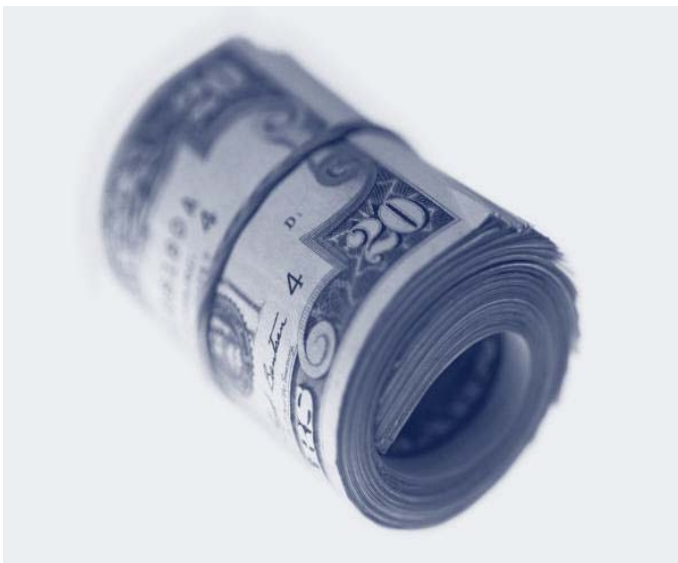


## Rolled Up Holiday Pay



**One of the most vexed questions in respect of the right to receive four weeks paid annual leave under the Working Time Regulations 1998 (“WTR”) is whether and in what precise circumstances, “rolled up” holiday pay arrangements are permissible. Under these arrangements, workers receive holiday pay as part of their contractual hourly or weekly rates and then receive no pay when they actually take leave. Such arrangements are common in sectors where there are temporary or irregular hours workers. It is also common in agency worker arrangements. When using this method, employers avoid the requirement of calculating the holiday pay due to each worker for each period of leave which is a notoriously difficult exercise and is seen by many as an excessive drain on administrative resources.**

Whilst the practice of rolled up holiday pay has been prevalent, cases have been brought on the basis that such arrangements do not accord with the EC Working Time Directive from which WTR derive. In making this argument, it has been pointed out that these types of arrangements could actually discourage workers from taking their holiday. In basic terms, the argument goes that the fewer holidays the worker takes, the more remuneration he will actually receive.

To add to the confusion, there was a division as between the Scottish and English Courts. In Scotland, the Court of Session decided in the case of *MPB Structures Limited v Munro* that rolled holiday arrangements were unlawful for the reasons set out above. Furthermore, in this case, the Court stated that payments made under rolled up holiday pay arrangements did not discharge an employer’s liability to pay statutory holiday pay. Effectively, this meant that workers could obtain payment twice in respect of annual leave, which many employers felt was an unjustified outcome.

However, in a subsequent case before the EAT in England, *Caulfield v Hanson Clay Products Limited*, it was decided that rolled up holiday pay arrangements complied with WTR provided that (a) the rolled up element is incorporated into the individual contract of employment and expressly agreed, (b) the percentage or amount of holiday pay allocated is clearly defined in the contract and preferably in the payslip, (c) the rolled up holiday pay is a true **addition** to the contractual rate of pay, (d) records of holidays taken are kept and (e) reasonably practicable steps are taken to require workers to take their holidays before the expiry of the relevant holiday year.

The *Caulfield* case in England was then appealed to the Court of Appeal which disagreed with the finding of the Court of Session in Scotland but decided given the divergence of view that the matter should be referred to the European Court for a decision.

The decision of the European Court has now been delivered and it has decided emphatically that rolled up holiday pay methods are not lawful in **any** circumstances. In the Court’s view, workers taking annual leave under the Regulations must be placed in the same financial position as they would have been if they were carrying out work. This means that payment must continue throughout the statutory holiday period in accordance with the calculation basis set out in WTR.

At first sight, this is not good news for employers who do rely upon rolled up holiday pay arrangements. However, having ruled on the primary issue, the European Court then considered whether employers should be given any credit for making holiday payments under a system which they had found to be unlawful. The European Court decided that genuine rolled up holiday pay arrangements may, if made “transparently and comprehensively”, be set off against the worker’s entitlement to payment when he or she actually takes leave. The

burden of proving this test rests with the employer.

Where therefore does this leave employers going forward? In a word, the matter is unclear, which is unsatisfactory for employers. On one interpretation of the European Court's decision, those employers who meet the requirements set out by the EAT in *Caulfield*, should not face any financial penalty if they continue with rolled up holiday pay arrangements applying the set off approach as stated above. However, there is another interpretation of the Court's decision which is that this dispensation, only applies in respect of *backdated* claims and that going forward, the set off defence would **not** apply. The effect of this interpretation is simply that the European Court, when ruling that rolled up holiday pay was unlawful, was not intending its decision to be retrospective, so long as the conditions of the payments being transparent and comprehensive etc are met.

It is also important to note that the European Court stated that members of the EU must adopt measures appropriate to ensure that practices which are incompatible with the Working Time Directive are not continued. It cannot be ruled out therefore that the UK Government may take initiatives to amend WTR and specifically outlaw and declare void rolled up holiday pay schemes. We also need to wait and see how the Courts in the UK will interpret what the European Court meant precisely by reference to the phrase that holiday pay arrangements must be transparent and comprehensive and whether the set off argument applies to past and future payment arrangements. On this basis, the safest approach would be for employers to commence processes now in terms of planning and agreeing with workers and trade unions, replacement schemes as soon as possible in terms of which holiday pay is made when workers actually take holiday or leave their employment. This also accords with the latest guidance issued from the DTI.

If you wish to discuss any aspect of this update further, please do not hesitate to contact any member of our Employment Law Division who are:-

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