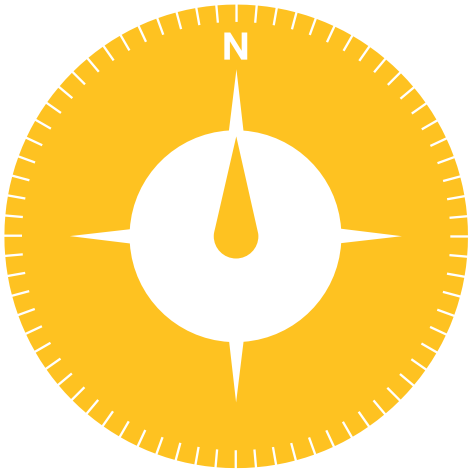
Holiday Pay

How did we get here? An analysis of recent case law

Go further

Introduction

Go further



In light of the recent landmark EAT judgment on holiday pay we consider the current trends in the case law and analyse the potential risks and impact.

We also provide recommendations on possible options to address this issue and suggest the next steps to protect your business. It remains a 'potential' issue at present, because the law is in a state of flux in this area. It is positive news for employers that Unite has indicated that it will not be appealing the recent EAT decision. However, there will undoubtedly be further cases challenging the principles in the EAT judgment, particularly on the issue of back pay. The government have set up a task force to consider legislative amendments. The law may not therefore be settled in this area for some time.

Contents

Calculating Holiday Pay: The UK Legal Perspective

Go further

Regulation 16 of the Working Time Regulations (WTR) provides that a worker must receive a week's pay for a week's holiday. The calculation for a week's pay is contained in sections 221-224 of the Employment Rights Act 1996 (ERA). The definition of a week's pay differs depending on the circumstances. The starting point is the worker's working pattern. Workers may be divided into four categories:

Category A

Those with normal working hours and whose pay does not vary with the amount of work done or the time at which they work during those normal working hours (section 221(2), ERA).

Category B

Those with normal working hours, but whose pay varies with the amount of work they do in those hours; for example, piece workers (section 221(3), ERA).

Category C

Those with normal working hours but whose pay varies depending on the times or days on which their normal working hours fall; for example, shift workers (section 222(1), ERA).

Category D

Those who do not have normal working hours; for example, workers on zero-hours contracts (section 224, ERA).

This is the most straightforward category. A week's statutory holiday pay is the amount payable under the contract of employment if the worker works his normal working hours in a week (section 221(2), ERA).

Methods of Calculating Holiday Pay

- The holiday pay calculation for these categories is more complex, as it is based on a 12 week average: average hourly rate x normal working hours.
- For the average hourly rate the employer must identify the relevant 12 week period*. The starting point is the period of 12 complete weeks ending with the first day of the leave (sections 221(3) and 222(4), ERA).
- However, if, during any one of those weeks, the worker earned no remuneration, the employer must discount that week, and extend the 12-week period backwards by a further week until it is reviewing a 12-week period in which the worker received at least some remuneration in every week (section 223(2), ERA).
- Once the relevant 12-week period has been determined, the following calculation is used to establish the average hourly rate: The employer calculates the total number of hours worked during the relevant 12-week period. This includes not only normal working hours, but also any overtime, including those hours that are not compulsory or guaranteed. The employer then calculates the total remuneration attributable to those hours. This figure includes overtime hours, but at the normal rate of pay that would have been paid if they formed part of normal working hours (that is, excluding any enhanced overtime rates) (section 223(3), ERA). It also includes shift premia for normal working hours. The total remuneration is divided by the total hours from the first step to give the employer the average hourly rate of remuneration. To calculate the weekly normal working hours, the average hourly rate is then multiplied by weekly normal working hours to determine the rate of a week's pay for statutory holiday purposes.

- Category D. For workers with no normal working hours, a week's pay is calculated as an average of all the sums earned in the previous 12 working weeks* (excluding those weeks in which no remuneration was payable). This average includes overtime and commission.

* Although the WTR expressly permit the variation or limitation of certain provisions relating to annual leave in a relevant agreement (collective agreement, workforce agreement or individual agreement between worker and employer), these relate to certain provisions only such as the start date of the leave year; the worker's and employer's obligations to give notice of the taking of annual leave. Notably, there is no express right for an employer to agree to vary the 12 week reference period for the purposes of calculating a week's pay. However, it does clearly say that whatever is paid will be counted as partially discharging the liability under the WTR.

Recent Case Law: A Brief Summary

Go further

There are a number of recent cases on holiday pay which challenge the unequivocal drafting of the WTR and call into question whether the WTR are compatible with the European Working Time Directive (WTD). In brief, these are the key lines of authorities on the calculation of holiday pay:

Williams and others v British Airways plc 2011 (Supreme Court)

This decision is authority for the principle that holiday pay during annual leave should take account not only of basic pay, but also of contractual supplementary payments which form part of "normal remuneration". This decision was made following a referral to the Court of Justice of the European Union (CJEU), in which the CJEU held that "normal remuneration" would include remuneration that is intrinsically linked to the performance of tasks that a worker is contractually required to perform. This is binding authority on this principle. Essentially the line of cases that has followed this (summarised below) is the UK and CJEU seeking to apply and interpret this basic principle to a range of specific circumstances.

Lock v British Gas Trading Ltd 2013 (CJEU decision – awaiting UK interpretation)

The CJEU delivered judgment in May 2014 in this case about the calculation of holiday pay for workers whose remuneration is made up of a fixed component and regular variable component. The CJEU concluded that, following the Williams decision, the holiday pay of such workers should comprise both their basic salary and an amount that reflects the commission or other regular variable pay components previously earned over a representative period. This case will now be remitted for specific interpretation on the facts and under UK law by the original tribunal that heard the case. This is due to be heard by the Leicester employment tribunal in February 2015.

Neal v Freightliner Limited 2012 (Birmingham ET Decision – case settled before EAT)

Although only a first instance employment tribunal decision, this case followed the trend set by the CJEU in the Williams case. In this case an employment judge held that in light of Williams a worker's overtime payment had to be taken into account when calculating holiday pay. In this case it appeared that a distinction was made between voluntary and compulsory overtime, although later decisions appear to make no such distinction. Although in this case it was expressed that Mr Neal conducted 'voluntary' overtime, in reality, this was deemed to be compulsory overtime since he was contracted to work a 35 hour week but was regularly rostered to work 8.5/9 hours per day. Therefore, in effect, the overtime he performed was not voluntary at all and was intrinsically linked to the performance of the tasks that were required to be carried out under the contract. This case was due to be considered along with others by the Employment Appeal Tribunal (EAT) at the end of July, however, it was settled between the parties before the hearing. This case does not therefore provide any binding authority.

Fulton and others v Bear Scotland Ltd and others 2013 (Glasgow ET decision)

In this case an employment judge decided that a worker who worked regular overtime as a matter of course was entitled to have that overtime reflected in their holiday pay. Further, standby and emergency callout duties had to be taken into account too. Applying Williams, these were activities that were held to be intrinsically linked to the performance of tasks required to be carried out under the contract. This case has been appealed and is therefore not currently binding authority.

Wood and others v Hertel (UK) Ltd and Law and others v AMEC Group Ltd 2013 (Nottingham ET decision)

This was another first instance tribunal decision in which it was concluded that overtime should be included in the calculation of holiday pay, although it was held that a radius allowance need not be included. The tribunal in this case was willing to add an additional 49 words to the WTR in order for them to be interpreted in a manner consistent with the WTD. The effect of these words is to treat everyone as if they have no normal working hours and thus apply the 12 week average calculation to all. This case appears to significantly dilute the approach taken in Neal and implies that any overtime may be intrinsically linked to the requirements of the contract, whether it is ad hoc or non-voluntary overtime. This case has been appealed and is therefore not currently binding authority.

Fulton and others v Bear Scotland Ltd; Wood and others v Hertel (UK) Ltd; Law and others v AMEC Group Ltd

The Fulton and Wood cases were joined and the appeals in both cases were heard by the EAT on 30 and 31 July & 1 August 2014. We were in attendance and tweeted live from the EAT as the arguments unfolded. The judgment was handed down on 4 November 2014.

The judgment confirms that workers have the right under Article 7 of WTD to be paid "normal remuneration" during their four weeks "EU leave".

Pay must therefore be calculated based on typical average pay and not based only upon basic hours' pay, which has been the long established position under the WTR.

In all of the appeals before the EAT, the facts concerned regular, non-contractual overtime. This therefore leaves the door open to further claims to seek clarity over the degree to which overtime must be "voluntary" and the regularity with which such overtime would need to be performed to conclude that it falls within a worker's "normal remuneration".

The EAT determined that the WTR could be read in a manner that achieves compliance with Article 7 of the WTD. This outcome potentially gives a significant number of UK workers – who have been paid holiday pay calculated on their basic hours' only – claims for unlawful deductions from wages.

Retrospective claims and limitation periods

Prior to the EAT decision, there were growing concerns that the worst case scenario could result in claims for backpay dating back as far as 1998, when the WTR were introduced.

The good news for employers is that the EAT held that if there was a gap of more than three months in any alleged series of deductions from wages, employment tribunals would lose jurisdiction to hear claims for the earlier deductions. Workers are not entitled to artificially designate holiday retrospectively as "EU leave" or "UK leave" so as to create an unbroken chain of deductions.

These conclusions will severely restrict the ability of workers to pursue retrospective claims which it had previously been feared could go back to the commencement of employment or the introduction of the WTR. This conclusion means unions and workers will not yield the windfall payments many were hoping for.

Note:

It is worth noting that these principles only strictly apply to the four week statutory minimum holiday period guaranteed under the WTD, which has been enhanced under UK law under the WTR to 5.6 weeks' (28 days') leave. However, some employers take the view that it would create a further administrative burden and confusion to differentiate between these two types of leave for the purposes of calculating holiday pay. Indeed it was a key line of argument for the appellants in the EAT proceedings that any decision to re-write the WTR by the courts will result in an arbitrary distinction between the methods of calculating the 20 days "EU leave" and the additional 8 days "UK leave".

What should you do next?

Until now many employers have adopted a "wait and see" approach and perhaps made some budgetary provision for potential claims. However, we have seen an increasing number of claims being lodged in recent months by unions and individual employees as this issue hits the headlines and public awareness increases. Many employers remain concerned that it would be premature to take significant action to amend their approach to holiday pay pending any appeals, although this now seems unlikely. The government have established a working party and legislative change will no doubt be considered. However, it seems doubtful that there is a realistic prospect that the basic tenet of the case, ie "normal pay when away" will be overturned in future cases. Therefore, now would seem to present an opportune moment for employers to consider changes whilst there is a modest window for back pay claims. Because the cases themselves are highly fact specific and pay and working arrangements are unique to every employer, we recommend you seek legal advice on specific areas of risk in your business.

Action Points

1. Review your current methods of calculating holiday pay
2. Consider any areas of potential exposure to liability by thinking about:
   a. Is there a contractual duty to perform overtime?
   b. Is there a right to refuse overtime?
   c. How regularly is overtime performed?
   d. Do you pay shift premiums/allowances?
   e. Do you operate a commission scheme?
3. Make budgetary provision for back pay
4. Make any necessary changes to your holiday pay calculations going forward
5. Seek legal advice especially if you receive notice of claims from ACAS

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