MILLS & REEVE

briefing

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Statutory holiday pay: where are we now?

In this briefing we take stock of the latest case law developments about workers' entitlement to paid holiday under EU and domestic law

Overview

Legal framework

The EU's Working Time Directive requires all member states to ensure that their workers are entitled to a minimum of four weeks' paid annual leave every year. In the UK this obligation was implemented by the Working Time Regulations 1998.

The Regulations have worked perfectly well for salaried workers with regular working patterns, but in recent years two major inconsistencies have emerged between the literal wording of the Regulations and the way the European Court of Justice has interpreted the requirements of the Directive. Firstly it has emphasised that workers should not be deprived of the right to paid holiday merely because they have not been able to exercise it due to long-term sickness. Secondly it has said that holiday pay should reflect pay "normally" received and must include all elements of pay "intrinsic" to the performance of the job. It follows that a wide range of remuneration should be reflected in holiday pay, not just "basic" pay.

Public and private sector contrasted

The core holiday entitlement stipulated by the Directive is directly effective – that is it binds public sector employers regardless of what our domestic legislation says. That means that the cases turning on how the Working Time Regulations should be interpreted are directly relevant only to employers in the private sector.

Private sector employers are, in theory at least, are entitled to rely on the Working Time Regulations to work out how much holiday pay they should be paying. However, under EU law our domestic courts must interpret them in conformity with the Directive if at all possible – even if that means reading in additional words. So in reality the distinction between the obligations of public and private sector employers can become a little blurred.

What about additional leave?

The developments discussed in the rest of this note do not apply to the additional 8 days' paid leave introduced in 2007. Nor do they apply to any additional contractual entitlement.

In practice however, many employers will apply the same rules to this additional leave, as well as any contractual entitlement in excess of that. While this is obviously an additional cost, systems may not be set up to differentiate easily between statutory and additional leave. To that extent these new developments may be relevant to all types of holiday pay.

Calculating holiday pay

The basic rules

Under the Working Time Regulations, the statutory rules on a week's pay form the starting point for calculating pay for each week's holiday. For salaried workers with regular hours who receive the same pay every salary period, the calculation is simple and there is no need to look beyond these rules.

Difficulties have however arisen in relation to workers who do not fit into this category. This could either be because their pay includes a number of variable elements or because they receive commission or similar payments on top of their basic salary. In these circumstances the rules on a week's pay, at least if literally interpreted, can come into conflict with the Directive.

Overtime

It has always been clear that guaranteed overtime (ie overtime that the employer is obliged to offer and the worker obliged to work) should be reflected in the calculation of holiday pay.

At the end of 2014 the Employment Appeal Tribunal decided in the *Bear Scotland* case that the same principle should apply to some non-guaranteed overtime – ie overtime that the worker is obliged to work if offered. For these purposes overtime includes not only any higher hourly rate paid during overtime, but shift premiums and other special allowances.

It is not completely clear what the position is with purely voluntary overtime. Last year we had a decision from the Northern Ireland Court of Appeal which said that a Belfast industrial tribunal had been wrong to assume that such overtime could never be included in the calculation, but stopped short of offering any clear guidance on this point. It seems likely however, that if regularly worked to form a settled pattern, voluntary overtime should be included in holiday pay calculations.

Commission

The rules on a week's pay make provision for averaging pay over a 12 week reference period where employees' pay "varies with the amount of work done". Since a decision from the Court of Appeal over 10 years ago it had been thought that results-based commission did not fall within this description and so did not have to be included in holiday pay.

This ruling has in effect been reversed by the EAT in February 2016 in the case of *Lock v British Gas*. It said that the employment tribunal had been right to ignore the earlier Court of Appeal decision in the light of subsequent rulings from the European Court of Justice. However the EAT decision is being appealed, so we will probably have to wait until 2017 for the Court of Appeal to issue definitive guidance.

Reference periods

The correct reference period in relation to results-based commission will be considered by the employment tribunal in *Lock* once all the appeals have been decided, assuming they are ultimately resolved in the employee's favour.

The European Court of Justice thought that an annual reference period might be appropriate, but the Working Time Regulations provide for a rolling 12 week period. There are arguments that this shorter reference period may not always produce a fair result. This is particularly so in the case of seasonal overtime, or where commission or bonuses are paid on a longer cycle. It is possible that employers may have some latitude to agree an appropriate reference period, but uncertainty about the correct approach is likely to continue for a considerable time.

Back-dated claims

Under the Working Time Regulations, claims for underpayment of holiday pay must normally be brought within three months of the underpayment. There is however an exception if there has been a "series" of underpayments, when the time limit is three months from the last underpayment in the series.

In *Bear Scotland* the EAT expressed the view that a series of underpayments came to an end if there was a gap of three months or more between each separate underpayment. This aspect of the ruling is now going to be re-visited in a further appeal to the EAT involving the same parties.

In the meantime however the Government has intervened. As from July 2015, claims for underpayment of holiday brought it in the employment tribunal cannot in any event go back more than two years from the date the proceedings are launched. This means there is now an upper ceiling on the value of claims based on a series of underpayments, although claims already in the system prior to July last year will not be affected.

Carrying forward leave

Does it accrue during periods of sick leave?

It has been clear for a number of years that workers will not normally lose entitlement to holiday pay merely because they are off sick during the whole holiday year. Under UK law it is also reasonably clear that they have a choice about whether to take paid holiday during what would otherwise be a period of sick leave, or to carry it forward into the following leave year. However if choosing to carry leave forward, the worker is not obliged to notify the employer, as this is the default position.

How long can leave be carried forward?

The European Court of Justice has accepted in a number of cases that the leave accrued during periods of long-term sick leave cannot be carried forward indefinitely. It has not laid down hard and fast rules, but a limit of between 15 and 18 months is unlikely to infringe the Directive.

In 2015 the EAT tackled this question in a dispute with a private sector employer in the printing industry. It decided that the Working Time Regulations should be interpreted to permit carry-forward for up to 18 months in these circumstances, despite that fact that, if literally interpreted, they prohibit carrying forward the core four week leave entitlement.

Practical implications

It is fair to assume that it will be some years before we have a reasonable degree of certainty about how holiday pay should be calculated for non-salaried workers. This is something that employers will have to learn to live with. We do however believe that the direction of travel is clear, at least while the UK remains in the EU: we are moving away from a regime where workers will accept a reduced rate of pay just because they are on holiday.

Employers affected by these developments will therefore have to decide whether to continue to wait while these new appeals grind their way through the legal system, or grasp the nettle now. Many employers are looking at simplifying their pay structures as a response. There is no right or wrong answer. The correct decision will depend on the composition and attitude of the workforce, and the degree of exposure to back-dated claims.

We would strongly recommend that employers take legal advice before attempting to re-negotiate terms and conditions or settle outstanding liabilities.