

# In Practice

## Holiday Pay

### An Update

**The purpose of the Working Time Regulations is to ensure accordance with European Community Health & Safety obligations. Part of these obligations include the necessity of employers allowing workers to take at least 20 days' paid holiday per annum. Alexandra Porter reviews the current situation.**

Last week the ECJ delivered their judgment in the case of *Caulfield/Robinson-Steele* which centres round the vexed subject of rolled up holiday pay. The case concerned temporary and shift workers in the construction and retail industries and it was referred to the ECJ by the Court of Appeal (with a conjoined case referred by the Leeds Employment Tribunal) for guidance on the legitimacy of incorporating an amount of holiday pay into the daily, or hourly, wage (which the workers would not receive whilst on holiday) instead of continuing to pay the employee the daily wage throughout their period of four weeks' holiday.

It would be nice to say that there was now some finality to the area but in the event the judgment was somewhat confusing. Departing from the Attorney General's opinion, the ECJ first ruled that rolled up payments were unlawful and that workers must be given a payment of wages during their holiday period (in order not to disincentivise them from taking holiday). Having apparently outlawed holiday pay, the judgment then stipulated that where part payments in excess of the normal wage had been made throughout the year in what amounted to transparent and proper additional payments of holiday pay, that these sums could be set off against whatever holiday pay was deemed owing. Of course, (and this is where the judgment has been seen to technically allow rolled-up systems to continue) if, as part payments ought to be in a properly-administered rolled up scheme, these part payments amounted to full payment of holiday pay historically owing, it is hard to see how a tribunal claim for an additional payment can be successful.

There are two interpretations which may flow from the above ruling. Firstly, what happens where a worker took holiday *at the start* of the employment year and hence had not received the appropriate amount of rolled-up payments to cover the cost of her holiday period? Under the ECJ judgment it appears that the worker would legitimately be able to bring a case in respect of the full amount owing for the period of holiday already taken, even though she was due to be paid the full amount in rolled up payments in future during the course of the year. (Though this begs the question, in reality, how many employees would be this litigious during the course of their employment?). In that scenario an Employment Tribunal would be obliged to rule in

favour of the employee in respect of the outstanding sums, making the employer liable to pay them immediately. And, broadly-speaking, this is fair: it is a central tenet of the system that a worker not be discouraged from taking their holiday at any time due to an absence of sufficient funds.

Following the above scenario, one can see that by ruling as the ECJ did, the potential minefields for the employer in predicting in advance the appropriate amounts of holiday pay to make sure the worker had received enough to cover the cost of their holiday prior to going away on leave, would be sufficiently troubling to adopt a different system in the long term but allow them some protection in the short term whilst they re-established a non-rolled up system.

A second, linked, interpretation is that the ECJ anticipates that the UK will introduce further legislation to specifically outlaw rolled up pay but does not want, by its judgment, to retrospectively expose employers who have conscientiously administered a proper rolled up system to litigation. By indicating that in principle rolled-up holiday pay cannot be legitimate but allowing a tribunal to set off sums already paid the ECJ paves a way for future statutory amendment whilst pacifying those employers who have properly administered their rolled-up schemes. (In this regard particularly see paragraph 67 of the judgment:- "...Member States are required to take the measures appropriate to ensure that practices incompatible with Article 7 are not continued.")

In any event the whole principle of a rolled—up scheme now seems so hedged round with potential errors that it is a brave employer who is willing to maintain their system and become the inevitable test-case at some stage in the future. Whilst there are no doubt technical arguments in relation to setting off, I would not confidently advise employers to maintain their current systems in the face of an ECJ clearly- articulated principle that rolled-up "part payments" were not allowed. Indeed, while the ECJ decision is clear that up until March's ruling tribunals will be obliged to take account of rolled-up payments already paid, there is no suggestion that the same principle must be applied by national courts in relation to rolled-up payments in future. The cases will now return to the Court of Appeal and the Leeds Employment Tribunal for post-ECJ determination. It will be interesting to see how these national courts implement the ruling.

For those employers who currently operate rolled-up systems, in all likelihood a tribunal will have to be satisfied of the factors the LJ Laws who referred *Robinson-Steele* from the Court of Appeal deemed important:- the rolled-up element should amount to a true addition to the contractual rate of pay and be clearly identified as such on the wage slip and/or contract and the employer should be able to prove that they are in fact ensuring that holidays are in fact taken. If the employer is unable to prove they have such measures in place then they will be in breach of the Directive and hence the Regulations.

On another issue, the ECJ also observes, endorsing what has long been the case in national law, that any agreement to pay rolled-up holiday pay must demonstrably show an increase on the current annual wage to account for the supplemental holiday pay (ie that a new breakdown of pay which simply re-allocates part of the salary to holiday pay is not enough).

Turning now to the issues of the interface of holiday pay with sick pay and the question of enforcement of the provisions relating to holiday pay, the key case is that of *Ainsworth*, in which it is anticipated that the House of Lords will give judgment in early 2007. In that case the Court of Appeal considered two separate issues relating to holiday pay were considered. The first was the relationship between holiday pay and sick pay. The issue concerned the fact that the employees had been off work for a long period of time and were seeking to claim full pay for the period during which they were technically “on holiday” as opposed to the half-rate sick pay they were then receiving. The Court of Appeal judgment ruled that a worker should not be able to claim for holiday pay during a period of extended sick leave, on the basis that the overwhelming significance of Regulations 13 and 14 was that of providing “leave from work”. If an employee was on sick leave they had not been at work and as such were not in need of leave.

Enforcement and the question of compensation was the second issue this case raised before the Court of Appeal. In *Ainsworth* an ingenious argument was put forward to escape the absence of long-term enforcement provisions in relation to Regulation 13 of the Working Time Regulations (there is currently no provision for compensation for a series of deductions over more than one year): a claim was put forward under the Employment Rights Act section 23 (3), namely that the failure to pay holiday pay over a number of years amounted to an unlawful deduction from wages.

Compensation was sought for a number of years’ loss of holiday pay. The Court of Appeal was not impressed by the attempt to use the Employment Rights Act to circumvent the absence of a recoupment provision in the Working Time Regulations allowing a claim for more than one year’s holiday pay to be brought. The Court of Appeal made it plain that holiday pay should only be considered within the context of the Working Time Regulations, being as it was “ a single and exclusive regime for the enforcement of the new statutory rights”.

Enforcement remains perhaps the most significant unanswered question in the case history of holiday pay, and perhaps the biggest statutory deficiency in the Working Time Regulations. In nearly every other regard the Working Time Regulations allow for enforcement by means of a system of inspection and the threat of criminal sanctions against breaching employers. But Regulation 13, which relates to the right to paid holiday, is excluded from Part 4 of the Regulations and Schedule 3, which otherwise canvas enforcement action. It will be interesting to see what the House of Lords makes of this particular nettle:- I suspect, as in the Court of Appeal, they will be reluctant to accept the device of using the Employment Rights Act to remedy perceived deficiencies in the Working Time Regulations. But can it be fair for an employee denied holiday pay over a number of years to only receive compensation in respect of the last year?

The ECJ in *Caulfield* (para 60) makes it clear that the key purpose of the Regulations is to protect the worker’s health and safety by ensuring that they take holiday, and that that protection must be comprehensive in order to protect them from unscrupulous employers who might prefer to pay them in lieu. Perhaps one of the best ways for the State to ensure this scenario did not occur would be to put an employer at statutory risk of paying a number of year’s back holiday pay by amending the Working Time Regulations to include a provision by which compensation was payable for the entire

term of the contract during which holiday pay had not paid, effective from the date of the amended Regulations.

In the meantime, the law as it stands:-

- a worker is entitled to twenty days of annual leave in each leave year (reg 13).
- a worker is entitled to be paid during the holiday taken (reg 16).
- a worker means anyone employed under a contract of service or for services (reg 2).
- there is no opportunity to contract out of this obligation (reg 35(1)).
- further particulars of the right to paid holiday should be incorporated in the written particulars of employment given to staff in the first two months of their employment.
- a longer period of paid or unpaid leave can be given by contractual agreement.

For employers administering holiday pay provisions – what you need to know:-

- Leave accrues in relative proportions to one year from the date of commencement of employment. There is no qualifying period.
- You can limit your employees to taking holiday at certain dates, but if you do, you must give them notice calculated at twice the period of the proposed leave.
- An employee must give you a period of notice of twice the length of the period of the proposed paid leave.
- Leave not taken may not be replaced by a payment in lieu except where the worker's employment is terminated and leave has not been taken.
- Can I pay rolled up holiday pay (ie a wage which includes an amount on top for holiday pay paid throughout the year)? Up 'til now you could, see above. But since the promulgation of the ECJ decision in *Caulfield*, to avoid the risk of litigation it is probably best to swap to a non-rolled up system. If you do operate a rolled up system, it is very important to note that any provision for rolled-up holiday pay should be a proper increase on the salary already paid to the worker prior to the introduction of the system to account for the twenty days paid leave.
- Where a worker is entitled to holiday pay but fails to take it then there is no statutory entitlement to "roll it over" to the next leave year nor to make them a payment in lieu.

- The situation is different where an employee's employment has been terminated. In that scenario, where the worker has taken less than his or her proportional entitlement to leave upon termination, then under Regulation 14 (2) the worker is entitled to a payment in lieu of untaken leave for that year.
- If an employee is on maternity/paternity leave they must be entitled to take time off at a different time to the period of maternity/ paternity leave.
- Where the employee is on long-term sick leave they are not necessarily entitled to paid holiday where that would effectively fall within their period of sickness absence (pending the outcome of the House of Lords' decision in Ainsworth).

For an employee not currently receiving holiday pay – what you need to know:-

- Submit a statutory grievance in line with the statutory grievance procedure within three months of the date when you were refused holiday or not paid for holiday taken.
- In the event that the grievance is not upheld then make a complaint to the Employment tribunal (within six months of the date when you were refused holiday or not paid for holiday taken).
- The amount of compensation is usually the amount of holiday pay which you should have been paid, though the tribunal does have some discretion to award more than this.
- The maximum amount of holiday pay you can claim is one year's worth as there is currently no statute or common law precedent which allows for recovery of a series of missed payments.
- What if my employment was terminated whilst I had not taken my accrued paid holiday for that year? You are entitled to be paid in lieu for the outstanding period of accrued leave not taken that year.

**Alexandra Porter Thomas More Law**

### **Citation of cases**

Inland Revenue Commissioners v (1) K Ainsworth (2) S Kilic (3) C O Stringer (4) M Thwaites [2005] EWCA Civ 441, (2005) IRLR 465 : Times, May 16, 2005

NS Smith v AJ Morrisroes & Sons Ltd: JJ Cafferkey & Co Ltd v Byrne: Wiggins v North Yorkshire CC: McNulty v PC Harrington Ltd (2004) EAT 22/11/ 2004 (2005) IRLR 72