

Why holiday pay is so important for the recycling and waste management sector

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Calculating holiday pay seems an unlikely topic for board-level discussion. However, this seemingly innocuous pay-roll task has, in recent times, been high on the list of business critical issues. This is due to a series of court decisions which, for some businesses, has resulted in potential liabilities running into millions of pounds. With its high numbers of workers, myriad shift allowances and overtime arrangements, holiday pay is of particular relevance to the recycling and waste management sector. Akshay Choudhry, an associate at law firm Burges Salmon, explains why.



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The issue

For many years now, UK workers have been entitled to a limited amount of paid holiday each year. An EU-derived entitlement designed to promote health and safety for workers, the right was introduced in the UK by the Working Time Regulations 1998 (the "Regulations"). Since the introduction of the Regulations, most employers have paid this holiday at the worker's basic rate of pay only.

However, over the past 18 months, decisions from both the European Court of Justice (ECJ) and the UK courts have confirmed that, in many cases, paying holiday at the basic rate of pay is insufficient. Instead, workers should be paid their normal remuneration (which is usually higher than basic pay as it includes overtime, commission, allowances etc) when on annual leave; the rationale being that a worker must not be deterred from taking their holiday (which they would be if they stood to receive less than their normal remuneration) as this would run contrary to the health and safety objective.

So, what constitutes 'normal remuneration'?

Those hoping for a straightforward answer should stop reading now! The test applied by the ECJ is that (in addition to basic pay) payments which are intrinsically linked to a worker's employment and/or which relate to their personal or professional status qualify as 'normal remuneration', provided they are made with sufficient regularity.

Applying this test, a series of recent UK decisions has given employers a degree of clarity in relation to certain types of payments. In summary, the following payments should arguably now be included in a worker's 'Euro-leave' holiday pay (see appendix one), provided they are made on a sufficiently regular basis:

- non-guaranteed overtime (i.e. overtime which the employer is not obliged to provide but which the worker is obliged to work if offered)

- productivity or performance bonuses based on an individual's performance (although if the bonus is paid only once a year, for example, it is arguable that this is not a regular enough payment to count as normal remuneration);
- on-call or standby payments;
- commission payments based on an individual's performance; and/or
- any other allowances or payments which meet the above test

In addition, the Regulations already required employers to include within holiday pay calculations both guaranteed compulsory overtime (i.e. overtime which the employer is obliged to provide and the worker is obliged to work) and certain shift premiums where these are paid to employees with normal contractual working hours for working those hours at particular times (e.g. where an employee's normal shift pattern involves working unsociable hours). Such sums should also be included in holiday pay calculations for both Euro and Domestic Leave (see appendix one).

Implications for employers

These recent cases mean many employers have been calculating holiday pay incorrectly for nearly two decades. In industries where overtime or other ancillary payments are prevalent, such as the waste sector, the impact is particularly acute. There are a number of potential consequences:-

Historic claims for underpayments – workers who can show they have been underpaid holiday pay may be able to bring unlawful deductions from wages claims, with the potential for long-serving workers to bring claims stretching back over a number of years. However, two factors may reduce this risk:

(a) from 1 July 2015, new limitation rules will apply meaning a worker will only be able to claim a maximum two years' worth of back pay; and

(b) irrespective of when a claim is brought, a three month break rule will apply. If there is a gap of three or more months between underpayments of holiday pay, the worker will be out of time to bring a claim for any deductions which occurred before the three month break. This is helpful for limiting historic liability. For most workers, the underpayments only arise in relation to their Euro Leave (see appendix one). Current case law says that Euro Leave is arguably deemed to be taken first in any holiday leave year. After that has been exhausted, the worker then takes Domestic Leave (which is likely to have been paid correctly- i.e. not underpaid). Assuming most workers exhaust all of their holiday each year, this means there is likely to be at least a three month break between underpayments each year.

Increase to wage bill moving forwards - if you do need to change the way you calculate holiday pay as a result of these decisions, how to do this will present significant issues particularly where profit margins are tight; contractors and customers in outsourcing arrangements would be well-advised to check the terms of their commercial contracts to see if there is the potential for price adjustment in these circumstances.

Liability for other employers' liabilities - when businesses are sold, or when services – such as waste collection - are outsourced, the parties will normally enter into indemnities regarding historic liabilities for employees who transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).

These indemnities can include liability for underpayments of holiday pay. Contractors or customers involved in any such transactions should check their commercial contracts to understand their positions – you could find yourself responsible for a predecessor's underpayments or liable for underpayments to employees who transferred out of your business some time ago.

Alternatively, you may be in the more welcome position of being able to pass the liability onto someone else. If you are currently in a TUPE negotiation, make sure any such potential liability is addressed.

Possible shortfall in pension contributions - if holiday pay is included in pensionable earnings (as defined in the relevant pension scheme rules) employers may find they are facing a shortfall. It is understood that John Lewis has set aside £7m for its additional pension liabilities.

Employee relations - while understanding the effect on the financial bottom line is important, businesses also need to consider the employee relations angle. A heavily unionised workforce may, for example, require a different approach to one which is not.

Unresolved issues

Unfortunately for employers trying to get to grips with this, the waters are muddied further by the number of questions yet to be determined.

Firstly, while the payments identified above are ones which should arguably now be included in holiday pay, question marks remain over others. For instance, what about discretionary bonuses? Or commission or bonuses based on group (as opposed to individual) performance?

Similarly, and of a particular concern for employers in the waste sector, it is uncertain whether voluntary overtime (i.e. overtime the worker is not obliged to work) should be included – there is currently no binding authority to say it should be. However, given the direction of travel, it is likely that voluntary overtime which is worked on a sufficiently regular basis will need to be included in holiday pay calculations in the future.

Secondly, assuming a claim is made before 1 July 2015 and there is no three month break in the underpayments, how far back can the claim go? One argument is that claims should be limited to six years (applying the Limitation Act 1980), but an alternative approach would permit claims back to 1998 (when the Regulations came into force) if the worker had been employed throughout that entire period.

Thirdly, having determined what types of payments to include in a holiday pay calculation, an employer must determine what relevant payments have been received by the workers in question. To do this, the employer should use a reference period over which it will assess what payments the workers have received.

However, what should that reference period be? The only thing we know is that the reference period must be representative of the worker's normal remuneration. One argument is that a 12-week reference period should be used, since this is typically the reference period used by the Employment Rights Act 1996 to calculate pay for a variety of purposes. However, in other cases, non-binding comments from the courts suggest a 12-month reference period might be appropriate.

Indeed, it might be the case that different reference periods will apply in different circumstances, depending on how widely pay fluctuates during the course of a year. We await clarification.

What should employers do now?

Perhaps unsurprisingly, there is no 'one size fits all' approach. However, a sensible starting point for all businesses is to carry out an audit of what payments (over and above basic pay) are made to identify those which:-

- 1) are already included in holiday pay
- 2) should now be included in holiday pay (in light of recent case law)
- 3) can genuinely be excluded (e.g. reimbursement of expenses which correspond to actual expenses incurred)
- 4) are uncertain in terms of status as the legal position remains unclear.

It can be a good idea to involve your lawyers in the audit so that a legally privileged report can be prepared and confidentiality maintained.

Depending on the audit outcome, various options are available. One approach is to **do nothing**, at least until 1 July 2015 (when the two year limit on backdated claims will come into force). Another option, depending on your bargaining position, may be to **settle historic claims** – possibly with a one-off, flat payment to all affected workers to avoid having to calculate individual entitlement.

Alternatively, or as well as settlement, you could start to **include relevant payments in holiday pay calculations**, although you will need to consider timings for this to minimise the risk of triggering claims.

Finally, you could **change working practices** in order to reduce your holiday pay bill. For example, can you reduce overtime by changing shift patterns, introducing time off in lieu, reviewing operating practices or using agency workers? Alternatively you could remove allowances altogether or amend commission arrangements. You will need to be wary of breaching contractual arrangements when making any such changes though.

While these developments are unwelcome for employers and there remain a number of unknowns, there are a variety of measures you can take to manage your risk once you've taken steps to understand it. The first step is to ensure that holiday pay is firmly on your board's agenda.

Appendix one

Holiday entitlements

As a reminder, workers are entitled to:

- Four weeks' annual leave (referred to as 'Euro Leave'), which derives from the European Working Time Directive.
- An additional 1.6 week's annual leave (referred to as 'Domestic Leave', which was provided for by the UK government.
- The payments referred to in this article relate to the four weeks 'Euro Leave' only and not to the additional 1.6 weeks except where otherwise stated.

Appendix Two

The key cases on holiday pay

- Williams and others v British Airways plc (Case C-155/10)
- Lock v British Gas Trading Ltd (Case C-539/12)
- Bear Scotland Ltd v Fulton and another (UKEATS/0047/13)
- Lock v British Gas Trading Ltd (ET/1900503/12)