

**NATIONAL MINIMUM WAGE REGULATIONS:
CONSULTATION NOTE ON A PROPOSAL TO REPLACE FAIR ESTIMATE
AGREEMENTS**

Introduction

In Volume II of their 3rd Report in June 2001, the Low Pay Commission recommended “the Government should consult representatives of output workers and their employers to see whether there is a case for a change in the Regulations on fair estimate agreements”.

2. This followed representations to the Commission from both employer and employee groups, which argued for changing the Regulations on fair estimate agreements. We have considered this and had some discussions with key stakeholders, and are now consulting more widely. This note is aimed at both employer and employee groups and at output workers, including homeworkers.

Executive Summary

3. When it introduced the minimum wage in 1999, the Government wanted to apply the minimum wage for output work and homeworkers, who have no time limits on their work and often operate without employer supervision. The Government decided to enable employers and workers to enter into ‘fair estimate agreements’, under which employers must set a fair estimate of the hours needed to complete each block of work to be done, and the minimum wage must then be paid for the hours actually worked up to the limit set in the estimate. If no fair estimate agreement is in place, then the output workers must be paid the minimum wage for all hours actually worked.

4. The Government has received representations from both homeworker employers and homeworker representatives arguing that these agreements are not working well. Few employers are making use of the agreements and, where they are doing so, they are reportedly setting unreasonably short figures for the number of hours needed to complete the work. We suspect that in practice many employers are paying homeworkers piece rates – these companies are operating outside the legislation and are liable to enforcement action.

5. This paper proposes replacing the fair estimate agreement system with a system of fair piece rates, designed to ensure that an average or ordinary worker would earn the minimum wage. Comments on this proposal would be welcomed by 9 May (see below for details of who to send comments to). A Regulatory Impact Assessment on the costs and benefits of the proposal is attached as an Annex.

Background

What is output work?

6. For the purposes of the minimum wage ‘output work’ has a precise meaning which is defined in Regulation 5 of the National Minimum Wage Regulations 1999. It is work that is paid for under a contract, **wholly** by reference to the number of pieces made or processed by the worker, or to some other measure of output such as the number or value of sales made or transactions completed by the worker.

7. Output work does not just comprise the stereotypical home working job involving repetitive tasks in a low-tech industry (such as packing envelopes or cutting cloth). Output work covers a wide range of activities and industries, such as door-to-door newspaper distribution (where payment is by number of deliveries) and many jobs in sales or other customer services (where the work involves travelling or telephoning and payment is by commission-only). Output work can also be done at the employers’ premises rather than at home.

What is a homeworker?

8. Homeworkers are people who work for an employer but do not work at the employers’ premises. They are – like other workers - entitled to the minimum wage. However they are often paid according to a piece or output rate and in those circumstances will be output workers for the purpose of the Regulations.

“Fair estimate agreements” of hours to be worked

9. When introducing the minimum wage in 1999 the Government had no wish to end output work and home working. But it wanted this work to be covered by the minimum wage, and applying this for workers who had no time limits for their work and no employer supervision was not straightforward.

10. The Government decided to tackle the difficulties by enabling the employer and worker to enter into ‘fair estimate agreements’. Regulation 25 of the National Minimum Wage Regulations 1999 lays down the requirements for entering into a fair estimate agreement. The agreements must be made in writing between employers and each worker and agreed before the start of the pay reference period or periods covered. Employers must set a fair estimate of the hours needed to complete the work to be done, and the minimum wage must then be paid for the hours actually worked up to the limit set in the estimate. The estimate for the number of hours needed will not be regarded as ‘fair’ if it is less than four-fifths of the time an average worker would take to do the same amount of work in the same conditions.

11. The workers contract must also specify an agreed piece rate which the worker will be paid for each item produced or sold. The worker must be paid at least the minimum wage for the specified hours, provided the task has been completed, and then be paid the agreed piece rate for any items produced over the number of items specified in the agreement.

12. Regulation 24(2) makes it clear that it is only possible to enter into a fair estimate agreement in relation to output work where the contract does not set any normal, minimum or maximum working hours and the employer does not in practice determine or control the hours worked by the worker.

13. If no fair estimate agreement is in place, then the workers must be paid the minimum wage for all hours actually worked.

14. Most workers will already have a contract of employment, either written, oral or implied. In law it is not possible for a worker’s contract to be changed unilaterally. If an employer tries to do this the worker can sue in the county court for breach of contract. If the worker thinks the breach of contract

is serious and undermines the contract completely then he can sue in the county court for constructive dismissal or, if he is an employee, claim in an employment tribunal for unfair constructive dismissal. We recognise of course that some bad employers may try to change workers' contracts unilaterally. But the legislation clearly states that any workers that are presently paid under a fair estimate agreement or as a time worker (see paragraphs 31 and 32 below) may only be transferred to a fair piece rate system with their agreement.

Why were the Regulations drafted in this way?

15. Before the minimum wage was introduced, homeworkers and other output workers were paid simply by results, not by the time taken on the work. The employer did not need to have any control over the hours worked, and may often not have been aware how long his workers were spending on the tasks. But because the minimum wage is an hourly rate, there was a need to convert the rate workers were paid for their output into an hourly rate for the purpose of working out whether the minimum wage had been paid.

16. The fair estimate agreement was designed to meet the needs of employers and workers. The *fair* element of the agreement should prevent the employer from deliberately setting unachievable targets. The *estimate* element should ensure that the employer does not need to pay additional hours to a worker who takes longer than necessary to do the required work. The *agreement* element should ensure that the fair estimate is acceptable to both sides.

Issue

17. The Government has received representations from both homeworker employers and homeworker representatives arguing that fair estimate agreements are not working well. It appears that few employers are actually making use of these agreements. A variety of reasons have been given for this but the principal point seems to be that they are seen as complex and difficult to administer, and that in practice it may be difficult to predict the estimated hours for each block or tranche of work taken on by an individual homeworker from week to week.

18. Homeworker representatives have also expressed concern that where employers are using fair estimate agreements, the figure used for the number of hours needed to complete the task is often unreasonably short, so that few of the homeworkers covered by these agreements are receiving the minimum wage. They reported that most of the homeworkers that were subject to these agreements were not satisfied with them. It seems clear that in practice these arrangements are being imposed by employers, rather than being agreed with each worker as required by the Regulations.

19. We suspect that in practice many employers are paying homeworkers piece rates rather than entering into fair estimate agreements or paying the minimum wage per hour worked. Where this is the case, these companies are operating outside the legislation and are therefore liable to enforcement action.

20. Clearly this situation is not satisfactory and we need to consider how best to tackle it. Both homeworker employers and representatives have suggested that it would be more straightforward to simplify fair estimate agreements with a system of fair piece rates linked to the current minimum wage. This is discussed below.

Proposal

21. The proposal is essentially to amend the National Minimum Wage Regulations 1999, so that employers would be required to pay all output workers either the minimum wage for all hours worked or a 'fair piece rate' that links to the minimum wage.

22. The 'fair piece rate' proposal would make three changes to the fair estimate agreement system: -

- (a) the first would be to remove the 'four fifths' rule, which in effect has allowed employers to pay output workers less than the minimum wage;
- (b) the second change would be to discard the requirement to make an estimate of the hours needed to complete the task, and instead introduce a requirement for the employer to set a fair piece rate linked to the minimum wage;

(c) the third change would be to discard the present requirement to reach agreement with the worker, and require the employer instead to issue a notice providing details of the fair piece rate to be paid.

23. We will discuss each of these proposed changes in turn. Views on these would be welcomed

(a) Whether to remove the four fifths rule

24. The Regulations state that a fair estimate agreement will not be regarded as 'fair' if the estimate for the number of hours needed to complete the work to be done is less than four-fifths of the time that an average worker would take to do the same amount of work in the same conditions. It is therefore possible at the moment for employers to pay some output workers less than the minimum wage.

25. Where these agreements are in place, some employers are reportedly setting unreasonably short figures for the time needed to complete each block of work. It appears that the four-fifths rule has been a complicating factor, which has helped bad employers confuse the issue and pay well below the minimum wage.

26. It seems to us entirely reasonable that employers should be paying the minimum wage - not four fifths of it - to all average or ordinary output workers. We therefore propose to remove the four fifths rule.

(b) Whether to replace fair estimate agreements by a system of fair piece rates

27. As mentioned above, both employers and homeworker representatives have reported that fair estimate agreements are complex and difficult to administer, and that it is often may be difficult to predict the estimated hours for each homeworker from week to week. It seems to us that the fair piece rate proposal would be more straightforward and easier for both sides to understand. By

itself, this should encourage more employers and homeworkers to take up these arrangements, and make it more difficult for bad employers to introduce arrangements that are unfair.

28. Clearly if the fair piece rate was set on the basis of an average or ordinary worker, then some faster workers would earn more than the minimum wage and some slower ones would earn less. We recognise that this could be seen as a movement away from the principle that all workers should earn at least the minimum wage, but two points should be borne in mind. First, the existing Regulations covering fair estimate agreements already use the concept of an average worker and allow for the possibility that some slower output workers might be paid less than the minimum wage. We accept however that this may not be widely understood and that the proposal would make this possibility clearer. Second, homeworker representatives report that the majority of homeworkers presently earn less than the minimum wage, and that this cannot solely be accounted for by the four-fifths rule. We have to accept that the present arrangements are not working well. Increased clarity can be expected to help employers understand their obligations and workers their rights under the national minimum wage legislation.

29. Under the proposal it would be possible for faster workers to earn more than the minimum wage per hour worked and slower workers to earn less. Taken in the round, we believe this to be fair, as long as an average or ordinary worker receives the minimum wage for each hour worked.

30. A possible benefit of the proposal is that at present the great majority of homeworkers are paid piece rates rather than through fair estimate agreements or for every hour worked. A legitimate system of fair piece rates could encourage employers and homeworkers to review the way that their piece rates are presently set.

31. It may be worth exploring the possible read-across between this proposal, which affects output workers, and the position of factory workers that are paid a piece rate. Most factory workers are expected to work for a set number of hours per day and as such they are classified under the Regulations as time workers. They must therefore be paid at least the minimum wage on average for the hours that they work in each pay period, even if they are paid according to a piece rate. In other words, if a factory worker working set hours on a piece rate produces relatively few items in a pay

period, for whatever reason, so that his average hourly pay falls below the minimum wage for that period, then his pay must be 'topped up' so that he receives at least the minimum wage.

32. However factory workers that are not working set hours (for example those with zero hours contracts) and are paid solely according to a piece rate are output workers, and they would be covered by the fair piece rate proposal.

(c) Whether to replace the need for agreement between employers and workers with a system of notices

33. Under the present Regulations, fair estimate agreements must be made in writing between the employer and each worker, and agreed before the start of each pay reference period covered. However it seems to us on reflection that this would be administratively burdensome (and of course it is not happening now in practice). It is important to be clear that the hours worked by output workers are often not under the control of employers, especially in the case of homeworkers.

34. It would be possible instead to require the employer to serve a notice on the worker before the start of the pay reference period, specifying rates for the item or items to be produced by the worker. It would be possible to draft the provisions so that, as long as the worker was producing items for which the rate had already been specified to him, there would be no need to give any further notice. The provisions would not require the notice to specify the number of items to be produced; the employer would still be able to specify this, but that would be a matter of contract between the parties.

35. It seems to us on balance that it would be reasonable to allow the employer to decide whether to use the hourly system or opt for the fair piece rate alternative. This presumes (of course) that the fair piece rate must be properly set and that workers are fully informed of their rights, so that bad employers cannot impose unfairly low rates on their workers.

36. Two further practical issues arising from the proposal need to be considered.

How should fair piece rates be set?

37. The proposal is that fair piece rates might be calculated on the basis of an average or ordinary worker and this would mean that some of the workers would earn less than the minimum wage. One possibility could perhaps be to set the rate so that rather more than half of the workers earned at least the minimum wage. A further possibility could be to set a wage floor, perhaps at the level of the minimum wage, to protect the slowest workers, although this would of course require the hours worked to be recorded.

38. A further key question is how then to ensure that employers set the piece rate fairly. This is of course already an issue under fair estimate agreements, but could become more significant if the fair piece rate system was widely employed. Perhaps employers could be required by the Regulations to conduct trials to see how long ordinary or average workers take in practice to produce each block of work, or to set rates by reference to factory workers, with appropriate adjustments being made for the equipment used and other relevant differences.

39. Alternatively, perhaps we should rely on the threat of action by enforcement officers. If challenged, employers would need to be able to demonstrate that they had set the piece rate in a reasonable way. It should be noted that section 28 of the National Minimum Wage Act 1998 places the burden of proof onto employers to demonstrate that their workers have been remunerated in accordance with the minimum wage. This would ultimately fall to employment tribunals to decide but it would not seem to be reasonable for employers to set the rate by reference to their best workers only, as we understand sometimes occurs.

40. If the worker was asked to perform a number of tasks (some more difficult than others), then one possibility could be to allow them to be paid different rates for different items, some of the rates being below and some above the rate that would enable an average worker doing just the one task to earn the minimum wage, as long as the collective rate enabled an average worker to earn the minimum wage over each pay reference period. Employers would have to ensure that workers were not given items which amounted a collective piece rate which was too low, or to have top up arrangements in place to ensure those workers received the minimum wage. Alternatively, we could

instead require the rate set for each item to enable an average or ordinary worker, producing just that item, to earn the minimum wage.

How should we ensure that output workers are made aware of their rights?

41. We need to consider what information should be contained in the notices mentioned above. It seems to us that employers should be required to provide workers with a notice making it clear that they are entitled to a fair piece rate, linked to the minimum wage; and that they should also be required to set out how they had calculated their particular rate. It would then be for the Government to decide what targeted publicity might be needed, to ensure that homeworkers are fully informed of their rights and that bad employers cannot continue to pay low wages.

42. There may of course be other questions that we have missed. Comments on this proposal, and in particular the issues discussed in paragraphs 21 to 41 above, need to be submitted no later than 9 May. They should be sent to:

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Department of Trade and Industry
Employment Relations Directorate
Upper Ground Bay 129
1 Victoria Street
London SW1H 0ET.
020 7215 6231
E-mail: Mike.O'Donnell@dti.gsi.gov.uk

The Consultation Criteria

The Cabinet Office's Code of Practice on Written Consultation applies to consultation documents issued after 1 January 2000. The criteria are set out below and every effort has been made to ensure that they are followed in this consultation document.

1. Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.
2. It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
3. A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.
4. Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others), and effectively drawn to the attention of all interested groups and individuals.
5. Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation.
6. Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and reasons for decisions finally taken.
7. Departments should monitor and evaluate consultations, designating a consultation coordinator who will ensure the lessons are disseminated.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinetoffice.gov.uk/servicefirst/index/consultation.htm>

Comments or complaints

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

Philip Martin,
DTI Consultation Co-ordinator,
Room 564,
1 Victoria Street,
London SW1H 0ET
or telephone him on 020 7215 6206
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NATIONAL MINIMUM WAGE REGULATIONS: REGULATORY IMPACT
ASSESSMENT ON A PROPOSAL TO REPLACE FAIR ESTIMATE AGREEMENTS

Introduction

This assessment estimates the costs and benefits of the proposal, set out in the attached consultation paper, of replacing the present system of fair estimate agreements for output workers by a system of fair piece rates.

Purpose of the Proposal

2. To introduce an improved system which delivers a level of pay, linked to the national minimum wage, for output workers and homeworkers in particular.

3. The Low Pay Commission recommended in 2001 that “the Government should consult representatives of output workers and their employers to see whether there is a case for a change in the Regulations on fair estimate agreements”. This followed representations to the Commission from both employer and employee groups.

4. When introducing the minimum wage in 1999 the Government wanted to apply the minimum wage to output work and home working and decided to do this through ‘fair estimate agreements’. Under these agreements, employers must set a fair estimate of the hours needed to complete the block of work to be done, which should be agreed with the output worker, and the minimum wage must then be paid for the hours worked up to the limit set in the estimate. The estimate for the number of hours needed is not regarded as ‘fair’ if it is less than four-fifths of the time that an average worker would take to do the same amount of work in the same conditions. If no fair estimate agreement is in place, then the workers should be paid the minimum wage for all hours that are actually worked.

5. The National Group of Homeworkers (NGH) have argued that these arrangements have not worked well in practice. Evidence submitted recently by the NGH to the Low Pay Commission states that the majority of homeworkers interviewed in Bradford received piece rates which equated to £1.50 to £2.00 per hour. A larger survey conducted for the NGH in 2000, with a sample size of about 100 workers, found an average pay rate of £2.66 per hour. This data all came from fairly small samples.

6. According to the 2000 NGH Report, few employers of homeworkers seem to have used the fair estimate agreements system and many of these were unhappy with the terms of the agreement. They argue that these agreements are complex and difficult to administer and employers usually specify time periods for tasks which are unreasonably short, so that workers have been unable to earn the minimum wage.

7. Whilst the NGH have found anecdotal evidence of some homeworkers being paid piece rates that deliver rates of pay below minimum wage levels, we do not have national data showing what proportion of the 1 million workers who mainly work from home are affected by this problem.

8. However, it is possible to derive an estimate of the scale of this issue using data from the Labour Force Survey and analysing home workers by occupational group and their pay distribution. In total, data from the Labour Force Survey suggests that around 950,000 employees and self-employed who do paid work mainly from their own home or within the grounds or building of their own home. The DTI have analysed this data by occupation and pay distribution and it indicates that around 70,000 workers may not be receiving the minimum wage despite their being entitled to it. Our analysis shows that most of the homeworkers covered by the Labour Force Survey are in average to high-skilled occupations and most of them are being paid well above minimum wage levels.

9. We understand however that the National Group of Homeworkers believe that the number of homeworkers earning the minimum wage is substantially higher than this. The reasons for the discrepancies between the various figures quoted in this area are unclear, but we propose to explore this issue further with the different parties involved.

10. The Government has considered how best to take fair estimate agreements forward. Both homeworker employers and representatives have suggested that it would be more straightforward to introduce a system of fair piece rates that provides an hourly rate linked to the minimum wage. We have held a series of discussions with homeworker employers and representatives in recent months and the principal features of the consultation paper are as follows: -

- it proposes to remove the present ‘four fifths’ rule, which in effect has allowed employers to pay output workers less than the minimum wage. Under the fair piece rate system an average worker should receive the minimum wage, but this would mean of course that about half would earn more than the minimum wage and about half would earn less. In practice we expect that this arrangement should deliver better rates for most homeworkers, but the paper also invites views on whether the fair piece rate might be set so that most workers earned more than the minimum wage, and whether a wage floor for very slow workers might also be introduced;
- it proposes to discard the present requirement to reach agreement with the worker, and make the alternative dependant on the employer issuing a notice. This would make it the choice of the employer whether to stick to the basic hourly system or go for the alternative provided;
- it proposes to discard the requirement to make an estimate of the hours needed to complete the task, and instead introduce a requirement for the employer to set a fair piece rate linked to the minimum wage;
- the central proposition is that this system would be more easily understood and that this – together with appropriate publicity and enforcement efforts in due course – should mean that more employers will take advantage of the new arrangements and enable more homeworkers to be clear about whether they are receiving a fair rate, and if necessary complain to the Inland Revenue.

Costs and Benefits

11. We do not have sufficient data on the rates paid to output or homeworkers to know exactly how many workers are likely to be affected. But as mentioned above the Labour Force Survey suggests that around 70,000 homeworkers may not be receiving the minimum wage, despite having an entitlement to it.

12. Moving from the current legislation (where employers are supposed to pay at least four fifths of the minimum wage) to the proposed new arrangements (where an average or ordinary worker should receive the minimum wage) should deliver a wage benefit to workers (and a wage cost to homeworker employers). If we assume (see the discussion above) that there are 70,000 homeworkers all earning a basic minimum wage entitlement of four fifths of the minimum wage, and that because of the new regulations they start to earn on average the minimum wage, the direct cost of the regulation would be around £90 million per year¹. The benefit to these workers would also be around £90 million and would equate to an average benefit per worker of around £1300 per year before adjusting for taxes and any benefit entitlements.

13. The proposed arrangements should also be more easily understood and we hope that this, together with targeted enforcement efforts, will help to substantially increase compliance with the minimum wage amongst home workers. However, these costs have already been fully budgeted for in the original Regulatory Impact Assessment (RIA) in 1999 and we do not intend to cost the pick-up in compliance resulting from any new legislation.

We assume that all output workers were being paid in accordance with the minimum wage regulations (as envisaged in the original RIA), and so the costs and benefits of the proposal are limited to those over and above the ones in the original RIA.

14. Whilst the difference between paying a group of homeworkers under the present arrangements and the central proposal that an average homeworker should receive the minimum wage is estimated at around £90 million, the other suggestion that more than half of workers should be paid at least the

¹ “Around £90 million” is calculated as follows: 70,000 (number of workers) *0.82 (increased wage rate per hour) *31.25 (average hours worked per week) *52 (weeks per year) = around £90 million

minimum wage and that there should be a wage floor (perhaps at the level of the minimum wage) to protect the slowest workers, would put significantly higher costs onto employers. The Government will consider this point very carefully once representations have been received. These estimates are all subject to considerable uncertainty.

Administrative costs

15. It is possible that there could also be some administrative costs of switching to a new fair piece-rate system. There could also be some savings if there are no longer requirements to keep a record of hours worked and to agree a new Fair Estimate Agreement for each pay reference period. However, any costs and savings are likely to be minimal for RIA purposes. Given the anecdotal evidence of the current low take-up of FEAs, any savings from switching to a new system are likely to be small. As for the costs side, the cost of implementing any new piece-rate system are expected to be only slightly higher than the costs implicit in the original 1999 RIA.

16. To estimate the extra administrative cost, we first calculated the number of employers that are likely to be affected by the proposal. Based on workplace-based data from the Labour Force Survey and breaking it down by occupational category, we estimate that there are around 3,600 organisations employing homeworkers who would be eligible to benefit from the proposed changes. If we assume that new fair piece-rates have to be calculated and agreed in each case, then some extra managerial time will be required. Assuming that an extra half-day of managerial time is required in each case, the estimated cost is £90 per firm² or £330,000 for all organisations affected by the proposal.

Impact on small firms

17. There should be little impact on any firms that are already paying in accordance with the minimum wage Regulations.

² £90 per firm is calculated as follows: Personnel manager is used as a proxy for a manager. New Earnings Survey (2002) gives this as £18.67 an hour. For a half-day and adding non-wage labour costs of 30 per cent gives an estimate of around £90 per employer.

Declaration

18. I have read the Regulatory Impact Assessment and I am satisfied that the balance between cost and benefit is the right one in the circumstances.

Signed by the Responsible Minister:

Date:

Contact point:

Jonathan Gershlick

Employment Relations

Department of Trade and Industry

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