HOLIDAY PAY – RISK/LIABILITY ASSESSMENT

What’s the issue?

1 This is an updated briefing following the issue of the judgment in *Bear Scotland Ltd & Ors v Fulton and Ors* on 4 November 2014. The legal background to the holiday pay issue is set out in a note on our website.

2 The Working Time Directive (WTD) gives employees the right to holiday pay, but does not explain how it should be calculated. In recent decisions the European Court of Justice (ECJ) said that contractual sums that are *inherently linked to performance of the individual* – i.e. calculated and earned according to whether and how much work is done - should be included in the calculation. To date most UK employers have interpreted UK legislation implementing the WTD to exclude these sums when calculating holiday pay due to workers. The latest decision from the Employment Appeal Tribunal in the *Bear* case has cleared up some of the previously unanswered questions in this area. In particular, LJ Langstaff decided that the existing UK legislation can be read in a way that fits with the WTD and ECJ case law. He also confirmed that holiday pay should include *some types of overtime*.

What do we need to do now?

3 For now, the judgement may put claimants off making significant claims for back-pay (for the reasons explained later in this note.) Auditors are, however, still asking businesses to factor in the potential for claims and we expect unions to press for changes to the pay systems going forward, so we continue to recommend a staged approach as follows:

3.1 Gather and analyse your records to estimate past and on-going liability (as far as possible given the constraints/unknowns) and decide whether or not to make provision for it.

3.2 Decide whether or not to adjust the payment system going forward (or engage with any recognised trade union if holiday pay forms part of your consultation or pay bargaining structure).

3.3 Take basic steps to prepare to respond to claims for past payment.
How do you estimate potential liability?

You may find it helpful to take the following 5-step approach:

4.1 Identify the individuals potentially affected;

4.2 Consider which payments may need to be taken into account;

4.3 Calculate the value of each possible additional holiday payment;

4.4 Establish how far back the liability may go;

4.5 Think about any other factors which might have a bearing on possible claims.

Who is affected?

5.1 First, consider which individuals may be affected. All workers have the right to holiday pay, not just employees. Casual, agency and temporary workers are therefore likely to be covered. For simplicity this briefing refers to employees but you should consider anyone who is paid in some way by you for holidays.

5.2 Past as well as current employees may be able to bring claims. ET claims must be lodged within three months of the last relevant payment.

5.3 You can exclude anyone who has entered into a settlement agreement waiving all claims.

What types of payment should be factored into holiday pay?

6.1 Commission, guaranteed overtime and regular non-guaranteed overtime. It will also potentially cover some types of bonus/incentive payments, shift allowances and similar premiums. It may be helpful to work through the table at the end of this note.

6.2 The EAT decision concerned overtime which the employees were obliged to do when it was offered. It is unclear at the moment whether regular voluntary overtime needs to be included, but the focus in the decisions is on ‘normal pay’ and there is therefore an argument that it should be.

6.3 We do not know how annual performance bonuses will be treated. It seems unlikely that they will be included given that they are rarely affected by holiday. The policy difficulties and practicalities of factoring them in are also obvious.

6.4 If you are simply trying to estimate maximum liability at this point, it is sensible to take into account anything that is relatively fixed or consistent and paid at regular intervals (i.e. ‘normal pay’), but is affected by taking holiday. Until the law is completely settled, employee representatives may include all types of remuneration that fit the description above in their claims.
Calculate the amount of each type of holiday pay increment

7.1 Once you have identified the correct populations who may be covered and the payments you are going to include, you should estimate the cost of back-pay claims from existing employees (and possibly also those who have left recently and still have time to bring claims.)

7.1.1 Statutory or contractual leave included? It is reasonably clear from the EAT decision that it applies only to the 20 days EU entitlement and not to additional UK statutory or contractual leave.

7.1.2 Reference period? This is still unclear. One option is to look at an average pay figure in the previous 3 months but if that has the capacity to create an unfair result – either benefiting the employer or the employee, a 12 month period may be more useful. This is, of course, easier said than done for seasonal workers or those with significant monthly variations in pay.

8 Is there liability for back-pay?

8.1 The EAT decision on this is potentially helpful to employers and will, for the time being, limit back pay, but it may be appealed.

8.2 The Employment Tribunal will only be able to consider the claim if it is brought within 3 months of the last in a series of deductions. The EAT decided that a gap of more than 3 months between underpaid holiday periods breaks the series of deductions. This cuts off any claim for underpayment that dates from before the gap. As a result the potential for workers to claim holiday pay over a number of years seems very limited, depending on how they have spaced out their holidays.

8.3 The EAT judgment applies only to the 4 weeks’ leave that is derived from the WTD (“euro” leave) so holiday pay for the additional 1.6 weeks’ holiday provided for in the WTR is not affected. The question is which days of annual leave in the holiday year are derived from the WTD and which are derived from the WTR?

8.4 Unfortunately the EAT judgment does not help us answer this question. Some commentators say that it is for the employer to decide which category a period of leave fits into. Others are of the view that the 1.6 weeks’ leave will always fall after the four weeks’ leave entitlement has been exhausted given that those days are described in the WTR as being “additional leave”. If the latter view is adopted, annual leave taken towards the end of the leave year may not count for the purposes of calculating a series of deductions. This will make back-pay claims even more difficult to bring.

8.5 At the moment, you can estimate liability for back pay by finding the last day upon which someone took holiday and;

8.5.1 If it is more than three months ago, they may be out of time to make a claim

8.5.2 If it is less than three months ago, they may still be out of time if it is more than three months since they took ‘euro’ leave

8.5.3 Liability for a series of underpayments will stop at the point at which you can find a three month gap between the relevant types of leave
Be aware that the EAT took a “creative approach” in deciding that the series could be broken in this way and an appeal is anticipated on this point. If the principle was to be overturned on appeal by a higher court, claims could go back to 1998.

In addition, Employment Judges have the ability to accept unlawful deduction from wages claims notwithstanding the fact they have been presented out of time if they are satisfied that it was not reasonably practicable for the claims to be brought in time. Given the uncertainty in the law in relation to calculating holiday pay, it is possible that an Employment Tribunal would accept out of time claims provided they are brought within a reasonable period following the EAT’s decision in Bear having been issued this week.

What other factors influence the risk of claims?

When calculating or estimating liability you may also want to discount for factors that could influence the likelihood of claims being made. Factors include:

Limited scope for recovery and the complexity of suing for back-pay may put claimants off – although at the moment that does not appear to be preventing no-win, no fee lawyers fromcourting claims.

Some large private sector employers and public sector organisations with a union presence are already receiving collective claims. At the opposite end of the spectrum, where the employers, numbers of individuals affected or values of claims are smaller, the risk of claims materialising may be lower overall.

Fees may be a disincentive for some. Unions will usually assist with this but they may be less keen to do so when the arguments are complicated and the prospect of recovery is limited. Individuals will have to balance the fees against the prospect of both succeeding in their claim and its value.

Some care should be taken with material generated to estimate liability or decide on strategy on the basis that it may be the subject of disclosure or orders for production. If you are concerned about this or wish to take further advice on it please get in touch.

Deciding whether to change your pay system for the future

The level of exposure for particular businesses depends on a range of factors including the attitude of the unions, the activity of no-win no-fee firms and the particular pay system with each business.

At this stage we don't know whether employers will see floods of back-pay claims but even with the possibility of an appeal it is unlikely that the basic principle will change and many holiday pay systems will have to be adjusted.

The main factors to weigh in the balance (apart from cost) can be summarised as follows:
<table>
<thead>
<tr>
<th>Reason</th>
<th>For changing the holiday pay calculation</th>
<th>Against changing the holiday pay calculation</th>
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<td>Outcome of UK litigation remains unclear</td>
<td>Employee claims for failure to calculate the pay taking allowances etc. into account are much more likely to be actionable since the decision that the WTR can be read so as to comply with the WTD.</td>
<td>We do not yet know precisely which payments need to be included – see ‘difficulty with assessing the correct formula’ below.</td>
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<tr>
<td>Breaking the series of deductions</td>
<td>By making a change to the calculation you will make it harder for those who have past claims to bring them in the Employment Tribunal because you may ‘break the series of deductions’.</td>
<td>The ‘break the series’ approach has been approved by the EAT but has not yet been tested and is likely to be challenged in the higher courts.</td>
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<td>Employee awareness/prompting claims</td>
<td>There is already significant publicity attached to these claims. No-win, no-fee lawyers are already offering services on the internet. The cat is already “out of the bag”.</td>
<td>It is difficult to imagine how you would communicate a change without it being noticed by employees – particularly given the high profile press coverage. For those in a unionised environment it would be almost impossible to do this under the radar.</td>
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<td>Employee relations</td>
<td>The move is likely to be seen as positive by employees/employee representatives. For those with collective bargaining agreements there is a possibility that a deal could be struck regarding settlement of past claims, but on balance we think that the unions will be nervous about that – they owe an obligation to members that may restrict a deal of that kind.</td>
<td>You may limit overall liability if you wait for the unions or employees to take action themselves.</td>
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<td>Difficulty with assessing the correct formula</td>
<td>You could, in theory, make the change to the calculation temporary and clearly reserve the right to make changes to it if the statutory provisions or case law develop in a way that means you have been too generous.</td>
<td>You will have to make up some aspects of the approach to calculation – e.g. what reference period you use for calculation. The exact approach is yet to be determined by the UK courts.</td>
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What to change?

12.1 You may acknowledge that there is an obligation to pay employees differently but try to offset that liability by using lawful mechanisms to change the pay system. The effectiveness of these will depend on a range of factors including the terms of your existing contracts. You should take advice before deciding to make changes. Options could include:

12.1.1 Recalibrating commission (and analogous) schemes so that the factoring in of the holiday pay element results in the employee being in the same position overall as before the Lock judgment;

12.1.2 Reviewing the remuneration structure and changing schemes, possibly replacing them with cheaper alternatives; or

12.1.3 Converting some types of payments to non-monetary benefits.

12.1.4 Managing overtime/clarifying its status in policy/contracts

12.2 Re-framing your pay system to take into account elements of pay that are variable is not straightforward – so if you decide to make a change, you will need factor in the time that it will take to set this up.

Planning for Litigation

13 Claims notification/response

13.1 In all cases brought before the Employment Tribunal you will have to deal with ACAS early conciliation, so you will be on notice of the claims before they come in. We are aware that ACAS are already struggling with the administration of the process given the numbers of claims lodged recently. The Employment Tribunal system is likely to have cases stayed or sisted while test cases continue to go through the courts.

13.2 In the short term the following suggestions will make sense:

13.2.1 Keep an eye on legal updates;

13.2.2 Try to clean up your payroll data to ensure that variable but regular pay is clearly labelled and identifiable;

13.2.3 Enter into a dialogue with unions if they raise the point;

13.2.4 Ensure that you have briefed your HR team to spot claims or grievances coming in

13.2.5 Prepare a potential response to grievances that are raised on the point

13.2.6 Consider whether you need to appoint a person to be responsible for overseeing/monitoring claims if they start to come in; and

13.2.7 Talk to other employers/advisers who have direct experience of handling volume litigation in order to ensure that your responses are consistent and managed efficiently.
Managing the administration – how we can help

14.1 Alongside the legal and strategic issues involved in dealing with these claims, the practical work involved in volume claims if you receive them could be significant. We are ideally set up to help you with this.

14.2 We have invested in a bespoke employment-specific case management system which can be used to manage large volumes of Employment Tribunal claims. Our system incorporates simple data input stages, style documents and, importantly, the ability to generate MI about the numbers of claims, types of claims and their current status.

14.3 Previous experience of helping clients with large volumes of multiple claims (particularly in relation to Equal Pay claims) has highlighted the importance of robust administrative management of claims from the moment they are lodged to ensure that time is not wasted further down the line tracking the history of individual claims. Our systems are specifically designed to help address this issue and ensure that time, effort and resource spend are directed at resolving the issues and not at resolving discrepancies in information held by you/us; the employees’ representatives and the relevant employment tribunal.

14.4 We can also help you in producing MI reports to ensure that you have easy access to reports and statistics about the progress of your claims.

Brodies LLP

15 December 2014