Holiday Health Check: The Relationship with Sick Leave and the Relevance of Overtime

Holiday pay continues to be a knotty issue for employers, as highlighted by the recent press reports that John Lewis has paid out £40 million to compensate workers following an error in the calculation of holiday pay. The relationship between holiday entitlement and sick leave and the impact of overtime on holiday pay rates are particular issues frequently raised by employees.

Much of the uncertainty stems from the apparent incompatibility of the Working Time Regulations 1998 (WTR) with the European Working Time Directive (WTD), which the WTR implement into English law. The WTD has been interpreted as requiring workers to be entitled to carry-over any holiday which is unused as a results of sickness absence to the following holiday year whereas the WTR expressly prevent carry-over by providing that holiday must be taken in the leave year that it accrues and only permitting payment in lieu on the termination of employment. In a consultation published in 2011, the Government proposed making some changes to the WTR to expressly state that carry-over must be allowed where a worker has not been able to take their holiday due to sickness absence. The Government’s response to the WTR element of the consultation is still awaited.

Thankfully, following a number of ECJ and UK decisions, we now have some clarity on the principles applying to holiday entitlement and sick leave. The position in relation to overtime and holiday pay is unfortunately much less certain following the recent Employment Tribunal decision in Neal v Freightliner Ltd (ET/1315342/12), although an application to appeal this decision has now been made.
Follow our Q and A below to check your current practice on holiday entitlement and pay is up to date with legal developments and consult our checklist of issues to review.

**Holiday Health Check: Q and A**

**Holiday and Sickness Absence**

1. Should employees who are sick during a period of pre-arranged holiday be permitted to reschedule that holiday entitlement?

   Yes, following the ECJ case of *Pereda v Madrid Movilidad SA* [2009] IRLR 959.

2. Should employees who request to take holiday during sick leave be permitted to do so?

   Employers who allow this will not contravene the WTR. However, it is possible for an employer to prevent an employee from taking his holiday at any given time by following certain procedures in the WTR in relation to the issue of counter-notices. In practice, this is unlikely to be an attractive option for employers.

3. Should employees who are unable to use their holiday entitlement as a result of sickness absence be permitted to carry over this entitlement to the following holiday year?

   Yes, following the ECJ case of *Stringer and others v HM Revenue & Customs* [2009] IRLR 677. In *NHS Leeds v Larner* [2011] IRLR 894, the Court of Appeal decided that the WTR could be interpreted so as to be consistent with the WTD, this permitting carry-over in the UK where a worker has been unable to take holiday during the holiday year, due to sickness.

4. Does carry-over happen automatically or are there steps a sick worker must take before unused holiday can be carried over to the following leave year?

   Following the Court of Appeal's decision in *Larner*, it is not necessary for a worker to request carry-over of unused holiday entitlement; carry-over must be allowed in any event.
Does the carry-over requirement apply only to statutory holiday entitlement derived from the WTD (four weeks) or to the additional entitlement under the WTR (1.6 weeks) as well?

The ECJ case of Neidel v Stadt Frankfurt am Main [2012] IRLR 607 and the UK case of Sood Enterprises v Healy UKEATS/0015/12 considered the issue of carry-over following sick leave in relation to additional holiday entitlement. In these cases it was decided that the carry-over requirement does not apply to any additional holiday entitlement unless the worker is entitled to carry-over by virtue of a “relevant agreement” (that is a workforce agreement, or any part of a collective agreement which forms part of the contract or any other written agreement between the employee and employer which is legally enforceable, such as the contract of employment).

Many workers benefit from a contractual entitlement to carry over some holiday entitlement. This can only apply to holiday entitlement in excess of the four weeks under the WTD (which cannot, in ordinary circumstances, be carried over) so, in practice, workers with this benefit will be able to carry over both categories of unused holiday entitlement to a subsequent holiday year if they have been unable to take it due to sickness. The carry-over of additional leave is restricted to the following leave year.

The position on carry-over of any additional contractual entitlement to holiday in excess of the total 5.6 weeks under the WTR, will depend on the provisions in the contract and whether any carry-over entitlement is wide enough to cover both the additional entitlement under the WTR and additional contractual entitlement.

Does the carry-over of holiday entitlement continue indefinitely?

Following Stringer it was uncertain whether carry-over that was required by the WTD could apply indefinitely for a number of years where a worker continued to be on long-term sick leave. In the German case of KHS AG v Schulte [2012] IRLR 156 heard by the ECJ in 2011, the ECJ decided that a limitation of 15 months imposed on the carry-over of holiday untaken due to sickness was compatible with the requirements of the WTD. In reaching this conclusion the ECJ took into account the purpose of holiday, which is to guarantee a period of rest from work, and of relaxation and leisure, and the International Labour Convention on holiday and pay (which, in accordance with Article 6 of the WTD, must be taken into account) which states that paid holiday (where it is not taken in the leave year) should be taken no later than 18 months from the end of the year in respect of which the entitlement has arisen. In Schulte, the reference
period in which the holiday accrued was 12 months and the ECJ found that the 15 month carry-over period (as prescribed by the relevant German law) was acceptable as this was longer than the reference period. Although the UK position is slightly different because the WTR do not provide any limitation on carry-over (or carry-over at all, as explained above), it seems likely that such a limitation on carry-over would be accepted in the UK; employers should therefore be cautious about trying to limit carry-over to periods of less than 15 months. Equally, there is a reasonably strong argument to resist accruals and pay-outs for longer periods of carry-over.

Overtime and Calculating Statutory Holiday Pay

7 Do payments for overtime affect how much holiday pay an employee is entitled to receive?

This issue is in the spotlight again following the decision of the Employment Judge in Neal v Freightliner Ltd (ET/1315342/12). Unfortunately, the legal position is uncertain and we are waiting to hear if leave to appeal the decision has been granted. In the meantime, employers should consider including overtime payments in calculations for holiday pay. This is because the Judge in Neal found that it was insufficient for Mr Neal’s employer to calculate his holiday pay in accordance with the pay he received for working his normal contractual working hours. Instead, additional pay received for voluntary overtime hours should have been included in the calculation. As a result, he was successful in his claim for unlawful deductions from wages.

As with holiday entitlement and sickness absence, the uncertainty in relation to overtime arises because of the apparently inconsistent provisions for calculating holiday pay under the WTR and the WTD. The WTD requires that workers be paid for four weeks’ annual leave. Pay in this context has been found by the ECJ to mean “normal remuneration” which is not restricted to basic salary (Williams and others v British Airways plc [2011] IRLR 948). In contrast, the WTR provide that workers are entitled to a week’s pay for a week’s leave, to be calculated in accordance with specific provisions in the Employment Rights Act. These state that holiday pay should normally be calculated in accordance with basic pay for an employee who works a fixed number of hours and that overtime hours and pay do not usually need to be factored into the holiday pay calculation.

The apparent incompatibility of the WTR with the WTD was the subject of Mr Neal’s claim and the Employment Judge found that it was necessary to read certain words into the WTR so that the provisions excluding overtime hours and pay from the holiday pay
calculation did not apply. The result appears to be that where a worker works variable voluntary overtime, holiday pay must be calculated in accordance with the worker’s average weekly remuneration (including payments for voluntary overtime) in the period of 12 weeks before the holiday is taken. However, as this decision was taken at first instance and is currently subject to an application for appeal, we anticipate that employers may prefer to await further clarification before making potentially costly changes to the way holiday pay is calculated.

8 Should overtime payments be taken into consideration when calculating the rate of pay for the additional leave entitlement under the WTR?

No, the principles covered in the case law considered above are limited to the entitlement to four weeks of leave derived from the WTD. In relation to additional leave, it does not appear necessary under the WTR to take account of overtime when calculating holiday pay.

Understanding Holiday Pay: Checklist

See the table below for issues to check now in relation to your organisation’s holiday pay and why those issues matter.

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<th>What to check</th>
<th>Why does it matter?</th>
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<tr>
<td>What the contract says about holiday entitlement and pay</td>
<td>This is the starting point because, whatever the provisions of the WTD and the WTR, if a worker’s entitlement under their contract is more generous, this must be honoured.</td>
</tr>
<tr>
<td>Whether workers have any entitlement to carry-over of holiday under their contracts</td>
<td>If there is a contractual entitlement to carry-over, a worker will be entitled to carry over both the four weeks of his holiday entitlement derived from the WTD if it is untaken due to sickness absence and any additional untaken holiday in respect of which carry-over is allowed by the contract. This means that it may not be necessary to distinguish between different types of holiday when calculating carry-over entitlement. If there is no right to carry-over of additional holiday entitlement, one option is to specify that the first four weeks of holiday taken in any leave year is holiday derived from the WTD. This should avoid the issue, in the event of sickness absence,</td>
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### What to check

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<td>of whether any untaken holiday is holiday derived from the WTD, and therefore subject to the carry-over obligation, or additional holiday, which is not.</td>
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If an accrual has been made for holiday pay in respect of workers on long-term sick leave and/or PHI

Although there are good arguments against claims for holiday pay/entitlement in respect of accruals over many years, until we have greater clarification of the approach that will be taken by a UK Court, it is sensible to make an accrual in respect of holiday for the duration of an individual’s absence, particularly as the cost of this can be substantial.

How holiday pay is calculated for workers who work voluntary overtime

If overtime payments are not included in holiday pay calculations, the company’s approach may be challenged by workers, especially following publicity over payments made by John Lewis. This is most likely to be an issue where overtime is regularly worked (as in *Neal*) as the individual will be noticeably worse off during periods of holiday.

The terms of the company’s sick pay policy

There is little reason for a worker who is receiving full sick pay to opt to take holiday-entitlement instead. A worker who has exhausted his entitlement to sick pay may choose to take holiday so that he continues to be paid during the period of absence. This makes it more likely that the worker will use up his holiday entitlement before the end of the holiday year and carry-over will not then apply. Equally, an employee may only opt to reschedule a period of holiday if he is unwell, if he is entitled to receive contractual sick pay in respect of the period of absence instead.

There are many other considerations when determining the level of sick pay benefit to be offered, but there are clear advantages to limiting basic contractual sick pay entitlement and then offering significantly more sick pay on a discretionary case by case basis. Bear in mind that it can be difficult to change sick pay entitlements for existing employees. It may be more appropriate to limit changes to new joiners only instead.

Whether any evidential requirements apply to employees who wish to

Such requirements can help to prevent abuse. They include, for example, a requirement to report sickness on the first day, and to provide medical
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<td>reschedule holiday as a result of sickness and claim contractual sick pay instead</td>
<td>evidence for longer absences.</td>
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