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Workers not paid for holiday can claim compensation for entire engagement (UK)

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Summary

In a decision with major implications across the UK gig economy and beyond, the Court of Appeal has ruled that workers who were incorrectly classified as independent contractors and not paid for holiday they took can claim compensation for the whole period of their engagement.

Legal background

Whether someone is an employee, a worker or an independent contractor (self-employed) will determine their employment rights in the UK – including any right to paid annual leave. In brief, workers and employees are entitled to paid holiday but the self-employed are not. If someone has been incorrectly categorised as an independent contractor and brings a claim for holiday pay, how much compensation are they entitled to? This question has been considered in a number of recent cases.

Facts

In the case at hand Mr Smith was a self-employed plumber who worked exclusively for Pimlico Plumbers Ltd (Pimlico), having signed an agreement which stated that he was "an independent contractor of the Company, in business on your own account". There was also a company manual which referred to a 40-hour working week, although the agreement itself stated that there was no obligation to provide or accept work. Mr Smith was registered as self-employed, but his contract imposed various requirements on him. These included that he should drive a branded van with a tracker, wear a branded uniform, carry a Pimlico ID card, and follow administrative instructions from the control room.

Six years after having started work, Mr Smith suffered a heart attack and decided that he wanted to reduce his working days from five to three. Pimlico refused his request, took away the branded van and terminated its agreement with him.

Mr Smith brought various claims before the Employment Tribunal (ET). It found that he did not fall within the narrower definition of 'employee', but he was a worker. Pimlico appealed this decision all the way up to the Supreme Court.

In 2018, the Supreme Court held that Mr Smith should have been classed as a worker by Pimlico and had been incorrectly deemed an independent contractor (*Pimlico Plumbers Ltd and another – v – Smith* [2018] UKSC 29). The case then returned to the ET to decide on compensation, including how much he was owed for unpaid holiday.

Under the Working Time Regulations 1998 (the UK law which implements the EU Working Time Directive (WTD)), there is no right to carry over untaken holiday into a new holiday year and any claim for unpaid holiday must be brought within three months of the last period of holiday. But various ECJ decisions have found that there is a right to carry over untaken holiday into a new holiday year in certain circumstances, such as when workers have not been able to take it in the holiday year in which it fell due because they have been ill. The ECJ ruled in the case of *King – v – The Sash Window Workshop Ltd* (Case C-214/16, 29 November 2017) that where a worker is not given the holiday to which they are entitled under the WTD, they can carry over that right indefinitely and must be paid in lieu of all untaken holiday when their engagement ends.

But both the ET and the Employment Appeal Tribunal (EAT) decided that the principle in *King* only applied if the worker had not taken the holiday at all. In this case, Mr Smith had taken holiday but not been paid, so any claim should have been brought within three months of the last period of holiday, and the claim for unpaid holiday pay did not simply carry over until the end of his engagement. The decision was appealed to the Court of Appeal (CA).

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Judgment

The CA disagreed with the earlier decisions, and ruled that Mr Smith was able to claim compensation for all of the unpaid leave that he took throughout his engagement. This applied for up to four weeks per year, which is the WTD 'Euro-leave' entitlement to holiday.
The CA reached this decision because it took the view that the ECJ's decision in *King* applied equally to taken but unpaid leave. This meant that each year that Mr Smith took holiday but was not paid for it, four weeks carried forward from that year until the end of his engagement. Mr Smith worked from 2005 until 2011, so this could be a significant sum of money when it finally comes to be calculated by the ET.
The basic reasoning is that there is a single right to paid annual leave under the WTD which should not be subject to any preconditions. The right to paid leave is a health and safety measure, and so workers must be able to have genuine rest and relaxation when they are on holiday. A worker who does not know whether they will be paid for the time off is not able to benefit fully from the leave.
This ruling is particularly significant because it effectively avoids the two-year limit on deduction from wages claims from workers in Mr Smith's situation. If a worker takes holiday but is not paid for it, this is a deduction from wages. Since 2015, there has been a 'backstop' on deductions from wages claims which means that for most claims an employment tribunal cannot go back further than two years when awarding compensation. The EAT said that it was an individual deduction each time Mr Smith took holiday and wasn't paid for it. This meant any claim had to be brought within three months of the last deduction, and a claim for a series of deductions could only go back for two years. The CA's decision changes this position completely, because the unpaid holiday all carries over until the end of the engagement. The worker only needs to bring their claim within three months of the end of the engagement, and can then claim for the full amount of carried over 'Euro-leave' holiday, even if this covers many years.

Commentary

This decision will be of concern to many businesses who have engaged individuals on an independent contractor basis in circumstances where there is doubt as to their classification – relevant to businesses in the gig economy and beyond. They may well have allowed these individuals to take time off as holiday, but not paid them for that time. If it turns out that these individuals had been misclassified and were actually workers or employees a business may now find itself facing group holiday pay claims stretching back for years.
The limit of two years of back pay for deduction from wages claims was originally brought in to assist employers when the ECJ ruled in *Williams and others – v – British Airways* (Case C-155/10, 15 September 2011) and *Lock – v – British Gas* (Case C-539/12, 22 May 2014) that holiday pay should be calculated on the basis of 'normal remuneration' rather than basic pay only, so potentially including payments such as overtime and commission. Employers have now had the opportunity to change their holiday pay calculations to comply with the law, so it may well have outlived its usefulness for that purpose in any event. The two-year limit is also still in place for standard deduction from wages claims, such as where an unscrupulous 'employer' has simply failed to pay a worker properly over a long period of time, which is perhaps unfortunate as this was not the real purpose behind the limit being introduced.
Although the decision is based on EU law, it relates to annual leave (which is an essential principle of EU social law), and these proceedings were commenced before the completion of the Brexit deal on 31 December 2020. This means that the UK courts in this case must still follow the EU law on paid annual leave as it was before Brexit. For future similar claims, both the Supreme Court and the CA will have the power to depart from pre-Brexit EU case law if it seems 'right to do so' – meaning it is possible that the higher courts could decide to depart from *King* and take a different approach to unpaid holiday. This currently seems very unlikely, however, given the strength of the CA's view in the case that failing to pay for annual leave prevents proper rest and relaxation and so undermines its underlying health and safety purpose.
The CA provided some clear guidance on when, in its view, an employer rule preventing carry over of holiday to the next leave year will be valid. The business must be able to show that the worker was given the opportunity to take paid leave, was encouraged to do so, and was informed that the right would be lost at the end of the leave year. Businesses can still have rules preventing the carry over of holiday into a new holiday year, but it is important that these are set out in a clear policy and that workers have a genuine opportunity to take their leave during the year if they wish to do so.
Given the importance and potential business costs of this decision, it is likely that it will be appealed.

Comment from other jurisdiction

Germany (Leif Born, Luther Rechtsanwaltsgesellschaft mbH): The CA's decision addresses several aspects that are also being discussed in Germany.
The distinction between employees and self-employed gig workers was considered by the German Federal Labour Court (*Bundesarbeitsgericht*, 'BAG') in 2020 (judgment of 1 December 2020 - 9 AZR 102/20). The

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Court ruled that a gig worker can be an employee. However, it should always depend on the circumstances of the individual case. Given the numerous obligations that the contractor Mr Smith was subject to in the described case, it can be assumed that the German courts would also have assumed the existence of an employment relationship. As a consequence, just as in the United Kingdom, the employee would be entitled to annual leave.
Concerning the expiration of annual leave, German law is also strongly influenced by the case law of the ECJ. In principle, annual leave expires at the end of the calendar year. In the event of special operational reasons or reasons in the person of the employee, annual leave does not expire until 31 March of the following year. This does not apply – in application of the decision of the ECJ of 20 January 2009, C-350/06, *Schultz-Hoff* – if the employee could not take their leave due to illness. In addition, the leave cannot expire – in application of the ECJ's judgment of 6 November 2018, C-684/16, *Max-Planck-Gesellschaft* – if the employer does not ensure that the employee is given the opportunity to exercise their right to paid annual leave, i.e. informs him/her in a timely and accurate manner.
This leads to a similar problem as the one the UK courts faced in this case. Under German law, all claims, including claims for the granting or allowance in lieu of paid annual leave, are subject to a statute of limitations of three years. The BAG recently had to decide whether an employee can demand allowance in lieu for paid annual leave that dates back more than three years or whether an employer can raise the defence of the statute of limitations even if it has not fulfilled its obligations to give the employee the opportunity to exercise their right to paid annual leave. The BAG has referred this question to the ECJ for a decision (C-120/21) The ECJ's decision is still pending, but the Advocate General has recommended in his opinion that European law precludes the applicability of the statute of limitations rules if the employer has not complied with its obligations to provide encouragement and information to an employee as regards taking that leave. This has already caused concern among some employers in Germany about 'infinite' annual leave entitlement.
As decided by the CA, it should not matter in this respect whether unpaid leave has already been granted. This is because under German law, too, only the granting of paid leave constitutes fulfilment of the annual leave entitlement. Accordingly, a German court would decide the UK case in the same way as the CA, at least if the ECJ follows the Advocate General's Opinion in Case C-120/21.

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