Welcome

If you have been keeping a close eye on employment law developments, you'll know that holiday pay has been up there with some of the most talked-about subjects in recent years. It has been clouded by uncertainty for some time, and there have been some significant cases with significant conclusions.

In this email, we explain the way things currently stand and how the developments in holiday pay calculations might affect you.

Paul Housego
Beers LLP

Holiday Pay - The Basics

Under the Working Time Regulations (WTR), full-time workers in the UK are entitled to a statutory minimum of 5.6 weeks' (28 days') paid holiday in every leave year.

That is more generous than necessary; the European Working Time Directive (WTD) requires at least four weeks' (20 days') paid annual leave. The extra 1.6 weeks added over time by the WTR is called 'additional leave'. It's important to be aware of this difference, because some rules apply to just four, and some to all 5.6, weeks of UK workers' paid annual leave.

Note 'paid'. There is a fundamental reason to pay eligible workers when they're on holiday, and it's not just because that's the law. Workers need rest; time to switch off. Some might be discouraged from taking leave if to do so would mean missing out on pay, and that would be at odds with the spirit of the working time rules.

The trouble is that, while Europe told us that workers must get paid annual leave, it didn't originally tell us how to work out what that should be. The WTR went with 'a week's pay for a week's leave', which has to be read alongside the method of calculating a week's pay set out in the Employment Rights Act 1996. Not the simplest calculation to apply - not always, anyway. That's because of variations in workers' pay structures and working hours. And, that being so, there can be no single, straightforward formula for calculating one week's pay across the board. It has to be an individual calculation every time because a week's pay means different things to different people; increasingly so as new types of working arrangements emerge.

About Us

Beers LLP has a national reputation and is recognised and named in the Chambers and Partners and Legal 500 directories for expertise in employment law. From our offices in the South West of England our specialist solicitors provide advice, representation and training on all aspects of employment law.

We advise strategically and tactically on how to resolve problems and disputes arising from HR issues. We look to you for your intended outcome, agree a way forward and implement it. We work with you to solve problems in a constructive and cost effective manner.

We are experienced at dealing with unfair dismissal, capability, misconduct, discrimination, union related issues, redundancy exercises and ex-employee problems.

We will represent you cost effectively in the Employment tribunals and the County Court.

We will provide you with up to date employment contracts for your staff; update your policies and procedures handbook and provide training for your managers to help you maintain best practice throughout your organisation.

Contact
Plymouth Office
North Quay House
Sutton Harbour, Plymouth
PL4 0RA
Tel: 01752 246000

Kingsbridge Office
29 Fore Street
Kingsbridge, TQ7 1AA
Tel: 01548 857000

The law has recognised this for some time, drawing a distinction between holiday pay calculations in respect of UK workers who have 'normal working hours' and those who don't. Those with normal working hours have had their holiday pay based on those hours, averaged over the preceding 12 weeks if pay varies. Extras like commission, certain types of overtime, and bonuses have generally not been included in those calculations.

For workers who don't have normal working hours, it's a different picture. Some of these additional amounts (commission and overtime) have been factored into the holiday pay calculation, which is a 12-week average of pay received.

Legal Developments

A series of cases looked at the holiday pay that some workers had received and whether additional elements ought to have been included. Among them were three particularly high profile decisions that have shaped the future of holiday pay calculations and placed the emphasis on workers receiving holiday pay that reflects their 'normal remuneration'.

In Williams v British Airways, a group of pilots said that their holiday pay should include their hourly rate 'flying pay', plus their allowance for being away from their base.

The European Court of Justice (ECJ) made it clear that holiday pay should reflect normal pay, which can be more than just basic pay. Additional elements should be included if they:

- are payments that are intrinsically linked to the work that the worker is contracted to do; or
- relate to the worker's personal and professional status.

However, payments that are intended to cover ancillary costs – meals, for example - needn't be included.

Then there was Lock v British Gas. Mr Lock was a salesman who claimed that his results-based commission (which made up about 60% of his earnings) should be factored into his holiday pay.

The ECJ said that contractual commission that is based on the sales a salesperson achieves should be included in holiday pay. That's because it is part of normal pay. To not include it would be to provide a disincentive to workers like Mr Lock taking holiday.

When the case returned to the UK, the Court of Appeal made it clear that under the WTR, contractual results-based commission should form part of a worker's holiday pay in respect of the statutory four weeks' holiday provided for by the WTD. Another of the outcomes, however, was continuing uncertainty about how exactly holiday pay should be calculated; the Court of Appeal didn't deal with that.

Another big decision on holiday pay was that of the Employment Appeal Tribunal (EAT) in a series of joined cases known as Bear Scotland. Again, normal pay was what mattered. And on the particular question of whether or not non-guaranteed overtime (overtime that doesn't have to be offered to a worker, but if it is then the worker must do it) should be included in holiday pay, the EAT said yes. There is an intrinsic link between work that a worker is required to carry out and the pay they receive for that.

So, the upshot of these cases is that employers weren't going quite far enough. In respect of the four weeks of WTD statutory leave (note that the additional 1.6 weeks is treated differently), workers should get their 'normal remuneration'. That is the basis of these holiday pay calculations. But the big question: what is 'normal'?

Sometimes it will be obvious. Where a worker has a settled pattern of work, their normal pay will usually jump out at you. But others' working patterns will vary, making 'normal pay' a far more difficult figure to pin down. In those sorts of situations, where there is a lot of variation in the work the worker does and in the pay they receive, the calculation would need to be based on an appropriate average.

Applying this in Practice

We're not going to tell you that holiday pay is now a doddle. The lack of clarity around calculations continues and this, coupled with the ever-present challenge that comes with each worker's situation being different from the next, is keeping employers on their toes.

But, broadly speaking, statutory holiday pay must reflect the pay that the worker normally receives. That applies to the four weeks of holiday provided for by the Working Time Directive. Holiday pay for the extra 1.6 weeks' leave provided for by UK legislation, and any extra contractual holiday pay, may still be based on the old method of calculating a week's pay, which can make things a little confusing. The best way of dealing with the difference in approach may well be to nominate the first four weeks of a worker's annual leave as WTD leave, and make sure to include in their holiday pay for that period the full complement of additional payments (commission, bonus and overtime) that are due.

Of course, this all needs to begin with a calculation of the pay that the worker normally receives. We know from the case law that included in this should be payments which, (a) are intrinsically linked to the worker's contractual work, (b) relate to the worker's personal and professional status, and (c) the worker usually gets in contractual, results-based commission (if appropriate).

Here are some Pointers:

Commission

Include in holiday pay results-based commission that is intrinsically linked to the work the worker is contractually obliged to carry out.

This will involve calculating the average commission earned. Again, there isn't a defined reference period. It might be 12 weeks, but it might be something else. Until we have firm guidance from the courts on this, employers must exercise a bit of common sense. As long as you use a reference period that fairly represents the worker's average earnings, you won't go far wrong.

Overtime

There's overtime and there's overtime. Some is considered to be part of a worker's normal hours anyway because it is guaranteed and compulsory, which means that the employer has to pay the worker for it even if that worker doesn't actually do the work. And, being part of normal hours, it must be included in holiday pay for the full 5.6 weeks' entitlement, not just the four weeks required by the Working Time Directive.

Non-guaranteed overtime, where the employer doesn't have to provide it but if it does then the worker must work it, is a separate category. It should be factored into holiday pay in respect of the four weeks' WTD leave. It has the necessary intrinsic link to the worker's work.

Then there's voluntary overtime - where there is no obligation on the employer to offer overtime and no obligation on the worker to accept any overtime offered. But even though it may sound a little too sketchy to be included in holiday pay, that isn't necessarily the case. There can still be the necessary intrinsic link, even if the worker can choose to turn down the overtime offered. And that sort of arrangement can, over time, become a settled pattern of work and part of normal pay. The facts will determine whether or not that is the case.

Normality can be a difficult concept to apply. What does 'normally received' mean when we're talking about any type of overtime? It's a question of fact, and it usually boils down to the period of time for which the worker has received that element of pay. In the tribunal case, Brettle v Dudley Metropolitan Borough Council, for example, workers who worked

overtime once every four or five weeks were entitled to have that voluntary overtime included in their holiday pay. It was sufficiently regular to qualify as part of their normal pay.

As with most things in life, the longer that something has gone on, the more likely it is to be considered normal. But that is as far as we can go; there isn't a set timeframe for this. So even where you don't think there is a settled pattern of overtime, that doesn't necessarily mean that there isn't the necessary ring of normality about it. You'll need to look very carefully at the situation in its full context to decide whether or not those additional payments qualify for inclusion in holiday pay.

Bonuses

This is a tricky category. Bonuses come in different forms, rewarding individuals and teams for attendance, productivity and performance, or sometimes 'just because it's Christmas'.

For a bonus to be included in holiday pay, there needs to be an intrinsic link between it and the work that the worker is contractually obliged to do. Many, but not all, bonuses that encourage and reward things like performance, productivity and attendance will qualify. And team bonuses could be included too, because the bonus does not have to be linked exclusively to the particular worker who's taking a holiday. There just needs to be that intrinsic link to the worker's work, and a cogent argument that the bonus is part of the worker's normal pay.

The discretionary end-of-year bonus is a little different and it's quite an uncertain area, not least because it isn't easily viewed as part of a worker's normal pay. If the bonus is paid to certain staff as a reward, then it's probably intrinsically linked to their work. If the bonus is paid across the board to staff, it will probably fail to meet the intrinsic link requirement.

The rules on this are far from settled and there is plenty of scope to run arguments about why a worker should or shouldn't be entitled to have their bonus taken into account in their holiday pay. Supplements for 'acting up'

Yes, it seems that these should be included in holiday pay. The intrinsic link is there.

Payments relating to a worker's personal and professional status

The sort of status elements would be qualifications, length of service, and seniority. As we know, payments based on these things should be included in holiday pay.

Tips

Do tips count as pay? This may actually be in the hands of the customer. If they pay cash tips directly to their waiter or waitress then those amounts could well fall outside the holiday pay calculation (the employer isn't making the payment), especially as the waiter probably doesn't declare the income, meaning that the courts will be reluctant to treat these tips as proper legal income. Card payments, on the other hand, go through the payroll and so workers receiving their tips in this way could argue that their holiday pay should reflect the tip element as well as the basic pay.

We'll have to wait for the courts to give a firm steer on the extent to which tips may be treated as normal pay.

Standby payments

Where a worker must be available to be called upon, sometimes in emergency situations, the payments they receive should be included in holiday pay because of the intrinsic link with work. The pay will form part of normal remuneration.

Allowances

Pure expenses don't count as part of holiday pay; that much we know. But there are other types of payments that take account of the type of work the worker is doing, or the time at or place in which they are doing it (a travel fee to work in a different location, for example). These may qualify for inclusion in holiday pay.

It might not always be easy to categorise these sorts of payments and, again, whether they are to be included in holiday pay or not will depend on the circumstances. The general rule is that if what you are doing is reimbursing a worker for their costs then that falls outside holiday pay. However, if the payment is more in recognition of the requirements of a role, it is likely that that element should be included in holiday pay.

Claims

There was at one time significant concern among employers that changes in holiday pay rules would lead to a rush of claims for backdated pay going as far back as 1998 when the Working Time Regulations came into force.

It's certainly true that where employers have not included what we now know to be legitimate additional elements like commission, overtime and bonuses in holiday pay, the affected workers will be able to bring claims for those underpayments. However, this is nowhere near as troubling as some first thought. That is because there are now some important limitations on claims brought since 1 July 2015.

The first is that a gap of at least three months between underpayments will break the series of deductions and prevent a worker from claiming historical underpayments. A word of caution: it's not safe to assume that one 'correct' payment will scupper a series of deductions. Your best bet is to eradicate underpayments altogether.

The second control that has been put on some claims, including those for backdated holiday pay, is a two-year limit on retrospective claims.

In reality, the risk of facing a hugely significant claim should be small. That said, even though workers' claims may be of relatively low value, the cumulative effect of many similar claims may not be. The best advice therefore is to make as sure as you can that holiday pay from now on includes everything it should. Easier said than done when the law still requires the case-by-case application of rules that are less than crystal clear. We recognise that, and we'd recommend chatting the issues through with us with a view to us helping you make the right decisions.

Conclusion

The upshot of the holiday pay situation may be that uncertainty remains the name of the game. We have some broad rules and, yes, we are in a better position than we were a few years ago, in understanding how holiday pay should be calculated. But there is no getting away from the fact that each calculation will involve taking a good look at the individual circumstances of each worker and applying the rules fairly and consistently.

And of course, who knows what will happen once Brexit negotiations take shape. What will become of the working time rules? Expect another holiday law bulletin before too long.

Paul Housego **Julian Parry**