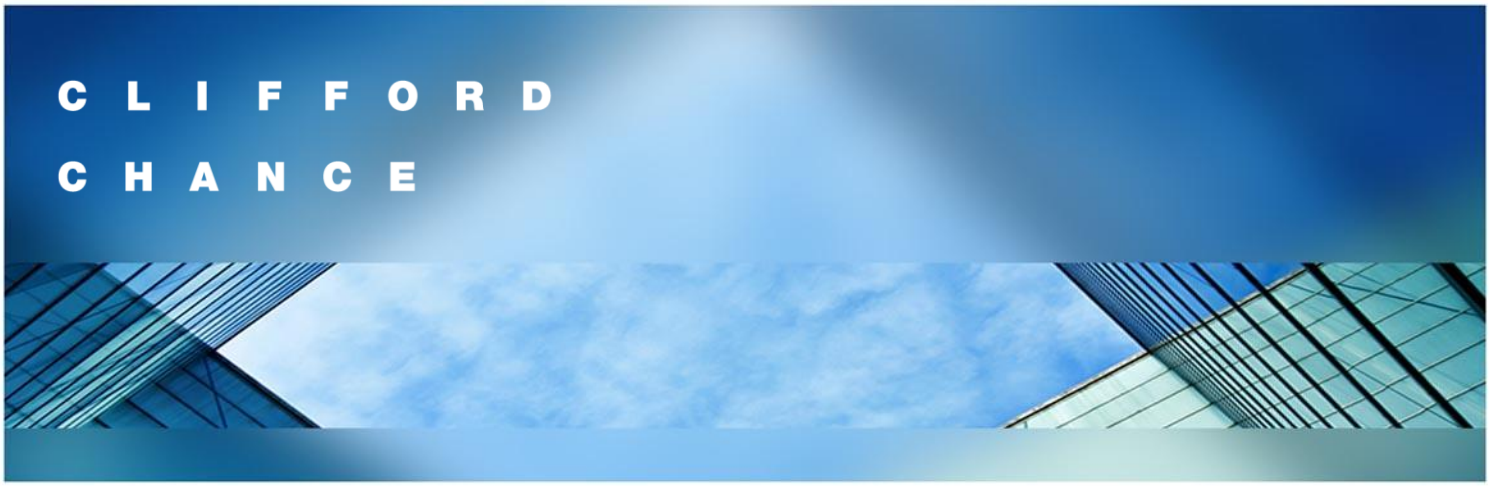

WHAT NOW FOR HOLIDAY PAY CLAIMS AND CALCULATIONS?

The question of how to calculate the holiday entitlement of a term time worker (i.e. an individual working only part of the year) might not appear to be relevant or significant to many employers. This thorny issue has now been considered by the Supreme Court in *Harpur Trust v Brazel (Harpur)*. The Court's decision has significant implications for employers in terms of the approach to calculating both the holiday entitlement of part year workers and other workers with atypical contractual arrangements, and the extent of any latent holiday pay liabilities arising as a result of adopting a different approach to date.

This Briefing explores some of the outstanding legal and financial issues in relation to holiday pay and how employers can mitigate their holiday pay liability risks.

Key issues

- How to calculate holiday entitlement?
- Holiday pay wages claims: what is the extent of an employer's exposure?
- What is the risk issue in relation to claims for pay in lieu of accrued but untaken holiday (Piloh's)?
- Are there other carry forward holiday risks?
- The future: Brexit Freedoms Bill

How to calculate holiday entitlement?

In Harpur the Supreme Court explored the question of whether a worker's right to paid annual leave is accumulated according to the working pattern of the worker and/or is pro-rated.

B was employed under a permanent continuing contract of employment, albeit one where the Trust was not obliged to provide a fixed minimum amount of work and paid only for the work done. In essence this was a zero hours contract. B's contract stated that she was entitled to 5.6 weeks' paid holiday.

The Trust had followed the approach set out in the (now withdrawn) ACAS guidance booklet: "*Holidays and Holiday Pay"* for calculating the pay of casual workers and calculated B's earnings at the end of each of the 3 school terms and then paid her one-third of 12.07% of that figure by way of holiday pay (i.e. 5.6 weeks divided by 46.4 weeks (i.e. 52 weeks less 5.6 weeks) (the 12.07% Method).

B challenged this approach arguing that a strict interpretation of the Working Time Regulations 1998 (WTR) required her employer to calculate a week's pay by taking the average weekly remuneration for the12 weeks prior to the calculation date; and then multiplying it by 5.6 on the basis that 5.6 weeks'

holiday per year is the minimum entitlement under the WTR (described as the 'the Calendar Method' by the Supreme Court).

Essentially the key question was whether the calculation of B's holiday entitlement or holiday pay should be pro-rated to that of a full-year worker to reflect the fact that she did not work throughout the year.

The Supreme Court has now upheld the Court of Appeal decision which agreed with B that the Calendar Method should be used. It held that while the pro rata principle does apply to part-time workers who work *throughout* the year but *for only part* of the week, it does not apply to part-year workers who work full time weeks but for only part of the year. Term time only workers are entitled to 5.6 weeks' holiday based on their weekly work pattern during the term, even though this gives them a disproportionately higher level of holiday entitlement than full-time or part-time workers who work throughout the whole year.

Applying this approach, a worker who works for 5 days a week for 6 months of the year is entitled to 5.6 weeks holiday i.e. 28 days' holiday (even though they only work for 6 months). By contrast a worker who works 2.5 days a week for the whole year; their holiday entitlement is only 14 days (i.e., 2.5/5 x 28) even though they work the same number of days as the part year worker.

Prior to the Court of Appeal's decision in Harpur the practice of many employers in relation to atypical workers was to calculate holiday entitlement as 12.07% of hours worked (the 12.07% Method (see above for the rationale)), and to make a top up payment if holiday was not taken.

Subsequently BEIS issued Guidance reflecting the Court of Appeal's decision to the effect that employers should not: (1) include in the holiday reference period any whole week in which no pay was received, or (2) apply the 12.07% Method.

The Court of Appeal's decision in *Harpur* produced the unpalatable scenario (from an employer's perspective) that the longer the period of the year that the worker is engaged but undertakes no work (and receives no pay), the bigger the disparity between the 12.07% Method and the approach under the WTR. An extreme example put to the court was that of a worker engaged on a permanent contract, but who works only one week of the year, for which they earned £1,000, would then be entitled to 5.6 weeks (notional) annual leave, for which they would receive £5,600. Under the 12.07% Method, they would receive £120.70.

The Supreme Court acknowledged that adopting the Calendar Method to calculate holiday entitlement/pay resulted in term time workers such as B receiving holiday pay representing a higher proportion of their annual pay than full time or part time workers working regular hours. However, it concluded that a slight favouring of workers with a highly atypical work pattern was not so absurd as to justify the wholesale revision of the Working Time Regulations which would otherwise be required for the 12.07% Method to be lawful. In the Supreme Court's opinion general rules (such as the WTR) sometimes provide anomalies when applied in atypical cases and in its view it would be unusual for a worker whose services are only required for a few weeks a year to be engaged on a permanent contract unless there was some other good reason to do so.

What steps should employer take in light of this decision?

- Employers still applying the 12.07% Method should assess how they can amend their holiday pay practices in order to ensure that they conform with the WTR approach advocated by the court.
- Employers should assess the extent to which they are exposed to existing and former workers bringing wages claims in respect of underpaid holiday pay. The extent of an employer's latent liability in relation to such claims is potentially unclear (see further below).
- Employers may also need to reconsider the use of permanent contracts for casual workers, instead engaging such workers on short-term contracts as and when required.

In addition to the above risks arising from the Supreme Court's decision employers also need to be mindful that there remain several outstanding areas of potential uncertainty and resultant financial exposure for employers in relation to holiday rights arising out of recent domestic and European case law. Some of these risk areas include: (i) claims on termination for pay in lieu of accrued but untaken holiday (Piloh's); and (ii) wages claims; and (iii) claims to carry forward (and be paid for) holiday from previous holiday years.

The risks of such claims will depend very much on the previous and existing makeup up of the workforce and the approach taken by the employer to their holiday rights. The main risk areas relate to: (i) workers who took holiday but did not receive holiday pay; (ii) workers who were prevented from taking holiday (because their worker status was not acknowledged); (iii) workers who were not given the 'opportunity' to take holiday; (iv) workers who took holiday but were paid at the wrong rate.

Holiday pay wages claims: what is the extent of an employer's exposure?

A worker who considers that they have not been paid the correct rate of holiday pay may bring a 'wages claim' claiming for each underpayment (deduction) in a series of deductions. The legislation requires a claim to be brought within three months of the last in the series of deductions and imposes a two-year backstop on claims; so even if a worker's holiday pay has been miscalculated for a longer period a maximum of two years' deductions can be recovered.

In the case of *Bear Scotland* it was held that if there is a break of more than three months between deductions that will end the series. So, a worker who has taken two 3-week holidays six months apart would not be able to treat the two underpayments as a series of deductions because the first deduction occurred more than 3 months prior to the final deduction. By contrast a worker who divides their holiday evenly over 12 months would be able to bring a claim for the entire 12 months of deductions as they form a series.

In February, the Court of Appeal in *Smith v Pimlico Plumbers* made strong obiter comments that *Bear Scotland* was wrongly decided; accordingly, there is a risk that Employment Tribunals may disapply *Bear Scotland* to permit wages claims in relation to a series of deductions regardless of the interval between the deductions. Of course, the two-year backstop will still apply so that any such claim can only go back two years. However, this is nevertheless

a significant potential liability for an employer with a sizeable workforce in relation to whom the holiday pay has been undercalculated.

Even if the Tribunals do consider themselves bound by *Bear Scotland*, the Supreme Court is due to hear a case this December in which it will rule on the correctness of *Bear Scotland,* finally resolving this issue.

What is the risk issue in relation to claims for pay in lieu of accrued but untaken holiday (Piloh's)?

The WTR provide that on termination of employment a worker is entitled to be paid in lieu of any accrued but untaken holiday. The WTR also provide that the basic 4-week EU holiday and the additional 1.6 weeks' holiday will be forfeit if it is not taken in the relevant holiday year (absent anything to the contrary in the employment contract permitting it to be carried over).

Case law has now established several exceptions to this basic forfeiture principle:

- If a worker is unable to take their 4-week EU holiday due to ill health absence, then the holiday may be carried forward into subsequent holiday years for up to 18 months.
- If a worker has been prevented from taking holiday because their worker status was not acknowledged they are entitled to carry forward the annual 4-week EU holiday entitlement indefinitely until it is taken, or the employment ends at which point they will be entitled to be paid in lieu of all accrued holiday.
- If a worker has taken holiday but not received holiday pay, they too are entitled to carry forward the annual 4-week EU holiday entitlement indefinitely until it is taken, or the employment ends at which point they will be entitled to be paid in lieu of all accrued holiday.

Employers that have denied worker status and not paid any holiday pay when leave is taken or refused to permit holiday to be taken are exposed to potentially significant financial liability for piloh payments if they have a large workforce and holiday has accrued over several years.

Such claims are potentially more financially significant than wages claims that are subject to a two year backstop; a piloh payment is not subject to a backstop as the amount crystallises on termination and there is no cap on the amount that can be recovered.

Are there other carry forward holiday risks?

In *the Pimlico Plumber* case the Court of Appeal held that a worker only loses the right to take basic leave at the end of the leave year if the employer can show that it specifically gave the worker the opportunity to take it and encouraged them to do so and informed them that the right would be lost at the end of the leave year. Arguably an employer will not be able to demonstrate it has actively encouraged its employees to take holiday if its actions effectively amounted to a deterrent (for example giving preferential treatment to employees who do not utilize all their holiday or failing to pay the correct rate of holiday pay so that the employee is financially disadvantaged by taking holiday). If the employer cannot meet the test set out by the court, the right to the basic 4-week EU holiday entitlement does not lapse but carries over and accumulates until the termination of the contract, at which point the worker is entitled to a 'Piloh' payment.

It remains to be seen whether workers will seek to assert that they are entitled to carry forward any unutilized basic holiday entitlement and to take it in a subsequent holiday year (or to be paid in lieu on termination) on the grounds that their employer did not given them the opportunity to take their basic holiday entitlement; because they were not actively encouraged to take it and/or advised that it would otherwise be forfeit.

To date it is judicially untested what an employer would need to demonstrate to persuade a court that it has given its workers the 'opportunity' to take their holiday. As such employers would be advised to:

- Ensure that contracts and or handbooks make it clear that holiday will be forfeit if it is not taken in the relevant holiday year (to the extent that no carry over is permitted);
- At regular intervals throughout the holiday year remind the workforce to book and take their holiday and remind them of the forfeiture provisions
- Exercise care that the approach to holiday requests does not result in a worker being unable to take all of their holiday entitlement.

Implications for transactions

In the context of both asset and share sales where there is an atypical workforce element purchasers need to consider:

- the 'employment status' classification of the workforce,
- the treatment of holiday and holiday pay,
- the extent to which the right to take paid holiday 'employer' has been flagged to workers, and
- whether post completion workforce reduction plans will potentially crystallise any Piloh obligations and if so the financial extent of any such liability.

The future: Brexit Freedoms Bill

The Government has proposed a "Brexit Freedoms" Bill the aim of which is to ensure that retained EU law can be more easily amended or repealed. In tandem a review of all retained EU law is being carried out to identify candidates for amendment/removal. Considering the various areas of uncertainty and financial implications of the EU derived right to paid holiday will the Working Time Regulations be a candidate for change?

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