

**HOLIDAY PAY ENTITLEMENT**

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**1.0 EXECUTIVE SUMMARY**

This report details for Council the implications of a recent ruling by the European Court of Justice regarding holiday pay. The ruling means that employers must now pay employees the same rate of pay, including any overtime or other additional payments that are linked to their job, whilst they are on holiday.

The Council must now pay holiday pay on any additional hours that an employee works, or additional responsibility that they undertake during the course of their job. If the council does not do this, it will be considered as an unlawful deduction of wages.

The Council has received legal advice that payment should be made to employees for the whole of this current leave year i.e. backdated to January 2014. The ongoing payment for holiday pay at the rate taking into account additional payments will be implemented from October 2014.

This paper seeks approval from Council to make the backdated payment for this leave year, which is estimated at £150,000 from January to June. The full year cost will be estimated to be between £200,000 and £300,000. It will be calculated on the first 20 days of holiday only and is subject to actual additional pay eligibility.

Discussions and negotiations are ongoing at a national level to ascertain any further implications of this ruling and further reports will be brought forward as necessary.

The recommendations are as follows:

- 3.1 Agree that Improvement & HR proceed on the basis that action should be put in place now to make the payments for the current leave year and the ongoing future payments.
- 3.2 Continue to engage with Trades Unions in relation to the issue.
- 3.3 Engage with COSLA regarding discussions at a national level to resolve issues arising from the ruling relating to historic back pay.

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### 2.0 SUMMARY

- 2.1 A recent landmark Judgment from the Court of Justice of the European Union (ECJ) upholding workers' rights in relation to holiday pay means overtime, standby/emergency callout, commission, as well as a requirement to factor in other variable payments and allowances should be included in the calculation of holiday pay. Basically there should be no difference between the pay received at work while on holiday. This case is called Lock v British Gas.
- 2.2 This is a significant Judgment because it represents a departure from how many employers currently calculate holiday pay under the Working Time Regulations 1998 and the Employment Rights Act 1996. The Working Time Regulations use the definition of a week's pay set out in the Employment Rights Act (ERA) as the basis for calculating holiday pay. Section 234 of ERA allows payments such as overtime to be excluded and for fixed contractual hours to be used as the basis for calculating a week's pay for the purposes of calculating holiday pay. Previous domestic cases have also found that payments such as commission should be excluded from holiday pay calculations because the amount of pay does not vary with the amount of effort or work done rather it varies according to the results which that work achieves. The ECJ has ruled that the purpose Article 7 of the Working Time Directive (which our domestic Working Time Regulations purport to implement) is to ensure that employees are not discouraged from taking holidays and suggest that the practices of many UK employers in calculating holiday pay (and some of the domestic case law to date) may be wrong.
- 2.3 Two domestic cases were heard on 30 and 31 July by the Employment Appeal Tribunal (EAT) addressing the issues arising from the ECJ Judgment. In its judgement, which is not likely to be issued until January 2015, the EAT will have to decide whether it can in fact read the UK Working Time Regulations 1998 in such a way as to give effect to Article 7 of the relevant Working Time Directive and the Lock Judgment. If not, Parliament will have to amend the Working Time Regulations. This is perhaps academic for local authorities which are in any event regarded as being an arm of the "state" – this means that Article 7 and the decisions of the ECJ interpreting are directly effective and can be relied on by the Council.
- 2.4 Pending appeals should not therefore be taken as a reason **not** to act now to regularise the position and protect against historic back pay claims. If 3 months or more elapses from the date correct payments are made, an employment tribunal claim of unlawful deductions from earnings will be time barred (subject to any arguments that it was not reasonably practicable for a particular individual to bring a claim in time).

- 2.5 To minimise any backdated and future holiday pay claims it is recommended that by paying the correct amount going forward Councils will end the series of deductions and mitigate against future challenge.

### **3. RECOMMENDATIONS**

It is recommended that Council agree the following actions:

- 3.1 Improvement & HR proceed on the basis that action should be put in place now to make the payments for the current leave year and the ongoing future payments.
- 3.2 Continue to engage with Trades Unions in relation to the process.
- 3.3 Engage with COSLA regarding discussions at a national level to resolve issues arising from the ruling relating to historic back pay.

### **4. DETAIL**

- 4.1 The Working Time Regulations, section 16(1) state that “A worker is entitled to be paid in respect of any period of annual leave to which he is entitled under regulations 13 and 13A, at the rate of a week’s pay in respect of each week of leave”. A weeks pay is calculated in accordance with section’s 221 – 224 of the Employment Rights Act, for employees who have normal working hours for the when employed under the contract of employment and also for those with no normal working hours (section 224).
- 4.2 A claim for unpaid holiday (or for an underpayment of holiday pay) can be brought as an unauthorised deduction from wages claim under the Employment Rights Act 1996, as there is no right to claim in the Working Time Regulations 1998 (WTRs). This means that an employee/worker or former employee/worker can take advantage of the more generous time limits which apply to unlawful deductions claims.
- 4.3 The Council will have to pay the correct amount going forward which would end the series of unlawful deductions. If 3 months or more then elapses (counting from the date of the wages payment including the full payment for any recent leave) an employment tribunal claim of unlawful deduction from earnings will be time barred. That would leave claimants with the option of suing in the civil court where the back pay period is limited to 5 years from the date of claim.
- 4.4 The recent case law about what should be included in a holiday pay calculation relates to overtime, standby/emergency callout and commission, however, there is also a requirement to factor in other variable payments and allowances when calculating holiday pay, such as premium rates for weekend, night, shift and evening work and additional non-contractual hours worked by part-time staff. This basically means that there should be no difference between the pay received at work and while on holiday.
- 4.5 All pay elements should be included in the calculation of holiday pay. Only genuine out-of-pocket expenses payments can be excluded. *Lock v British Gas Trading Limited* is a definitive and binding judgment of the Court of Justice of the European Union (CJEU).

- 4.6 The enhanced holiday pay rate only applies to the basic 4 weeks holiday leave entitlement derived from the Working Time Directive. The balance of 1.6 weeks was introduced by the UK Parliament acting on its own initiative rather than being required to do so by any Directive of the European Parliament. However, interpretation questions about this additional period of leave must be addressed using the UK statutory rules and so the holiday pay for this additional period is calculated using the value of a normal week's pay (section 221(2) Employment Rights Act 1996).
- 4.7 If Council workers have been receiving an underpayment of holiday pay (and it is likely that they have given the ECJ Judgment), they could seek to recover back payments of holiday by raising unlawful deductions from wages claims provided they raise a claim in time. The recognised unions would be likely to do this on behalf of the groups of staff they represent and pay the relevant tribunal lodging fees for doing so. The maximum period that an employee could bring a backdated claim for is usually limited to five years however, if it is brought as an unlawful deduction from wages claim in the employment tribunal, a claim could go back as far as the introduction of the Working Time Regulations in 1998. If the failures to pay holiday pay in full are treated as being a series of deductions (which is likely) any claim brought today will capture every one of the deductions in the series going back to and including the first such deduction. Conceivably that could mean the claim runs from 1 October 1998 (when the Working Time Regulations came into effect) to date. Given the potential impact of this in terms of Councils budgets, this issue is currently under discussion nationally with trades unions and COSLA to identify the issues and proposed a way forward. Further recommendations will be brought to the Council at a future date relating to this.
- 4.8 To minimise any backdated and future holiday pay claims it is recommended that by paying the correct amount going forward the Council will end the series of deductions. If 3 months or more then elapses from the date a correct payment reflecting recent leave is paid, an employment tribunal claim of unlawful deduction from earnings will be time barred. That would leave claimants with the option of suing in the civil court where the back pay period is limited to 5 years from the date of claim.
- 4.9 Simpson & Marwick has advised SPDS (Scottish Society of Directors of Personnel) that to limit the potential liabilities of councils and protect our interests we should note the findings in *Neal v Freightliner Limited* was the subject of the HR Guidance Note 05/13. The conclusions reached in that tribunal case are reflected in 3.4, 3.5 and 3.6 above. The employer has appealed against the judgment and the appeal will be heard by the Employment Appeal Tribunal on 30 and 31 July 2014. Moreover, the Neal case has been conjoined with the appeal in the case of *Fulton v Bear Scotland Limited*.
- 4.10 In the light of the clear terms of the CJEU Ruling in *Lock* Simpson & Marwick are not expecting the Employment Appeal Tribunal to allow either appeal and for that reason the existence of these pending appeals should be no reason not to act now to regularise the position and protect against historic back pay claims. Even if the EAT does allow the appeals, the UK Government will likely have to amend the domestic UK Working Time Regulations to ensure compliance with the Working Time Directive (as interpreted in the Lock case) going forward. Further, the Directive (and case law interpreting it) can be relied upon by workers in the public sector. This is why action is recommended now rather than waiting for the outcome from the EAT in the Neal and Fulton cases.

- 4.11 In light of the above, it would be appropriate for the Council to regularise the position and make a proposal to pay holiday pay calculated in accordance with the Lock principles with effect from January 2014 in the first instance. This will be done through discussions with the Trades Unions and early discussions on the mechanisms have recently taken place, subject to Council agreement. It is important that correcting payments are made as soon as possible to end the unlawful deductions for this leave year and in ongoing wages. It is not possible at this time to make a recommendation on historic pay, given the uncertainties on both sides. It is therefore recommended that the Council work closely with COSLA, along with other Councils, to investigate the options around an agreed process at national level. It will be important to mitigate as far as possible against Unions lodging multiple, protective unlawful deductions from wages claims.
- 4.12 The costs to the Council for this current leave year which runs January to December is estimated at £150,000 to June 2014, based on the Guidance from CoSLA regarding calculations and current rates of additional pay. The total cost for the year is not simply £300,000 as the payments are made for the first 20 days of holiday only and are dependent on additional payment entitlements on an ongoing basis. It is estimated that the full year cost will be between £200,000 and £300,000. Following a recent Benchmarking Exercise it has been confirmed that a large number of Local Authorities in Scotland have already implemented or are in the process of implementing this ruling in relation to the current leave year's back pay and ongoing payments. No councils have made back payments prior to the current leave year.

## **5.0 CONCLUSION**

- 5.1 The recent EJC ruling on holiday pay has significant implications for employers including the Council. In order to halt the current unlawful deductions of wages the paper makes recommendations to the Council to make backdated payments for this leave year and to regularise payments going forward.
- 5.2 Regarding historic back pay, further recommendations will be brought forward to the Council in due course, informed by COSLA and discussions with the Trades Unions.
- 5.3 The current cost to the Council, calculated according to a COSLA formula, is approximately £150,000 for the first 6 months of the year, based on current levels of additional pay and total year cost of approximately £200,000-£300,000.

## **6.0 IMPLICATIONS**

- 6.1 **Policy** – Will lead to changes in HR policy and how it is applied in relation to payments.
- 6.2 **Financial** –Financial cost to the Council at present is calculated at approximately £150,000 from January to June on the current rate of additional payments. The full year cost will be approximately £200,000 - £300,000. Ongoing revenue costs to services will vary depending on the rate of additional payments that are made. There will be as yet unspecified financial implications for the council in relation to backdated payments which need to be budgeted for. Additional staffing costs are likely to be incurred for working on backdated payments.

- 6.3 **Legal** – Failure to pay the correct holiday pay is most likely to be treated in law as a series of deductions which would leave the Council open to challenge via Employment Tribunal if we do not implement the changes promptly.
- 6.4 **HR** – Change in process to be developed and implemented across both HR and Payroll procedures in consultation with trades unions. This will have an impact on the HR work plan.
- 6.5 **Equalities** –EQIA to be completed. This is likely to affect significant number of part-time female workers as well as majority of former manual worker group.
- 6.6 **Risk** – Failure to pay the correct holiday pay is most likely to be treated in law as a series of deductions. As soon as we start to pay the correct amount then we are effectively ending the deductions. If 3 months or more elapses then claims could be time barred. There remains a financial risk around the current uncertainty on historic back payments.
- 6.7 **Customer Service** –None

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