Holiday pay update

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Introduction

Yesterday, the Employment Appeal Tribunal **(EAT)** handed down judgment in three joined cases which we shall refer to as Bear Scotland & Others –v- Fulton and Others. The decision has fired huge media interest and has resulted in the Business Secretary, Vince Cable, creating a taskforce to consider the impact of the ruling on businesses.

In July, we issued a note on the general direction of travel of the law in this area and the likely considerations before the EAT. We have considered the decision overnight and set out below our preliminary view on the general questions that are likely to be of immediate concern to employers. A "one size fits all" piece of advice is not possible. We would be pleased to answer more specific questions unique to your business in person. The irony is not lost on us that today is 5 November 2014 and we seem to have had our fireworks display one day early this year!

Before looking at the areas of immediate concern, it is helpful to summarise the background to the decision.

Legal Background

The Court of Justice of the European Union **(CJEU)** has become increasingly interested in workers taking holidays and receiving the correct holiday pay. The CJEU sees holidays as sacrosanct and has shown through its decisions a wish to ensure that nothing is done by employers which could be seen as preventing or dissuading employees from taking paid holiday leave. As a result, in recent years a body of cases addressing issues around holiday entitlements and sickness absence has grown up.

The key consideration in the Bear case has been the interaction between Article 7 of the European Working Time Directive 2003 **(WTD)** which requires the UK to ensure that workers have the right to at least four weeks' paid annual leave (but does not say how this should be paid) and UK law which implemented the WTD provisions in the Working Time Regulations 1998 **(WTR)**.

The WTR (as later amended) provides workers with 5.6 weeks' (i.e. 28 working days) annual leave. It also provides that workers are entitled to be paid at the rate of a 'week's pay' for each week of leave. Sections 221 to 224 of the Employment Rights Act 1996 (ERA) prescribe how to calculate a week's pay. The calculation depends on whether a worker's hours and remuneration vary week to week. If a worker does not have normal working hours a worker's hours or pay vary week to week and a week's pay is calculated by averaging pay over a 12 week reference period. In 2004, the Court of Appeal in Bamsey and others –v- Albion Engineering held that compulsory but not guaranteed overtime did not need to be taken into account when calculating a week's pay for the purposes of holiday pay.

Case law

In 2006 the CJEU ruled that workers must continue to receive their "normal remuneration" whilst on holiday (Robinson-Steele v RD Retail Service Ltd). The CJEU expanded on the concept of "normal remuneration" in 2011 in Williams and Others v British Airways plc. In Williams the CJEU ruled that workers should be no worse off during annual leave than if they were working. Thus, a week's pay should be at the rate of the worker's normal remuneration, which will include any payments "intrinsically linked" to the performance of the worker's job. In the Williams case this included flying supplements for pilots (but excluded certain expenses on the basis that these were only in fact incurred if an employee was at work).

A year later in Fulton v Bear Scotland (2012), the Employment Tribunal **(ET)** decided that normal remuneration should include payments received by an employee over a 12 week reference period including overtime, stand-by payments and call out supplements. In Neal v Freightliner (2013) the ET then decided that normal remuneration could include non guaranteed overtime payments.

The decision in Fulton was appealed and heard with two other similar cases involving Hertel and AMEC Group at the end of July (Neal settled before the appeal hearing on an undisclosed basis). At the EAT hearing in July the Government was also allowed to make submissions, given the potential wide-reaching consequences of the judgment.

The decision

The EAT's judgment yesterday runs to 45 pages and considered several issues, but the key issue and the issue which has been covered in the media is the decision that the WTR had to be interpreted consistently with the WTD and that in the case of "non-guaranteed overtime", holiday pay needs to be calculated to include such payments.

Much of the media coverage has been superficial on this point. It is important to understand that "non-guaranteed overtime" is overtime which the employees are not guaranteed to be offered, but if offered are obliged to work. Truly voluntary overtime does not fall within the ambit of the decision, but it is foreseeable that certain employees will seek to try and argue in the future that whilst there is no written obligation on them to work overtime if offered there is an implied obligation to work it (e.g. "You need to stay tonight to get that project completed by tomorrow's deadline?").

A major concern before the judgment was whether any backdating of claims for pay would go back for the normal limitation period of 6 years or even to when the WTR came into effect on 1 October 1998. However, the EAT put a substantial brake on any claims for back payments as it considered in some detail how the interaction between the WTD holiday entitlement (ie. 4 weeks) worked with the additional 1.6 weeks entitlement under the WTR. The Bear judgment only applies to the calculation of the WTD holiday entitlement. The EAT decided that in any holiday year, the 4 weeks of WTD leave is taken first. The remaining leave, which the EAT said by its nature is "additional" to the WTD leave will be taken afterwards, i.e. at the end of the holiday year.

Why is this important? This is a key consideration as the way an employee can pursue a claim for unpaid wages is in an ET by way of an unlawful deduction of wages claim. Such claims have a strict time limit and must be brought within 3 months of the last in any series of deductions. The ET has very limited flexibility to allow such a claim outside the time limit. Therefore, the series of deductions will cease when an employee is taking additional 1.6 weeks' leave under the WTR. The EAT has held that if such a gap is more than 3 months then a tribunal would have no jurisdiction to hear a claim. In many circumstances given the way we take holidays and depending on the holiday year, many claims could therefore be limited to the current holiday year (and potentially a shorter period if the correct payment for holiday is made in between incorrect payments). The EAT's judgment acknowledges that this is likely to be an area where there may be a further appeal.

Where does this leave employers?

The decision does not answer all the outstanding questions or give a certain answer that applies to all employers. As in many employment matters, the specific facts of the situation are important particularly in terms of whether there has been a break in a series of deductions.

The media coverage will inevitably result in claims for back pay. The introduction of tribunal fees and the requirement for pre-claim conciliation via ACAS before any claim is lodged mean that claims will not just be lodged with the ET without an employer having prior notice. Management of grievances and any claims will be a significant issue for many employers to grapple with. However, the limitation on the backdating of claims may (in the short term at least, pending any appeal to the Court of Appeal) make it less likely that mass claims are pursued.

No doubt further questions and themes will arise over the coming weeks, but we have tried to answer below some of the questions which are likely to be of immediate importance:

How do I deal with the interaction of overtime and other allowances and holiday pay going forwards?

It is important to remember that Bear is part only of the jigsaw puzzle in this area. Another case, concerning commission entitlement whilst on holiday, Lock –v- British Gas is likely to be considered by the EAT in early 2015. In Lock the CJEU confirmed that an employee should be compensated for any commission entitlement that he would have earned had he not taken holiday.

In Bear, there is a telling comment in relation to what amounts to a week's pay – "Despite the subtlety of the arguments, the essential points seem relatively simple. "Normal pay" is that which is normally received"

If you have not already done so, now is the time to sit down and look at your working practices and contractual arrangements. Truly voluntary overtime appears safe for the moment, but you need to review how you pay holiday pay if any worker earns:

- Overtime (which they are required to work if offered);
- Commission;
- Output related bonuses;
- Work related allowances (eg. shift or attendance allowances); and/or
- Call out or stand-by payments.

Such payments or allowances are likely to be intrinsically linked to normal pay and therefore are likely to need to be paid as part of holiday pay.

How do I calculate the potential liability that my organisation may face?

As set out above, the Bear judgment appears to limit the backdating of claims. Future cost will require an evaluation of the additional sums employees do whilst carrying out their normal work. An evaluation of the working arrangements and staffing needs together with the contractual arrangements will be necessary to consider the way in which this liability can be reduced (see below).

In terms of historic liability, a laborious task of looking at workers one by one may be necessary. We envisage a process as follows:

1. **Look at your current holiday year and ask yourself:** When does it run from? How many holidays is the worker entitled to? How many of those holidays are under the WTD entitlement (ie. the first 4 weeks or pro rata equivalent for part-timers)? When were those WTD holidays taken? Has there been a break of 3 months since those WTD holidays were taken? If so, there may be no valid claim. If not, then there may be a claim and a consideration needs to be made whether to address it now or only when requested by any employee.
2. **It may then be necessary, if there hasn't been a 3 month break in the current holiday year, to repeat the exercise for the previous holiday year.**
3. **Once the period of any exposure to liability for WTD holiday back pay claims has been identified, a calculation will be needed of the likely claim by asking:** What overtime/other "normal" payments did the worker receive as an average over the 12 weeks prior to each holiday period. This can then be used to calculate a daily rate to be applied to each day of holiday.

What can I do to reduce any costs of this judgment in future?

The Bear case concerns a specific form of overtime and one way to avoid this type of issue is to operate and have a clear policy and procedure that you operate voluntary overtime only. However, this may not reflect the working reality and still expose an employer to risks of claims. Before embarking on this change an honest assessment of the current arrangements is also necessary to ensure that there will not be an issue around a unilateral variation of contract if you are removing any guarantee of overtime from your workers.

Many commentators overnight have said that the decision will result in the greater use of temporary and/or agency workers for peaks in work. Looking at the way in which demand for overtime arises is a key consideration for future planning.

In terms of allowances, it may be that one approach is looking to renegotiate these and include some or all of them in annual salary eg. a higher salary in return for an agreement to work such hours as are required to fulfil the role but with no entitlement to overtime pay. However, this will undoubtedly have a cost.

The WTR provide that certain aspects of their coverage can be modified by an individual or workforce agreement; unfortunately the pay reference period for leave is not one of them. It may be one of the areas that Vince Cable's taskforce looks at to move to a longer reference period to iron out the effects of the reasonably short 12 weeks reference period in certain sectors (e.g. Christmas in the retail and hospitality sectors). This would be likely to be permitted by the CJEU, but whether this could be done before the next General Election seems unlikely. It is not yet clear what effect any change in Government would have on the approach.

As things develop over the coming weeks we will update you on any significant developments.

If you have any queries in the meantime please do not hesitate to contact me.

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