CARSON McDOWELL

Employment Law Update

Holiday Pay – not so relaxing!!

What is the issue?

Putting it at its simplest, the issue is how we calculate holiday pay. Is holiday pay to be calculated on basic pay only, or should other payments (like overtime pay, or travelling allowances) be taken into account?

In November last year, a high profile Employment Appeal Tribunal (EAT) judgment effectively rewrote the rules on how employers should calculate holiday pay in order to comply with the European Working Time Directive (WTD). The judgment involved three combined appeals, known collectively as the "*Bear Scotland*" cases. Initially, it was widely expected (and in some cases, hoped!) that the trade unions, employees and employers involved in the cases would take the cases to the Court of Appeal. In early December however, Unite (the trade union representing employees in two of the appeals) announced that it would not appeal. The time limits for the appeals to be lodged expired just before Christmas, and as far as we are aware, none of the parties have appealed.

The cases in question were in Scotland and England, and concerned the interpretation of wording in the Working Time Regulations 1998 (WTR) and the Employment Rights Act 1996 (ERA). In Northern Ireland we have separate, but (in this respect) identical legislation in the Working Time Regulations (Northern Ireland) 1998 and the Employment Rights (Northern Ireland) Order 1996. This means that the EAT judgment, although not strictly speaking binding as law in Northern Ireland, will definitely be taken into account by our Industrial Tribunals and is almost certain to be followed.

As the dust has started to settle we are seeing major organisations beginning to announce how they are planning to deal with the new rules. John Lewis has recently announced that they will follow "Bear Scotland" in relation to the payment of non-guaranteed, compulsory overtime and have confirmed that they will be making one-off back payments to employees who took holidays after 1 November 2014 (i.e. the date of the Bear Scotland Judgment) and who therefore may have been underpaid.

What did the recent judgments say?

Previous case law from the European Court of Justice established that for the purposes of paid holiday under the WTD, holiday pay must now correspond with "**normal remuneration**". This contradicts the rules contained in the WTR and ERA, which make clear that for workers with normal working hours, holiday pay consists of basic pay only and that overtime payments are only counted if the overtime is guaranteed and compulsory.

So what's the problem?

The problem is that "normal remuneration" is potentially much wider than just basic pay. This was the central issue in Bear Scotland – did "normal remuneration" include non-guaranteed compulsory overtime and other allowances?

The EAT said that normal remuneration equates to pay that is **normally received**, and therefore must include non-guaranteed compulsory overtime payments. The EAT also said that certain other allowances must also be included if those payments are intrinsically linked to the performance of tasks that the employee is *contractually* (our emphasis) obliged to perform.

Does this apply to all holiday pay?

Confusingly, no. The WTD only granted workers the right to 4 working weeks' paid holiday (which translates to 20 days for those working five days per week). The GB (and NI) WTR increased this to 5.6 working weeks' paid holiday (28 days). The dispute in Bear Scotland was only relevant to the interpretation of the WTD (i.e. 4 weeks' holiday). The additional 1.6 weeks under WTR or any additional contractual holiday entitlement are not impacted by the judgment.

That in turn raises the question: *which 4 weeks' holiday*? The first 4 weeks taken in a particular holiday year? Or the last? Or at the employer's discretion? The EAT seemed to indicate that this is for employers to decide, although the default position is likely to be that the new rules apply to the first 4 weeks' of holiday taken in each holiday year. This is on the basis that the WTR holiday is referred to as an "additional 1.6 weeks" which, when considered logically, would mean it falls at the end of an employee's holiday entitlement.

Other than basic salary or wages, what payments should I include when calculating holiday pay?

Every employer will have to assess this for themselves, because everything turns on the precise terms of the employment contract. The EAT drew a distinction between allowances that are "intrinsically linked" to the performance of the contractual duties and those that are "purely ancillary".

The case law so far indicates that the following should be included in holiday pay calculations:

- guaranteed and compulsory overtime
- non-guaranteed but compulsory overtime
- commission payments
- standby and emergency call-out payments
- productivity bonuses
- shift allowances and premia
- "acting up" supplements
- travelling time payment
- radius allowance

In contrast, reimbursement of expenses (mileage, train tickets etc) do not count. Where a payment is made in respect of purely ancillary costs i.e. costs incurred at the time of performing the tasks for which a worker is engaged / contracted, this should not be included.

A word of caution though – some payments or allowances may include an element of both "cost covering" and also remuneration i.e. payment for work done by an employee. An example is a travel allowance which pays for both the cost of the petrol and car, but also remunerates a worker for time that they have had to spend in the car. If this is the case, consideration should be given to including a proportion of a particular allowance in the holiday pay calculation.

What about purely voluntary overtime?

None of the combined *Bear Scotland* appeals involved purely voluntary overtime, so whether or not that type of overtime pay ought to be included is up for debate. That said, there is a very recent decision from the Northern Ireland Industrial Tribunal which indicates that purely voluntary overtime (i.e. where the employee is not contractually obliged to work overtime) does not need to be factored into the holiday pay calculation. This case should be treated with caution however and it is very likely that there will be further case law on this issue.

One "grey area" in relation to "voluntary" overtime is where in practice is the boundary between "voluntary" and "compulsory"? If an employee always works overtime, is there a point that it ceases to become "voluntary"? Does there become a point when voluntary overtime is performed with sufficient regularity that it forms part of "normal remuneration"? We therefore would urge caution before you rule out considering voluntary overtime altogether.

How regular does "non guaranteed but compulsory overtime" have to be to count?

We do not know! The EAT in *Bear Scotland* indicated that in order to count as part of "normal" remuneration, overtime needs to be worked for a "sufficient period of time". This suggests that occasional or one-off periods of overtime do not need to be counted for holiday pay purposes. However, the EAT did not give any guidance on what period of time would be "sufficient". The EAT said that where the pattern of work is settled, then it ought to be relatively easy to identify "normal remuneration" but where the pattern is not settled, then employers should take an average over a reference period. The EAT did not, however, say what that reference period ought to be.

So I need to change things going forward, but what about back-dated claims? Do I need to worry?

Before the EAT judgment, there was a lot of concern amongst employers that they potentially could have faced claims for underpaid holiday stretching back well into the past. However, the EAT judgment has substantially limited that possibility. What the EAT said is that if employees bring backpay claims under the unlawful deductions from wages rules, those claims must be brought within three months of the last in the "series of deductions". Therefore, if successive periods of (underpaid) holiday are punctuated by a gap of three months or more, that gap breaks the series, which in turn limits the prospect of claims stretching back into previous holiday years.

Employers will need to check their own holiday records to see if there is a "punctuated" gap of more than three months. The fact that the EAT ruling only applies to 4 weeks holiday pay (and not the additional 1.6 weeks) should also help to establish that there is no continuous, unbroken series of deductions on which employees can base their claims. To provide further comfort to employers in this regard, in GB the government is legislating to impose a maximum two year limitation period on most unlawful deductions from wages claims. There has been no announcement yet about whether the NI Assembly will follow suit.

What should I do now?

Clearly, employers need to take stock of their position and decide how best to deal with these changes. That is a difficult judgment call, because the cases are so new, they raise as many questions as answers. In addition there is at least one further very important judgment expected in spring time this year. That is in case called Lock v British Gas, which relates to commission payments and we hope the case will provide clarification on some of the significant unanswered questions and grey areas, in particular on the appropriate reference period.

In the meantime, we recommend that clients consider taking the following steps:

- review how you currently calculate holiday pay;
- review your contracts of employment to assess whether overtime is paid or not, guaranteed or not, or compulsory or not;
- audit other payments and allowances made to employees to assess the status of those payments and whether they count towards holiday pay calculation;
- reassess your overtime policies and practices;
- consider whether your human resources, payroll and other administration systems (manual or computerised) need to be altered or upgraded to deal with changes;
- consider whether you are going to nominate which 4 weeks of holiday attract the more generous calculations, or whether you will apply it to all holiday leave;
- identify and locate if you have the appropriate holiday leave records to be able to quantify any historic liabilities and whether there are any "punctuated" three month gaps; and
- plan for how you will deal with any queries or grievances that employees may raise.

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