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Unlimited unfair dismissal compensation:

What it means for your business

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If you dismiss someone unfairly, a tribunal can order you to pay them compensation. This can include a basic award and a compensatory award.

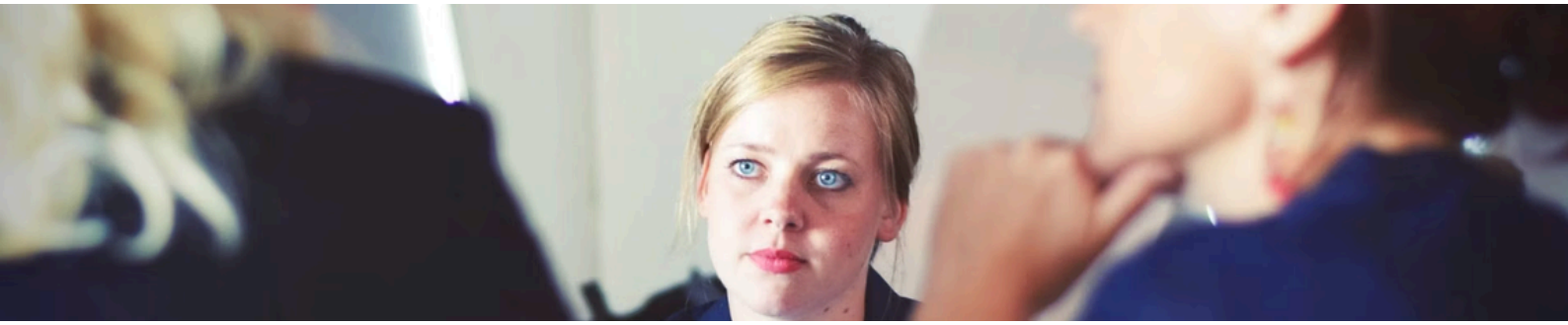
There's currently a limit on the compensatory award of £123,543 or 52 weeks' gross pay, whichever is lower.

From 1 January 2027, that limit is going away.

There will no longer be a statutory cap on the compensatory award.

A tribunal will look at how much money the employee has lost and may lose because they were unfairly dismissed. From January, the resulting compensatory award will no longer be restricted by the current cap.

For a small business, this makes getting a dismissal wrong potentially much more expensive.



What does “unfair dismissal” mean?

Unlike some other countries, in Great Britain you cannot just legally fire an employee at random.

For employees who have unfair dismissal protection, you need to have a potentially fair reason for letting them go.

Fair reasons include:

- Capability, including poor performance
- Misconduct
- Redundancy
- Statutory illegality
- "Some other substantial reason"

If you dismiss an employee who has unfair dismissal protection, and the reason does not fit into one of those categories, you could face an unfair dismissal claim.

"Unfair dismissal" can also mean that you fired someone for a fair reason, but you handled the process unfairly.

For example, let's say an employee's performance was poor for months. Their manager complained about them to you and other colleagues, but nobody properly raised the problem with the employee.

Eventually you, as the business owner, decide that you've had enough and you dismiss them.

There might have been a genuine performance problem. But if the employee wasn't clearly told what was wrong or given a reasonable opportunity to improve, the way the dismissal was handled could leave the business exposed to an unfair dismissal claim.

Are employees protected under unfair dismissal rules from day one?

Usually, no.

Right now, an employee generally needs to have worked for you for two years before they can claim ordinary unfair dismissal.

From 1 January 2027, that qualifying period will drop to six months.

This means that an employee who has worked for you for six months will generally have unfair dismissal protection, regardless of whether they're still in a probation period.

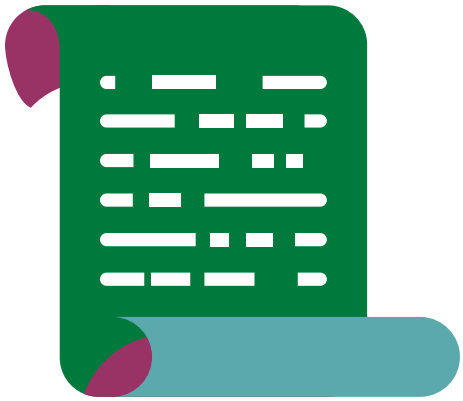
But there are some protections that apply from day one.

Employees don't need to have worked for you for six months if they're dismissed for certain automatically unfair reasons. This can include dismissing someone because they've raised certain health and safety concerns, blown the whistle or exercised certain statutory employment rights.

Discrimination claims also don't require a minimum length of service.

So, the first six months shouldn't be treated as a period where you can dismiss someone for any reason without risk. The six-month qualifying period applies to ordinary unfair dismissal claims, but other protections can apply from the start of employment.

What you need to do about these new rule changes



The fact that the compensation cap is being removed actually doesn't change what you should already be doing in your workplace.

It just increases the amount you may have to pay if you get your processes wrong.

1. Raise problems early

People problems often become difficult to resolve because they weren't nipped in the bud.

Dealing with a problem properly when it first appears is much easier than trying to build a fair dismissal process after months of doing very little.

This is particularly important because of the new six-month unfair dismissal rule being introduced from January 2027.

2. Write everything down

When you're dealing with an employee issue such as poor performance, misconduct or a grievance, make sure that you can justify the decisions you make and keep an appropriate written record of what took place. You need to be able to show what happened and why you made the decision you did.

If you're dealing with poor performance or misconduct, here's a good rule of thumb to follow:

- If someone's performance isn't good enough, tell them. Be clear about what needs to improve and give them a reasonable opportunity to do it. Keep a record of those conversations.
- If you're investigating misconduct, find out what actually happened before deciding what to do. Give the employee a proper opportunity to respond.
- And, if dismissal becomes an option, make sure that you can explain why that decision is reasonable based on everything that's happened.

The paperwork should always back up the process you've actually followed. No one should be relying on memory.

3. Train your managers

Your managers are often the first people to spot when something isn't working.

Make sure that they know what to do when a problem develops with an employee, whether that's an issue with their performance or something else that needs addressing.

They don't need to become HR experts. But they should know how to handle problems appropriately and recognise when it's time to involve you or whoever handles HR.

A manager who ignores poor performance for five months and only raises it when they want the employee gone leaves you with very little to work with.

With employees gaining unfair dismissal protection after six months, managers need to deal with problems when they arise rather than allowing them to drift.

4. Review your paperwork

Make sure that your performance and disciplinary processes are up to date and that what happens in practice matches what your policies say should happen.

It's also worth reviewing how you use probation periods now that employees will generally gain unfair dismissal protection after six months. If you use a six-month probation period, don't wait until the end to decide whether someone is working out. Build in reviews along the way so any problems are identified and addressed early.

Check your contracts and employee handbook too, particularly anything that sets out probation periods or dismissal procedures, so they reflect how you actually intend to manage employees under the new rules.

5. Get advice before making a dismissal decision, if you're unsure

The changes coming in January mean that more employees will be able to claim unfair dismissal, with potentially much more money at stake when something goes wrong.

Don't wait until a tribunal claim comes your way to get help.

It's much easier to make sure that you're following the right process before someone loses their job than to try to fix mistakes later.

If you'd like us to review your current processes, or you're dealing with an employee you're considering dismissing, get in touch. We can help you to work out what to do next.

Get in touch

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