” the total level of arrears falls into, to be applied to any employer found to be underpaying the NMW.

82. This again brings the penalty in proportion to the amount of arrears underpaid, regardless of how many workers have been underpaid. A large amount of arrears could be spread across many workers, or just suffered in total by one worker. The penalty would be the same.

83. However, it could result in a clearer deterrent. Employers will know up front that if they underpay by a certain range, the resulting penalty will be a fixed amount.

84. We would want the bands to be simple and for there not to be many. We are seeking views on this penalty, including what the bands should be, at what level the penalty should be set, and to what level it should escalate if the arrears remain unpaid or the penalty is ignored.

Questions

The government is interested in introducing a penalty for all employers found to be underpaying the NMW. Do you have any comments on this?

Are there any circumstances when you think that an automatic penalty for underpaying the NMW should not apply?

Do you have any views on whether there should be an upper or lower limit to the penalty options, and what the limit should be?

Please indicate which of the following options you would prefer:

Option A: Take no action

Option B: Fixed penalty

Option C: Fixed penalty per worker

Option D: Penalty which is a multiple of arrears

Option E: Banded fixed penalty

Please comment on the options in more detail:

Take no action

Do you have any comments on this option?

Fixed penalty

What should the level of the penalty be?

How should the fixed penalty escalate?

Fixed penalty per worker

What should the level of the fixed penalty be?

How should the fixed penalty escalate?

Penalty which is a multiple of arrears

What should the multiplier or level of the fixed penalty be?

How should the fixed penalty escalate?

Banded fixed penalty

What should the level of the fixed penalty be?

How should the fixed penalty escalate?

Do you have any comments on what more the government could do to offer guidance / raise awareness of how to comply with the NMW?

PART III: EMPLOYMENT AGENCY PENALTIES

The government is committed to an effective penalty regime which supports agency workers and reputable agencies by deterring the small minority of non-compliant agencies from mistreating their workers and cutting corners at the expense of reputable agencies.

Introduction

85. The Government is fully committed to providing effective legislation to protect those using the services provided by employment agencies and to help ensure agency workers get the employment rights to which they are entitled and stamp down on abuses. The Conduct of Employment Agencies and Employment Businesses Regulations 2003, which came into force in April 2004, are enforced by the Department of Trade and Industry's Employment Agency Standards (EAS) Inspectorate. The Inspectorate follows up every relevant complaint it receives which indicate a possible breach of the legislation, and undertake spot checks on the basis of risk.
86. While the great majority of employment agencies are reputable and seek to comply with the relevant legislation, there is a minority that are not willing to comply. This proposal seeks to address that non-compliant minority. It should have no detrimental implications for reputable agencies, and may indeed benefit them by improving enforcement against rogue agencies who seek to cut corners at the expense of the majority that comply with the law.
87. The EAS takes a risk-based approach to enforcement, providing help and assistance to the majority of employment agencies and businesses who are seeking to comply with the relevant regulations but taking firm action, including prosecution or prohibition where necessary, against those that break the law and mistreat their workers.
88. While EAS inspectors seek in the first instance to achieve compliance through advice and persuasion, the Inspectorate can take prosecution action, where appropriate, in a Magistrates' Court against an agency found to be in breach of the legislation. If the prosecution is successful, the agency may be fined up to £5,000 for each offence. The EAS can also apply to an employment tribunal for orders prohibiting those persons who are considered to be unsuitable from operating an agency for up to 10 years.
89. It is important that the enforcement powers available to the EAS are effective since we need firm mechanisms to deal with the disreputable minority of agencies who mistreat workers or seek to deprive them of their rights. Prosecution is therefore reserved for the most serious cases where the agency is not prepared or willing to comply with the relevant legislation or where the offence is so serious that prosecution is warranted. The EAS currently considers prosecution in between 5 and 10 cases per year.
90. It has become clear that the penalties currently available are not always adequate to achieve effective enforcement. While any breach of the

regulations governing employment agencies (the Conduct of Employment Agencies and Employment Businesses Regulations 2003) is a criminal offence, all criminal offences under the EA Act are summary offences (ie tried in a magistrate's court).

91. The EAS experience has been it has proved difficult to prosecute the small minority of determinedly non-compliant agencies who seek to exploit every possible loophole. Key difficulties relate to the limitations of prosecuting for summary offences, both in terms of adequacy of penalties and the relative lack of investigative and prosecution powers where criminal offences are summary only.

Inadequacy of penalties

92. This problem is most acute in terms of the penalty for contravening a prohibition order, ie when an individual who has been prohibited from running an agency ignores the ban and carries on in business. While the EAS has powers to seek the prohibition of unsuitable individuals from running an agency for up to 10 years, the maximum sentence for breaching a prohibition order is a level 5 fine (ie a maximum of £5000). This may not be an effective deterrent where the agency is generating a lot of money.
93. While in some circumstances, it will be possible for the EAS to obtain a confiscation order under the Proceeds of Crime Act 2002, which could make the effective financial penalty much greater and therefore more effective, this will not always be the case. In order for the EAS to be able to seek an order under the Proceeds of Crime Act, it must prove one or more of the following: that the agency has committed 4 or more offences, the agency or principal offender has previous "qualifying offences", one of which was for a period in excess of 6 months; or the net value of the proceeds from the offence must be in excess of £5,000. At present no offence under the 1973 Act or the regulations is a qualifying offence. In addition, such an order would only be made where it could be shown that the defendant had identifiable assets. This inevitably involves a lengthy investigation into an offender's personal means and requires the case to be committed to the Crown Court as there is currently no power to deal with it in the Magistrates' Courts. An order under the Proceeds of Crime Act, while a valuable tool in terms of penalties (it was used in the EAS's most recent prosecution), cannot therefore be considered a substitute for an adequate penalty for the most serious breaches of the Employment Agencies Act or the Conduct Regulations.

Lack of investigative powers

94. As the offences under employment agencies legislation are summary offences, the EAS's powers to investigate offences are limited.
95. Section 9(1) of the Employment Agencies Act already gives EAS Inspectors the right to enter any relevant business premises, to inspect any records or documents kept in pursuance of employment agency legislation and to take copies of any such records or documents. However, the right to take copies of documents in practice requires an element of co-operation from the agency concerned (since invariably this means taking copies on the agency's

photocopier), and in cases where the EAS is investigating serious allegations, such co-operation may not be forthcoming. While it is a criminal offence to obstruct an inspector in the course of their duties, and the vast majority of agencies readily co-operate with Inspectors, seeking a prosecution for obstruction is of itself a time-consuming and labour intensive process.

96. In an investigation, where it appears workers may have been denied money that is owed to them, it is crucial for EAS Inspectors to discover what payments have been made to an agency to identify what monies have been received and the identities of those making payment. In a number of cases, the EAS receives complaints from one or two workers who may have lost money as a result of bad practices of rogue agencies (such as agencies making illegal charges for work-finding services or not paying workers money that they have earned). But there may be a substantial number of other workers who have been similarly mistreated by that agency but who (for a variety of reasons) have not complained. Unless the EAS Inspectors can examine the agency's financial records, it is not possible to determine in such cases whether this is a generally compliant agency that has made a few bad mistakes or a rogue operation systematically cheating agency workers out of their money. The EAS's policy is to concentrate enforcement resources on the latter type of activity.
97. At present EAS Inspectors do not have clearly defined powers to examine an agency's financial records. EAS Inspectors cannot therefore obtain financial information from third parties such as banks and financial authorities regarding agencies suspected of obtaining money unlawfully.

Lack of prosecution powers

98. As offences under employment agency legislation are summary offences, EAS must have evidence that an actual offence has to take place before charges can be brought – there is no scope to prosecute for “attempting” to commit offences under this legislation (eg attempting to obtain money for job finding services). In effect this means that the EAS needs to identify witnesses to come forward to give evidence that the offence was committed. In the main, such witnesses will be agency workers who have been victims of these offences. Getting such victims prepared to stand up in court and give evidence against an agency that has refused Inspectors' requests to correct their illegal practices has proved to be a problem on a number of occasions. In addition, some potential witnesses may fear intimidation where highly disreputable agencies are involved. There is a fear that such individuals will be seen as potential trouble-makers and not get future work from other agencies. There have been cases where the EAS has evidence that the agency concerned has mistreated a number of workers and that such mistreatment warrants prosecution but where the lack of witnesses prepared to come forward means a prosecution cannot be brought.

Proposed solution

99. The Government is proposing that offences under the Employment Agencies Act 1973 and the Conduct of Employment Agencies and Employment Businesses Regulations 2003 should be triable either as summary offences in

a magistrate's court or as indictable offences in a crown court. The penalties and powers of prosecution would depend on which court the case came before.

100. Making the criminal offences capable of being indictable would have benefits in terms of penalties. While we would not expect any but the most serious cases to warrant treatment as an indictable offence in the crown court, these are the very offences where the current £5,000 limit on fines appears potentially most inappropriate. The usual practice in the case of indictable offences is that the maximum fine level should be unlimited on indictment rather than setting any particular amount. This would enable a court to set a fine level on conviction appropriate to the circumstances of each case and would have the added advantage that inflation cannot erode the relative amount of a maximum fine set down in legislation.
101. There would also be advantages in terms of investigative and prosecution powers. Making the offences triable either by magistrate's court or by crown court would:
- a) enable EAS Inspectors (sometimes unable to persuade agencies to allow them to make copies of documents) to take documents away for specified periods of time
 - b) enable the EAS to prosecute individuals where there is evidence they have "attempted" to commit offences under the EA Act (eg attempting to obtain money for job finding services) without necessarily having to rely on witnesses being prepared to appear in court.
102. We anticipate that the EAS would need to seek to try only a handful of cases in the crown court each year. However the Government considers that the current enforcement regime is not sufficiently well equipped to obtain the evidence it needs and provide an appropriate deterrent in the most serious cases. We do not anticipate that taking these additional powers would have any impact upon law-abiding agencies or indeed upon those agencies who swiftly put right any small and/or inadvertent breaches of the law when these are brought to their attention. Indeed, we would anticipate that such new powers would benefit the law-abiding by making the EAS better equipped to deal with those who deliberately seek to break the law and provide unfair competition to other agencies as well as mistreat their workers.

Questions:

Do you consider that prosecutions under employment agency legislation should be capable of being tried in the Crown Court in the most serious cases?

Do you agree that the maximum penalty for such serious offences should be an unlimited fine?

Do you consider that enabling such prosecutions to be tried in the Crown Court would have any implications for reputable agencies, and if so, what do you consider these implications would be?

103. Making the offences triable either by Magistrates' Court or Crown Court would not of itself give EAS Inspectors clear and specific powers to obtain production orders for documents, eg bank statements and other financial records.
104. However, we are aware of a number of cases where rogue agencies have sought to use the physical absence of normal financial records as a mechanism to block the investigations of the EAS eg. where the Inspectorate has evidence that workers have been deprived of money owed to them and has reason to believe other workers may also have been cheated and wishes to check the extent of the wrong-doing. To ensure that rogue agencies can no longer evade investigations in this way, the Government also proposes to amend Section 9 of the Employment Agencies Act 1973 to clarify powers available to EAS inspectors to be able to demand and secure copies of financial information from an agency or suspect directly or from third parties such as banks and financial authorities. To ensure this power could only be used appropriately, limits would be placed on the circumstances in which it could be used to enable a proper balance to be achieved between the needs of the EAS to establish the amount of money received from unlawful practices and the needs for confidentiality and privacy of information. We consider that such a power should only be available where a prosecution was under active consideration. On the basis of current experience and practice, we would therefore envisage such powers being used around 10 occasions per year.

Questions:

Do you agree the EAS should have powers to seek financial information from third parties such as banks and financial authorities where an agency or individual is suspected of a serious offence under the Employment Agencies Act:

where a prosecution is under active consideration?

in any other circumstances? (if yes, please state what these circumstances are)

What, if any, implications do you consider the grant of such powers would have for reputable agencies?

WHAT HAPPENS NEXT?

This consultation will close on 8 August 2007. The Government will consider the responses to the consultation and then publish a Government response, setting out how it intends to proceed.

Some of the measures set out in this consultation document would require primary legislation to implement, and if the Government decides to take these forward, it will do so when Parliamentary time allows. No decision or commitment can be made by the government in advance of the announcement of forthcoming legislative programmes. On the National Minimum Wage proposals, it is possible that some of the measures we are consulting on would also require secondary legislation.

In preparing this consultation, initial discussions have been held with a number of businesses, employees, representatives, professionals, trade bodies and associations. As part of this consultation, we would welcome the opportunity to discuss the issues with other interested parties.

To help the consultation process, the Government is considering planning a number of events, further details of which will be placed on the consultation website www.dti.gov.uk/consultations. If you wish to be kept informed of these meetings and progress on the consultation, please tick the box on the response form, giving your email address.

INITIAL REGULATORY IMPACT ASSESSMENT

Introduction

The vast majority of employers comply with National Minimum Wage (NMW) legislation. But nearly a decade on from the National Minimum Wage Act 1998 ('the NMW Act'), some unscrupulous employers continue to underpay their workers. This is both unfair to the compliant businesses that are undercut, and to the employees who are underpaid.

The Government is proposing a new strategy to deal with these cases, based on a fairer way of dealing with arrears of the National Minimum Wage, and a simpler, more effective penalty regime to deter potentially non compliant employers.

The Government is also proposing changes to the penalties regime for breaches of employment agency legislation, and to clarify the investigative powers of the Employment Agency Standards Inspectorate (EAS) to achieve more effective enforcement.

National Minimum Wage enforcement, penalties and arrears

Purpose and intended effect

Objectives

1. A key Government priority is to minimise the number of workers who are underpaid by making sure the right incentives are in place to ensure that employers comply with the law, preventing arrears from arising in the first place.
2. This is why the DTI has agreed to actively consider the 2007 Low Pay Commission (LPC) recommendation that “as a deterrent to non compliance, the Government introduce a penalty to apply to any employer found to have underpaid the minimum wage.” The DTI’s aim is for **a simple, effective enforcement mechanism** that employers can easily understand.
3. The DTI also aims for the fairest outcome for those who have been underpaid, and is therefore considering how to make sure that when arrears are restored, workers do not lose out in real terms as a result of that underpayment because their arrears may have lost purchasing power since they were incurred.

Background

4. Almost all workers in the United Kingdom are entitled to the NMW. Her Majesty’s Revenue & Customs (HMRC) enforce NMW legislation on the Government’s behalf in the UK. In agriculture, the NMW is enforced by the Department of Environment and Rural Affairs in England and Wales, and by the devolved administrations in Scotland and Northern Ireland.

Fair arrears

5. If a worker who qualifies for the NMW is remunerated for any pay reference period by his employer at a rate which is less than the NMW, the worker is entitled to arrears. These are defined under section 17(2) of the NMW Act as the difference between the remuneration received by the worker and the NMW rate they should have been paid at.
6. This calculation does not take into account that arrears may have lost purchasing power since they were incurred.

Penalty for underpayment

7. Currently employers who are brought to HMRC’s attention as underpaying the NMW are able to repay arrears without attracting a penalty, either by repaying arrears during the course of an investigation or repaying arrears in full on receipt of an enforcement notice. A penalty can only be applied if the employer does not comply with an enforcement notice. It can therefore be argued that the current penalty regime does not provide an

incentive for employers to comply at the right time, and does not do enough to prevent arrears from arising in the first place.

8. If the enforcement notice is not fully complied with, employers are issued with a penalty notice which penalises the employer with a fine. The minimum penalty is £224.70, for an employer who has underpaid one worker.

Rationale for Government intervention

Fair arrears

9. The government recognises that arrears may have lost purchasing power since they were incurred. This means that even where arrears are restored to a worker who has been underpaid, they may still be at a disadvantage in real terms compared to a worker who was paid correctly from the outset. Fair arrears would seek to restore to the worker what they had lost in real terms.

10. All workers have a right to fairness, whether working their complaint out themselves, using a third party such as HMRC, or going to an Employment Tribunal. We are therefore proposing that fair arrears should apply wherever an underpayment has occurred, irrespective of the means used to secure payment.

11. It is important that under fair arrears, an employer who proactively identifies an underpayment is able to calculate and restore the correct amount. The worker should be able to easily establish that they have received their entitlement. The government is therefore seeking a clear, straightforward and uniform approach, to be applied wherever underpayment has occurred.

Penalty

12. Fair arrears aims to restore to the worker what they had lost in real terms. The Government is not seeking to introduce a punitive element on employers through fair arrears. Fair arrears do not, therefore, fulfil the objective for a simple, effective deterrent to non compliance. As a result, the Government is also considering options for a penalty, with the objective of ensuring that arrears do not arise in the first place.

13. The current NMW penalty formula is not straightforward to calculate. It is:

twice the hourly amount of the NMW (as in force at the date of the penalty notice) in respect of each worker to whom the failure to comply relates for each day during which the failure to comply has continued in respect of the worker.

14. As a result, because employers may not know up front what the penalty they face is, the deterrent effect of the penalty could be weakened.

Consultation

Within Government

15. The DTI has consulted with several other departments including HM Revenue and Customs and the Department of Environment, Food and Rural Affairs as enforcers of the NMW and the Agricultural Minimum Wage. DTI has also consulted with HM Treasury, the Scottish Executive and the Employment Tribunals Service.

Public consultation

16. The Government is now undertaking a further three month public consultation on its proposed approach.

Options

17. As well as the option of **do nothing**, the following options on arrears and penalty regimes are also being considered:

i) Arrears

18. To reflect the concerns outlined in the section *Rationale for Government intervention*, the Government is considering the following options for a straightforward, generic mechanism to calculate fair arrears for all workers:

i) Charging interest on arrears;

Interest is applied in some areas of employment law, such as when awarded by an employment tribunal in discrimination cases¹⁵, or on the late payment of tribunal awards¹⁶. This is calculated to a set Government interest rate. This could accurately reflect what the worker might have lost in terms of interest earned whilst arrears were withheld. However, there are tax implications which could introduce complexity for the worker.

ii) Charging all arrears at the current rate;

When workers are repaid, they receive arrears calculated against the rate their underpayment was incurred under. Underpayments stretching over a longer period may have been incurred under more than one NMW rate.

The NMW rate has increased annually since its introduction. Whilst there is no guarantee of this, it does mean that generally, previous NMW rates are lower than the current rate.

It would mean that all arrears restored to workers would accurately reflect what the appropriate minimum wage is considered to be in today's economic circumstances.

¹⁵ The Industrial Tribunals (Interest on Awards in Discrimination Cases) Regulations 1996

¹⁶ Employment Tribunals (Interest) Order 1990

Using the current rate for all calculations would also mean that the employer would not need to work out each period of arrears to a different rate. They would use one single (current) NMW rate to calculate arrears.

This would not affect arrears which had been incurred under the current rate. Such workers would be receiving their arrears at the rate which was still considered the appropriate NMW.

iii) Adjusted arrears

Arrears could be calculated in the present way, and then adjusted to create an uplift payable to the worker from the employer. Adjusting the earnings owed would mitigate against the loss of purchasing power.

The adjustment would be determined by how much the worker had been underpaid, for instance as a fixed percentage of arrears, or as an amount depending on the “band” of arrears the underpayment fell into (for instance, arrears of £0 - £100 could see a different sum going back to the worker than arrears of £100+).

This would enable employers to quickly work out the adjustment and apply the uplift that was due to their workers, and workers could quickly ascertain whether they had been repaid their earnings correctly.

ii) Penalties

19. It is important to retain an incentive for employers to admit and repay arrears, even when caught. The Government is therefore proposing a penalty which escalates if arrears remain unpaid or the penalty is ignored, encouraging employers to pay arrears early, rather than delay. This would mean a penalty which is set at an initial level, but had the capacity to increase to a higher level if not acted upon. This would mirror the current penalty notice which is applied when an employer ignores or doesn't pay in full an enforcement notice. For each option, we ask what the initial level of the penalty should be, and what the penalty should escalate to.

20. To create a simpler penalty regime, the Government is also considering replacing the existing enforcement and penalty notice regime with a streamlined mechanism for demanding arrears and applying a penalty. As well as taking no action, the Government is consulting on the following options for the type of penalty to be introduced:

- a) Fixed penalty;
A fixed penalty which would be applied to a company who met the penalty criteria.
- b) Fixed penalty per worker;
A fixed penalty per worker underpaid.

- c) Penalty which is a multiple of arrears;
A fixed multiplier in legislation, which could be applied to the level of arrears outstanding to create the penalty amount.
- d) Banded fixed penalty.
A fixed penalty which is determined by what “band” the total level of arrears falls into.

Risks and unintended consequences

21. Potentially, the 95% of non compliant employers who currently settle arrears informally during the course of an investigation would be penalised under these proposals. It is therefore likely that the new penalty will be applied more often than the current penalty notice. Issuing and collecting more penalties has resource implications.

22. Informally settling arrears during the course of an investigation can be a quick route to restore arrears to workers without further action or investigation being taken. To gather the level of evidence necessary to penalise, greater input and investigation may be needed by HMRC and in some cases it could take longer to return arrears to workers.

23. Some employers may be less willing to work with HMRC and repay arrears if they are facing an automatic penalty for underpayment. This is why we have proposed an escalating penalty, as an incentive for employers to return arrears to workers as quickly as possible, to dissuade the minority of employers who may be inclined to prevaricate further once HMRC has established that arrears are owing.

24. The informal stage also enables employers to rectify what may have been an accidental error without being penalised. This would change, as all underpaying employers would face a penalty whatever their motivation.

25. Ultimately, these considerations could affect the throughput of cases. These risks should be weighed against the deterrent effect that a new penalty could have, and the question of whether it is right that employers should be able to be caught underpaying and not be penalised, whatever their motivation.

26. In terms of ways to calculate fair arrears, a risk has been identified under **option iii (adjusted arrears)**. If, for example, arrears of £0 - £100 could see a lower sum going back to the worker than arrears of £100+, then a worker owed £99 could choose to delay making a complaint until his arrears owed fall into the next band, in order to be entitled more money in terms of the uplift. However, if the adjustment were made using a flat percentage rate, this risk would be avoided.

27. Similarly, under **option ii (charging all arrears at the current rate)**, workers who are being underpaid might choose to delay making a complaint until the next NMW uprating, after which point, they will be owed more in terms of arrears.

Costs and benefits

28. Penalties will only be incurred if an employer is found to owe arrears and therefore is found to infringe the requirements placed upon them under the NMW Act. The costs and benefits associated with the new system of fairer penalties and arrears are therefore **avoidable under full compliance with the existing legislation**.

29. The following analysis represents an **illustrative example** of what the impact would have been on cases closed, assuming the same numbers of cases as in the financial year 2005/06 had the proposed new enforcement regime been in place instead of the existing one.

Assumptions

30. In 2005/06, 4904 employers were subject to a completed investigation by HMRC's NMW compliance teams, 1582 of which (32%) were found not to be paying the minimum wage, covering 25,314 workers.¹⁷ At this stage, 1501 (95%) of these employers settled informally, and the remaining 81 received an enforcement notice requiring them to repay all arrears to all workers in full in a given period of time (see Annex A).

31. Had a penalty notice been issued to any employer found to have underpaid the minimum wage, then all 1582 non-compliant employers would have been issued with a penalty.

32. If we assume the following (Scenario A):

- The number of complaints remain unchanged – the new system of fairer arrears means workers have more incentive to complain, but this increase might be mostly offset by the fall in the number of workers being underpaid, as the new system of an immediate penalty to all employers found to owe arrears means that employers have more incentive to comply with the existing legislation;
- The number of risk assessed cases remain unchanged;
- The proportion of all cases found to be owing arrears remain unchanged;
- The average number of workers per non-compliant case is 6.5;¹⁸
- The 1501 employers who settled informally in 2005/06 have a relatively higher propensity to settle and would therefore all

¹⁷ *National Minimum Wage - Annual Report 2005/06*, November 2006, URN 06/280: <http://www.dti.gov.uk/files/file35198.pdf>.

¹⁸ This figure would apply overall to all 1,582 cases.

According to the *National Minimum Wage – Annual Report 2005/06*, 25,314 workers were identified as having been owed arrears (and 1582 employers were found to owe arrears). This figure is much higher than previous years because just over 15,000 workers were identified in only 5 cases. If we deduct these extreme cases from our calculation, then:

$$(25,314 - 15000) / (1,582 - 5) = 6.5.$$

choose to settle after they had been given a penalty. The rationale behind this is that they could have waited for an enforcement notice which would have required them to pay the same arrears anyway, but they still chose to settle before this;

- The 9 employers that appealed the enforcement notice would also appeal the penalty under the new system given that the notice will require them to pay a fine on top of arrears; and
- The appeal rate of the remaining 72 employers (who did not appeal the enforcement notice) is now 10 per cent under the new regime given that the notice requires them to pay a penalty in addition to arrears.
- This implies that 1566 cases would have been settled at this stage, with 16 going to employment tribunal.¹⁹

33. Of the 9 cases closed in 2005/06 that went to tribunal, one appeal was successful,²⁰ giving an appeal success rate of 11%. Assuming the same rate holds, of the 16 employers that would have appealed under the new system, around 2 would have been successful.

34. Alternatively, if we assumed that of the 1501 employers who settled informally, a small proportion, say 1%, might be incentivised to appeal if they were to receive a penalty (Scenario B), then we would have expected around 31 appeals to tribunal in 2005/06. Again, assuming an appeal success rate of 11%, then 3 of these appeals would have been successful. A summary of the enforcement statistics for 2005/06 can be found in Annex A, with the illustrative effects of scenarios A and B found in Annexes B and C. Table 1 below summarises the impact of each scenario on the numbers of employers having to pay arrears and penalties, and the numbers of expected appeals to tribunal.

Table 1. Enforcement outcomes under the new scenarios compared with actuals for 2005/06 including the number of workers each total covers.

	Had to pay arrears owed*	Had to pay penalty**	No. appeals to tribunal
Do nothing	1,581 (10,277 workers)	2 (13 workers)	9 (59 workers)
Scenario A	1,580 (10,270 workers)	1,580 (10,270 workers)	16 (104 workers)
Scenario B	1,579 (10,264 workers)	1,579 (10,264 workers)	31 (202 workers)

Source: DTI estimates based on enforcement data from HMRC.

Note: * Assumes all employers that appealed and were unsuccessful had to pay back full arrears owed. **Assumes that all employers that appealed a penalty and were unsuccessful had to pay the original penalty owed.

¹⁹ Appeal: $[(81 - 9) \times 0.1] + 9 = 16$.

Settle: $1501 + (81-16) = 1566$.

²⁰ NMW solicitors decided to withdraw on the grounds that they could not contest the appeal.

Sectors and groups affected

35. All sectors are affected by the NMW, although agriculture has its own NMW machinery. In practice, the NMW is most keenly felt in food processing, textiles and clothing, retail, hospitality, security, cleaning, social care, leisure, travel and sport, and hairdressing.

36. Looking more specifically at sectors where non-compliance is most common, the NMW Annual report 2005/06 reports that the hospitality and hairdressing sectors have shown a significant increase in the number of complaints of underpayment over the last two years (the increase in hospitality figures is mainly as a result of HMRC's targeted enforcement regime).

37. HMRC are responsible for the enforcement of the NMW, with Defra responsible for the enforcement of the AMW.

Analysis of benefits

38. As stated previously, costs and benefits incurred through rectifying illegal activity are avoidable, however, for illustrative purposes, they will be outlined in the following sections.

Employees

39. Table 1 shows that in the new penalty scenarios, some workers might lose out because their employers might be incentivised to appeal the process and their appeals might be successful – but then this implies that the employer has not been found to be in breach of the NMW Act and therefore these workers would be legitimately being paid their given wages.

40. In general, however, workers identified as being owed arrears will benefit from the options of fair arrears. Under the **do nothing** option (the difference between the remuneration received by the worker and the NMW rate they should have been paid at), the amount of arrears paid back to the worker would have devalued since the time they were incurred. This option also doesn't take into account forgone interest which could have been earned on the additional wages.

41. In addition, the proposed penalty options serve the purpose of incentivising employers to comply with the existing NMW legislation. This means that there will be less workers being underpaid overall.

Exchequer

42. The options proposed for new penalties will vary in terms of money to the Exchequer. For example, depending on the level set for the fixed penalty under **option a**, it may or may not be less than the penalty implied by **options b, c and d**. It will evidently depend on the number of workers found to owe arrears for each case. The latter three options are more beneficial in terms of being proportionate to the crime, more so for **options c and d**, because they would imply a higher penalty imposed on an employer who has underpaid a

small number of workers but totalled a large amount of arrears, compared to another who underpaid more workers, but total arrears owed were less.

43. Overall, however, there ought to be a positive effect to the Exchequer under the proposed new penalty regime. Under **do nothing**, employers who are brought to HMRC's attention as underpaying the NMW have two opportunities to repay arrears without attracting a penalty. However, under the proposed new penalty system, all employers found to owe arrears will pay a penalty (i.e. in 2005/06, had the new system been in place, 1,582 employers would have had to pay the penalty instead of the 2 who failed to comply with the enforcement notice).

Analysis of costs

44. As discussed in the *Risks* section, applying an immediate penalty may have resource consequences. In some cases informal settlement during the course of an investigation allows arrears to be restored to workers quickly, without further investigation by enforcers which might prolong the process of repayment of arrears. It also enables employers to rectify what may have been an accidental error without being penalised. In addition, employers may also be less willing to work with enforcers if they are facing a potential penalty. This again could have an effect on the throughput of cases.

45. Also, risks were identified where underpaid workers may profit by choosing to delay complaining until the sum of their arrears owed increased in real terms, either by waiting until the next NMW uprating under **option ii**, or waiting until total arrears owed fall into the next "band" under **option iii**. This would depend on whether the incentive to the worker to achieve a higher rate of fair arrears outweighed the incentive to have back pay swiftly restored. **Option I**, or using a flat percentage rate to calculate arrears under **option iii**, arguably poses the least risk of profit to the worker through delay.

Tribunal service

46. More specifically, there will be costs incurred under the proposed options as the number of **appeals to tribunal** could increase for two reasons:

- all non compliant employers will now be issued with a penalty, and therefore the size of the pool of potential appeals is larger; and
- the appeal rate will probably be higher because not only do employers have to pay higher arrears, but they also have to pay a fine on top of them, therefore there will be greater incentive to appeal as the cost of appealing to tribunal for the employers might now be less than the expected savings if their appeal is successful (given a fixed success rate of 11% - see *assumptions*.)

47. Given the assumptions outlined under scenarios A and B under the section *Assumptions*, we could expect between around 7 and 22 additional appeals to tribunal over a year.

48. These appeals are usually listed for a one hour hearing with a Chairman sitting alone. The daily fee for a Chairman is £421 and they do at least 6 one hour cases a day. If we then add administrative costs, receipt and service of the claim, copying, etc which are fairly minimal plus an additional hours work on the day of the hearings greeting the parties, etc, we can assume that the cost per appeal to the Employment Tribunal Service (ETS) is around £100.²¹ The new system of an immediate penalty once non compliance is identified could impose an additional cost to the ETS of between **£700 and £2,200**.

HMRC

49. In addition, the cost to HMRC of defending each appeal is around £3,500 for a case of average size and complexity. This covers barrister costs and solicitors' office costs based on a two day hearing.²² Therefore, the new penalty system could impose an additional cost to HMRC of between **£25,000 and £78,000**.

50. Extra time may be needed to be taken to calculate arrears under some of the proposed new options for fairer arrears. Arguably, this applies more so to **option i**; which would imply calculating interest on arrears, less so in **option iii**; which involves going back and applying a different NMW rate depending on the date of arrears – as is the current system. The least cost will be under **option ii**; where arrears are simply calculated based on the current rate of the minimum wage- this is a more straightforward calculation than the current one, as the historical NMW rates that applied for different periods of the underpayment do not have to be known or used. Assuming that it would take around 5 minutes to calculate arrears per worker under **option ii**, 10 minutes under **option iii** and 15 minutes under **option i**. Then assuming there are around 10,000 workers identified as being owed arrears per year²³, then the cost of calculating arrears per year would be around **£30,000 under option i, £10,000 under option ii and £20,000 under option iii**.²⁴ These costs could be incurred by both HMRC and non compliant employers.

51. It is also possible that, faced with fairer arrears, underpaid employees could be incentivised to complain thus increasing the number of calls to the helpline and also increase the number of investigations that will need to be carried out by HMRC's compliance teams, which would imply additional costs to HMRC. However, this effect could be offset if the implemented policy is effective in reducing non compliance in the first place. In which case, there will be less employees in a position to complain, thus reducing the number of calls

²¹ Source: Employment Tribunals Service.

²² Source: HMRC

²³ Figures for 2003/04 were 9,428, 2004/05 were 11,261 and 2005/06 were 25,314 from the *National Minimum Wage – Annual report 2005/06*. However, in 2005/06 15,000 workers were identified in only 3 cases, so deducting these bring the 2005/06 figure to around 10,000 workers.

²⁴ Calculated as:

Time spent x median hourly wage (from 2006 Annual Survey of Hours and Earnings) x 1.3 (30% non wage labour costs) x 10,000 (total number of workers).

Figures rounded to the nearest £10,000.

to the helpline. As a result, the costs incurred as a result of this effect could be minimal.

Equity and fairness

52. Female workers tend to work in the lower paid sectors of the economy, and this is reflected by the fact that the last two years have shown a larger proportion of complaints of underpayment among females.

53. Similarly, workers from ethnic minorities are also more likely to work in the low paying sectors of the economy, with some 36 per cent of ethnic minority employees working in the low-paying sectors compared with 29 per cent of white employees.²⁵

54. In addition, new migrants have been found to be particularly vulnerable to exploitation by unscrupulous employers. Research has shown that people employed through international employment agencies were more likely to be underpaid or have more deducted from pay to cover accommodation and other services.²⁶

55. Fair arrears will benefit all workers who have been underpaid the NMW, and a new automatic penalty for underpayment will apply to any employer found to be underpaying the NMW. We will continue our policy of targeting publicity²⁷ and enforcement to ensure that workers in these areas are aware of their rights, and that employers are aware of their responsibilities.

Small Firms Impact Test

56. In their reports, the LPC have noted that small firms tend to be more affected by the minimum wage, with 4 per cent of jobs in small firms being paid at the adult NMW in April 2006, compared with 2.5 per cent in medium sized firms, and around 1.5 per cent in large firms. It is therefore more likely that cases found to owe arrears will cover small businesses. However, if a new penalty scheme is introduced that links the fine to the amount of arrears owed (and therefore linked to the number of workers who have been underpaid by the firm), then it is more likely that larger business will face a greater fine than small ones.

57. The DTI will consult with the Small Business Service and small firms on the proposals. A full impact test of the effect on smaller firms will be conducted for subsequent RIAs.

²⁵ *National Minimum Wage: Low Pay Commission Report 2007.*

²⁶ French, S. and Möhrke, 2006, *The impact of 'new arrivals' upon the North Staffordshire labour market*, Research for the Low Pay Commission. Centre for Industrial Relations, Institute of Public Policy and Management, Keele University.

²⁷ See particularly DTI and HMRC *National Minimum Wage Annual Report 2005/06* for further details.

Competition assessment

58. The NMW provides a floor for wages and therefore ensures that firms cannot compete against each other by driving down wages to unacceptable levels. The proposed options will act as a disincentive for firms to undercut others by charging less than the minimum.

59. Effective NMW enforcement supports both workers and business by tackling the competitive advantage gained by non compliant employers who exploit their vulnerable workers.

Enforcement, sanctions and monitoring

60. The NMW is enforced in two ways. HMRC takes proactive steps to secure enforcement and acts on complaints. Individuals also have a right of redress to an employment tribunal or civil court.

61. The Government also issues an annual report on enforcement action. The latest National Minimum Wage – Annual Report 2005/06 can be found online, at: <http://www.dti.gov.uk/files/file35198.pdf>.

Employment agency enforcement regime

Purpose and intended effect

Objectives

62. The Government is proposing measures to enhance the enforcement of the Conduct of Employment Agencies and Employment Businesses Regulations 2003.

Background

63. The Conduct of Employment Agencies and Employment Businesses Regulations 2003, which came into force in April 2004, are enforced by the Department of Trade and Industry's Employment Agency Standards (EAS) Inspectorate. The Inspectorate follows up every relevant complaint it receives which indicates a possible breach of the legislation, and undertakes spot checks on the basis of risk.

64. While EAS inspectors seek in the first instance to achieve compliance through advice and persuasion, the Inspectorate can take prosecution action, where appropriate, in a Magistrates' Court against an agency found to be in breach of the legislation. If the prosecution is successful, the agency may be fined up to £5,000 for each offence. Inspectors can also apply to an employment tribunal for orders prohibiting those persons who are considered to be unsuitable from operating an agency for up to 10 years. At present, the EAS considers prosecution in between 5 and 10 cases per year.

65. While any breach of the regulations governing employment agencies is a criminal offence, all criminal offences under the EA Act are summary offences (i.e. tried in a Magistrates' Court). The EAS experience has been that it has proved difficult to prosecute the small minority of determinedly non-compliant agencies who seek to exploit every possible loophole. Some of the difficulties relate to the limitations of prosecuting for summary offences, both in terms of adequacy of penalties and the relative lack of investigative and prosecution powers where criminal offences are summary only.

66. This problem is most acute in terms of the penalty for contravening a prohibition order, i.e. when an individual who has been prohibited from running an agency ignores the ban and carries on in business, thus rendering the prohibition ineffectual. The maximum sentence for breaching a prohibition order is a level 5 fine (i.e. a maximum of £5,000). This may not be an effective deterrent where the agency is generating a lot of money.

67. Section 9(1) of the Employment Agencies Act already gives EAS Inspectors the right to enter any relevant business premises, to inspect any records or documents kept in pursuance of employment agency legislation and to take copies of any such records or documents. However, the right to take copies of documents in practice requires an element of co-operation from the agency concerned (since invariably this means taking copies on the agency's photocopier), and in cases where the Inspectorate is investigating serious allegations, such co-operation may not be forthcoming. While it is a

criminal offence to obstruct an Inspector in the course of their duties, and the vast majority of agencies readily co-operate with Inspectors, seeking a prosecution for obstruction is of itself a time-consuming and labour intensive process.

68. As offences under employment agency legislation are summary offences, an actual offence has to take place before charges can be made. In effect this means that the EAS need to identify witnesses to come forward to give evidence that the offence was committed. In the main, such witnesses will be agency workers who have been victims of these offences. Getting such victims prepared to stand up in court and give evidence against an agency that has refused Inspectors' requests to correct their illegal practices has proved to be a problem on a number of occasions. There is a fear that such individuals will be seen as potential trouble-makers and not get future work from other agencies. In addition, some potential witnesses may fear intimidation where highly disreputable agencies are involved.

69. In an investigation where it appears workers may have been denied money that is owed to them, it is crucial for EAS Inspectors to discover what payments have been made to an agency to identify what monies have been received and the identities of those making payment. In a number of cases, the EAS receives complaints from one or two workers who may have lost money as a result of bad practices of rogue agencies. But there may be a substantial number of other workers who have been similarly mistreated by an agency but who (for a variety of reasons) have not complained. Unless the EAS Inspectors can examine the agency's financial records (at present the EAS do not have specific powers to do so), it is not possible to determine in such cases whether this is a generally compliant agency or a rogue operation systematically cheating agency workers out of their money. The EAS's policy is to concentrate enforcement resources on the latter type of agency.

Rationale for Government intervention

70. In the absence of government intervention there may be continued abuses of workers by rogue agencies who are not prepared to put right their procedures when problems are brought to their attention.

Consultation

71. The Government is now undertaking a further three month public consultation on its proposed approach.

Options

Option 1: Do nothing.

Option 2: Make offences under the Employment Agencies Act 1973 and the Conduct of Employment Agencies and Employment Businesses Regulations 2003 triable either as summary offences in a Magistrate's Court or as indictable offences in a Crown Court. The penalties and

powers of prosecution would depend on which court the case came before.

Option 3: As Option 2 and amend Section 9 of the Employment Agencies Act 1973 to clarify powers available to EAS inspectors to be able to demand and secure copies of financial information from an agency or suspect directly or from their bank or building society.

72. Under **option 2**, making the offences triable either by Magistrate's Court or by Crown Court would: enable EAS Inspectors, who are sometimes unable to persuade agencies to allow them to make copies of documents to take documents away for specified periods of time, and would also enable the EAS to prosecute individuals for "attempting" to commit the various offences under the EA Act (e.g. attempting to obtain money for job finding services) without having to rely on witnesses being prepared to appear in court.

73. To ensure this power available under **option 3** could only be used appropriately, limits would be placed on the circumstances in which it could be used to enable a proper balance to be achieved between the needs of the EAS to establish the amount of money received from unlawful practices and the needs for confidentiality and privacy of information. It is considered that such powers should only be available where a prosecution was under active consideration. On the basis of current experience and practice, we would therefore envisage such powers being used on around 10 occasions per year.

Costs and benefits

Sectors and groups affected

74. Obtaining an accurate picture of the numbers of agency workers in the labour market has always proven difficult. The Labour Force Survey reports a UK figure of nearly 260,000 agency workers in Q4 2006. But this is likely to underestimate the numbers of agency workers, partly because of definitional problems. The leading industry organisation, the Recruitment Employment Confederation (REC) suggests there are over a million agency workers in the UK. But the REC survey has a fairly low response. In addition, the situation is further confused by the fact that many agency workers may have more than one job and work with more than one agency, so double counting is frequent.

75. In order to get more reliable figures, the DTI commissioned a survey of agencies during 1999. Based on this data it estimated the number of agency workers at 550,000. Updating this figure for the growth in agency workers implied by the LFS since then would imply a figure of 560,000 in 2006. The DTI survey found there were around 10,000 agencies in 1999. This figure is likely to have grown since then: the ONS Annual Business Inquiry indicates there were around 17,000 enterprises involved in labour recruitment and provision in 2005, with a turnover of £27bn. The DTI survey found that most agencies have less than 10 employees. Some 37 per cent of those directly employed work in single site establishments. Agencies with over 100 direct employees account for approximately 15 per cent of the industry.

76. The proposals in this RIA are highly targeted at agencies not complying with the Conduct of Employment Agencies and Employment Businesses

Regulations 2003. We do not anticipate that taking these additional powers would have any impact upon law-abiding agencies or indeed upon those agencies who swiftly put right any small and/or inadvertent breaches of the law when these are brought to their attention. The EAS currently considers prosecutions in around five to ten cases per year, with only one successful prosecution since the Conduct Regulations came into force in April 2004. While more effective enforcement could feasibly raise the number of successful prosecutions, the number of cases considered for prosecution would still be expected to be very low in comparison to the total number of agencies.

Analysis of benefits

77. The purpose of the proposals is to tighten the enforcement and compliance of the Conduct Regulations. If this were effective, and potentially rogue agencies were to face a greater chance of being prosecuted effectively, and higher fines from being found guilty, then this should lead to benefits to agency workers in terms of facing fewer practises that contravene the regulations. Although there are currently only a small number of prosecutions each year, the improved deterrent effect could lead to a larger number of agencies following the regulations. It may also benefit the vast majority of agencies that abide by the regulations, as they will not face unfair competition from those breaking the law.

78. It is not possible to provide a quantification of these benefits at this stage. Response to the consultation will help establish the size of the benefits more accurately.

Analysis of costs

79. Under the proposals non compliant firms facing prosecution may face higher costs, owing to the greater costs involved in Crown Court cases than Magistrates' Court cases. However, these costs are avoidable if firms follow the Conduct Regulations and are therefore not regulatory costs. Under **Option 2**, inspected firms would also potentially face higher costs from the ability of EAS inspectors to take documents away. However, inspected firms who are confident they are compliant with the Regulations would have little incentive to refuse inspectors from making copies, and therefore the incremental cost from this measure is expected to be small. We will consider responses to the consultation on this matter.

80. The Government may face higher costs as a result of some prosecutions taking place in Crown Courts. It is estimated that the hourly cost to Her Majesty's Court Service (HMCS) in a Magistrate's Court may be around £415 per hour. In a Crown Court this figure rises to £1,023. A case brought by EAS might be expected to take around one day in court time. Assuming a 7 hour day, that would imply an additional cost to HMCS of £4,256²⁸ per case. If five cases were brought before a Crown Court each year, the total cost to HMCS would be around £21,000.

²⁸ 7*(1023-415)

81. **Option 3** may in principle affect a larger number of agencies than just those who are prosecuted by the EAS. But it is considered that such a power should only be available where a prosecution was under active consideration. On the basis of current experience and practice, this might occur in perhaps 10 occasions per year. For these firms, the costs of inspection may be higher if they were required to provide information to the EAS. These costs are likely to be low, although exact quantification is not possible at this stage. The overwhelming majority of agencies would, however, be unaffected. Responses to the consultation should provide the basis for a more accurate assessment.

Small Firms Impact Test

82. The measures discussed above are likely to have a greater impact on smaller firms, as these dominate the agency sector. However, the highly targeted nature of the proposals means the impact on small agency firms in general will be minimal. The DTI will consult fully with the Small Business Service and small firms on the proposals.

Competition assessment

83. To the extent that these measures require a small minority of agencies to reach the same standards of performance as the majority, this could lead to competition benefits in the sense that a more level playing field is created. The DTI will consult fully with stakeholders, including the Small Business Service and the Office of Fair Trading, so that any potential competition issues are identified.

Enforcement, sanctions and monitoring

84. Enforcement of these provisions will be through the Employment Agency Standards (EAS) Inspectorate. The effectiveness of the measures will be monitored by the EAS and the results reported in the EAS Annual Report.

Contact point

Any enquiries relating to this Regulatory Impact Assessment should be addressed to:

Christalla Kyriacou
Employment Relations Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Christalla.Kyriacou@dti.gsi.gov.uk

CONSULTATION CODE OF PRACTICE

The criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address:
www.cabinetoffice.gov.uk/regulation/consultation/index.asp

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way it has been conducted, please write to:

Stephen Childerstone
Better Regulation Team
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Tel: 0207 215 0354
Fax: 0207 215 2235
Email: Stephen.childerstone@dti.gsi.gov.uk

RESPONSE FORM

Name:

Organisation (if applicable):

Address:

Email:

Please tick the box below that best describes you as a respondent to this consultation:

- Micro business/organisation (up to 9 staff)
- Small business/organisation (up to 50 staff)
- Medium business/organisation (50 to 250 staff)
- Large business/organisation (over 250 staff)
- Business representative organisation/trade body
- Trade union or staff association
- Local government
- Central government
- Individual employee or worker
- Other (please describe)

If you are responding as a business, are you an employment agency?

- Yes
- No

If you are responding in an individual capacity, are you employed through an employment agency?

- Yes
- No

Please tick which section(s) of this consultation you are responding to:

- NMW fair arrears
- NMW penalties
- EASI

A. NMW fair arrears

A1. The government is interested in introducing a new way to calculate fair arrears for all workers. Do you have any comments on this?

A2. Please indicate which of the following options you prefer:

- Option A: Take no action**
- Option B: Interest on arrears**
- Option C: Charge all arrears at the current rate**
- Option D: Adjusted arrears**

A3. Why do you prefer the option you have indicated?

Please comment on the options in more detail:

Option A. Take no action

A4. Do you have any comments on this?

Option B. Interest on arrears

A5. How should this be calculated?

A6. Do you have any other comments on this?

Option C. Charging all arrears at the current rate

A7. Do you have any other comments on this?

Option D. Adjusted arrears

A8. How should the adjustment be calculated?

A9. If the adjustment is calculated by percentage, what should the percentage be and why?

A10. If the adjustment is calculated by adding a sum determined by the band of arrears incurred, what should the bands be and why?

A11. If the adjustment is calculated by adding a sum determined by the band of arrears incurred what should the sums be for the bands you have identified and why?

A12. Do you have any other comments on this proposal?

A13. Do you have any other comments or suggestions on how fair arrears could be calculated?

A14. If the government introduces fair arrears, do you have any comments on how awareness and guidance could be made available to workers and employers?

B. NMW penalties

Questions

B1. The government is interested in introducing a penalty for all employers found to be underpaying the NMW. Do you have any comments on this?

B2. Are there any circumstances when you think that an automatic penalty for underpaying the NMW should not apply?

B3. Do you have any views on whether there should be an upper or lower limit to the penalty options, and what the limit should be?

B4. Please indicate which of the following options you would prefer:

- Option A: Take no action**
- Option B: Fixed penalty**
- Option C: Fixed penalty per worker**
- Option D: Penalty which is a multiple of arrears**
- Option E: Banded fixed penalty**

B5. Why do you prefer the option you have indicated?

Please comment on the options in more detail:

Take no action

B6. Do you have any comments on this option?

Fixed penalty

B7. What should the level of the penalty be and why?

B8. How should the fixed penalty escalate?

Fixed penalty per worker

B9. What should the level of the fixed penalty be and why?

B10. How should the fixed penalty escalate?

Penalty which is a multiple of arrears

B11. What should the multiplier or level of the fixed penalty be and why?

B12. How should the fixed penalty escalate?

Banded fixed penalty

B13. What should the bands be, and what should the level of the fixed penalty be?

B14. How should the fixed penalty escalate?

B15. Do you have any comments on what more the government could do to offer guidance / raise awareness of how to comply with the NMW?

C. Employment Agency penalties

C1. Do you consider that prosecutions under employment agency legislation should be capable of being tried in the Crown Court in the most serious cases?

C2. Do you agree that the maximum penalty for such serious offences should be an unlimited fine?

C3. Do you consider that enabling such prosecutions to be tried in the Crown Court have any implications for reputable agencies, and if so, what do you consider these implications would be?

C4. Do you agree the EAS should have powers to seek financial information from third parties such as banks and financial authorities where an agency or individual suspected for a serious offence under the Employment Agencies Act:

i) where a prosecution is under active consideration?

ii) in any other circumstances? (if yes, please state what these circumstances are)

C5. What, if any, implications do you consider the grant of such powers would have for reputable agencies?

Thank you for taking the time to let us have your views.

We do not intend to acknowledge receipt of individual responses unless you tick this box

We will publish all the responses received in this consultation, unless you tick this box to ask that your response be treated as confidential

If you would like to receive a copy of the government's response to this consultation, please tick this box

Please return completed response forms by 8 August 2007 to:

Maria Gonzalez-Rey
Bay 464
Employment Relations Directorate
Department of Trade and Industry
1 Victoria Street
London SW1H 0ET
Tel: 0207 215 5944
Fax: 0207 215 6414
Email: maria.gonzalez-rey@dti.gsi.gov.uk

LIST OF CONSULTEES

Advisory, Conciliation and Arbitration Service (ACAS)
Agents Association
Association of Cleaning Services (ACS)
Association of Labour Providers (ALP)
Association of Model Agents
Association of Technology Staffing Companies (ATSCo)
Bakers, Food and Allied Workers Union (BFAWU)
Broadcasting Entertainment cinematograph and Theatre Union (BECTU)
British Association of Leisure Parks, Piers and Attractions
British Chambers of Commerce (BCC)
British Apparel and Textile Confederation (BATC)
British Beer and Pub Association (BBPA)
British Holiday & Home Parks Association
British Hospitality Association (BHA)
British Retail Consortium (BRC)
Business in Sport and Leisure (BSL)
Business Services Association (BSA)
British Shops and Stores Association (BSSA)
Cabinet Office
Chartered Institute of Personnel & Development
Children's Workforce Development Council (CWDC)
Citizens Advice Bureau (CAB) including Citizens Advice Northern Ireland
Cleaning and Support Services Organisation (CSSA)
Commission for Racial Equality
Community
Construction Confederation
Confederation of British Industry (CBI)
Construction Industry Council
Department of Agriculture and Rural Development for Northern Ireland
Department for Constitutional Affairs (DCA)
Department for Environment, Food and Rural Affairs
Disability Rights Commission
EEF
Employment Lawyers Association
Employment Tribunal Service (ETS)
Equal Opportunities Commission
Equity
Forum of Private Business (FPB)
Federation of Small Businesses (FSB)
Gangmaster Licensing Authority (GLA)
GMB – Britain's General Union
Her Majesty's Revenue and Customs (HMRC)
HM Treasury (HMT)
Institute of Directors (IoD)

Leicester City Council
Local Government Association
London Citizens
Low Pay Commission (LPC)
National Association of Supporting Artists (NASA)
National Care Association
National Day Nurseries Association
National Farmers Union (NFU)
National Group on Homeworking (NGH)
National Hairdressers Federation
Recruitment and Employment Confederation
Scottish Executive Environment and Rural Affairs Department
Scottish Low Pay Unit
Scottish Trade Unions Congress
Trade Unions Congress (TUC)
Union of Shop, Distributive and Allied Workers (USDAW)
Unison
Unite
Work Foundation



Printed in the UK on recycled paper containing a minimum of 75% post consumer waste.
First published May 2007. Department of Trade and Industry. www.dti.gov.uk
© Crown Copyright. 05/07/NP. URN 07/961