

Holidays

Where do we go now?

November 2014

A recent ruling of the Employment Appeal Tribunal (EAT) has changed the way holiday pay should be calculated for many workers. In the combined cases of *Fulton and others v Bear Scotland Limited*, *Wood and others v Hertel (UK) Limited* and *Law and others v AMEC Group Limited*, the EAT upheld workers' claims that holiday pay should have included non-guaranteed overtime pay, as well as other additional allowances. This follows a similar line of thinking to cases earlier this year around commission being included in holiday pay.

Although the decision is likely to be appealed, it has significant operational and financial ramifications for employers, and raises a number of questions, which are considered below.

What pay should workers receive during their holiday?

- Workers must receive their "normal pay" during their four weeks of holiday entitlement under EU law.
- "Normal pay" consists of basic pay together with any other pay the worker regularly receives for doing their job, including overtime payments, standby payments, attendance allowances, emergency call out payments and commission.
- Payments must be "regular" in order to be part of normal pay, but do not necessarily need to be frequent. So, for example, payment for overtime carried out during one or two seasonal spikes in work taking place at the same time every year is likely to be part of normal pay. In contrast, overtime during a one off exceptional project which is not likely to be repeated the following year may not be part of normal pay.
- It does not matter if the amount of the payment fluctuates from week to week (or month to month) – the payments will still count as part of normal pay.
- Although the EAT decision only concerned "non-guaranteed overtime", ie overtime which the employer did not have to offer but the employee did have to do if offered, the principles would apply equally to voluntary overtime, and any Employment Tribunal would almost certainly expect this to be treated as normal pay.

How can we ensure workers are receiving the right amount?

- There are a number of different approaches which employers can take to ensure that workers receive their normal pay during holiday periods. The key is to put in place a payment system which ensures that workers will not be worse off for taking holiday, or discouraged from taking it.
 - Where a worker receives regular payments of similar amounts, such as regular overtime or commission, then the employer may be able to calculate in advance an approximate annualised amount in order to assess how much should be paid during holiday periods.
 - Where payments fluctuate significantly from one week or one month to the next, then it may be more appropriate to carry out a calculation at the time that the worker takes the holiday looking back over a representative period, which should be at least 12 weeks but it could be appropriate to use a longer period in some situations. For example, it may be appropriate to use a one year period where commission is paid quarterly or overtime occurs on an annual or seasonal basis.
 - Where commission is concerned, adjusting the commission targets to allow for holiday could be a solution. So, for example, if there are monthly sales targets these could be reduced proportionately for any holiday taken in that month, to ensure the worker is not disadvantaged.
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What claims might workers bring in relation to past holiday?

- Workers can claim under the Working Time Regulations in respect of underpayment of EU holiday in the last three months.
- If workers wanted to claim in respect of holiday going back more than three months, they would have to claim it as an unlawful deduction from wages.
- An unlawful deductions claim would have to be brought within three months from the last of a series of deductions (subject to extensions of time for Acas pre-claim conciliation which applies to this type of claim). However, if there is a gap of more than three months in between deductions then the series is broken. This gap could arise because the worker has not been paid for holiday at all for a three month period, or has only been paid for additional UK holiday, or contractual holiday in that period.
- Workers will usually be regarded as having taken their four weeks' EU holiday first in a holiday year (unless, for example, they are using up carried over holiday from the previous year). This means that for many workers there will be a period towards the end of the holiday year when any holiday they take is additional UK holiday or contractual holiday, which may result in a three month gap between payments for EU holiday.
- The three month gap must be between the deductions (ie the payments in respect of the period of holiday) rather than between the holiday periods themselves. So, for example, if a worker took holiday on 1 September, for which he was paid at an "incorrect" level on 25 September, then the series of deductions would be broken only if there was no underpayment of EU holiday between 26 September and 25 December (as opposed to between 2 September and 1 December).
- It is unlikely that a worker could have any additional civil court claim, such as a breach of contract claim, as a result of the EAT decision.
- Even if a worker could bring an unlawful deductions claim going back several years (because there was never a three month gap between underpayments) it is likely that the claim would be limited to the previous six years of holiday pay.

What should we do now?

- Employers now have two options:
 - Option 1: do nothing, and wait to see whether the case is appealed. The employer would also wait to see whether any workers bring claims in the meantime.
 - Option 2: start paying normal pay for all holiday from now on (and possibly also paying for previous holiday periods).

There are advantages and disadvantages to each option.

- Option 1: wait and see. The advantage is that this represents no immediate additional cost. However, employers should bear in mind the following:
 - Even if the case is appealed, the judge in the EAT made it clear that the EU principle that workers must receive their "normal pay" during holiday is well established and extremely unlikely to change as a result of any appeal.
 - Assuming that this principle will not change, failing to pay normal pay for holiday from now on will store up increasing ongoing financial liability.
 - Workers could bring claims now in respect of the last three months (or more, if there was no "break"). There was a significant amount of publicity around the news last week, which may prompt workers to consider claims. We are also aware that unions are collating information and data about past holiday taken by their members. Workers can bring claims now and keep amending them to include any underpaid holiday in future as and when it arises.
 - If the case is appealed and the appeal court decides that that a three month gap does not break a series of deductions, then this could revive historical claims, reopening potentially substantial liability. As the "three month gap" rule is new law, there is a material risk this could change on any appeal.

- Option 2: pay normal pay for holiday from now on:
 - The disadvantage of this is the additional and immediate cost involved.
 - The advantage is that it will prevent future claims for underpaid holiday. It may also prevent back pay claims for past holiday which have not already been brought. After holiday pay has been paid properly for three months, any workers who have not previously brought a claim (or contacted Acas to start pre-claim conciliation) at that stage will be unable to do so in the future, regardless of the result of any appeal in this case. This is because any "series of deductions" will certainly have ended at the date the last "incorrect" payment was made and the period of three months to bring that claim will then have passed. The employer is therefore capping its liability at an early stage and eliminating the risk of future claims.
- Employers who correct holiday pay going forward may also wish to update pay for holiday taken in the last three months.
 - Some commentaries have suggested that this could extinguish historical claims by breaking the series of deductions, but this will almost certainly not be the case.
 - Although any amounts paid for past holiday should be capable of being set off against any claims workers bring for that three month period, workers can still bring a claim for previous holiday periods (as long as there has not been a three month gap to break the series).
 - The only way to eliminate the risk of these claims is to require workers to sign settlement agreements. This involves additional administration and expense for the employer, and also workers may not be prepared to sign the settlement agreement without additional payment for past periods of holiday beyond the last three months.

Next steps

Employers should assess their potential liability for historical claims, and the likely cost of increasing holiday pay in the future, and whether they would prefer to act now or wait. For many employers, there are likely to be significant advantages in putting the situation right at this point, but for others this will be less appealing. Given that the likely financial liability for past and future holiday pay will depend very much on the employer's workforce, individual work and holiday patterns and the nature of any overtime, commission or other payment arrangements, specific advice should be sought.

Business Secretary Vince Cable has announced that a taskforce is being set up to assess the impact of the ruling. However, it is difficult to see what action the Government could take to limit liability for employers, as the issue concerns rights under EU law.

Please note that this briefing is for general guidance only and specific advice should always be sought on individual situations. If you would like to discuss the impact of the decision on your workforce please speak to your usual employment department contact or email one of the Employment Partners.

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