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Insights

EMPLOYMENT RIGHTS ACT 2025: KEY CHANGES TO UNFAIR DISMISSAL FROM 1 JANUARY 2027

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Summary

The Employment Rights Act 2025 (**ERA**) will introduce from 1 January 2027 two landmark changes to the law relating to unfair dismissal. They represent the most significant changes for over a decade.

Reduction of the qualifying period

From 1 January 2027, the qualifying period for unfair dismissal will reduce from two years to six months. Employees with six months' service on 1 January 2027 will gain protection immediately. This means anyone already in employment now will be covered from the outset.

In terms of probationary periods, this gives employers a shorter time to assess whether a new hire is right for the role.

Employers should:

- Consider the length of their probationary periods – probationary periods of three to four months are advisable, extendable at the employer's discretion by ideally no more than one month
- Set clear performance standards, have regular reviews, and deal with performance issues early

One small point that might be overlooked is the statutory extension of the qualifying period. If an employer dismisses or gives notice of dismissal to an employee who is just short of qualifying service, the statutory minimum notice period of one week can be added for the purposes of unfair dismissal. This can carry the employee into qualifying threshold. In the case of the ERA, an employee dismissed on (say) 28 December 2026 would, under the relevant statutory provisions, have their termination date extended by one week to 4 January 2027, moving them from a two years' service requirement to a six months' requirement.

However, because of a quirk in the drafting of the implementing statutory instrument, it is possible that, in such circumstances, although the employee's termination date will be carried over into January 2027, the old statutory cap will still apply. The possible retention of the cap will only apply to employees whose termination date has been carried forward from December 2026 under statute as described above. This point is still not 100% clear, and we will clarify as soon as we are in a position to do so.

Estimates of the latest "safe" date to avoid the above from happening vary from 18 December to Christmas Eve. Given the current lack of clarity, employers would be advised to aim for an earlier date if possible.

Removal of the compensation cap

Currently, unfair dismissal compensation is capped at the lower of 52 weeks' gross pay or £123,543. The ERA abolishes the cap entirely from 1 January 2027, after which there will be unlimited compensation for all unfair dismissal claims. Unlimited awards will still be subject to deductions for matters such as contributory fault and "Polkey" reductions, where it is decided in a procedurally flawed dismissal that, even if a full and proper procedure had been followed, it would have made no difference to the final outcome. However, removing the cap on compensation will have a significant impact.

Although the main beneficiaries will probably be high earners (see below), there are other possible consequences of the removal of the cap which employers should consider, including:

- settlement expectations for managed terminations could be increased as employers will not have the cap as an upper ceiling. Unfair dismissal is still a claim sometimes sidelined by high earners because of the cap – this will no longer be the case;
- elements of executive remuneration which may previously have been glossed over or even discounted in unfair dismissal settlements/claims could start to feature. With uncapped compensation, matters such as:
  - carry arrangements, for employees in private equity
  - share options
  - equity schemes linked to shares
  - LTIPs
  - pensions

    - discretionary and other bonuses

  may become routine considerations in unfair dismissal compensation;

- as a result of the above, schedules of loss, and possibly disclosure in unfair dismissal claims could become more complex and difficult to calculate; and
- one upside for employers is that, once unfair dismissal is an uncapped claim, there will possibly be fewer “engineered” whistleblowing and discrimination claims, as there will be no need to find a pretext for an uncapped claim.

Because issues of substantive and procedural fairness will become more important, employers should consider senior terminations carefully – whereas it may have previously made sense to move straight to “without prejudice” discussions, under the new law processes and procedures carried out prior to such discussions will be more important, not least to put employers in a stronger bargaining position in negotiations and/or litigation.

Related Capabilities

- Employment & Labor

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