WHITE & CASE

Insight: Employment

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Holiday Pay: Carry Over or "Use It or Lose It"

In recent years there has been an increasing number of domestic and European cases which have focused on the interaction between statutory holiday entitlement and long-term sickness absence, at times leading to inconsistent approaches. In particular, since 2009 there has been a line of cases which has developed an employee-friendly interpretation of Article 7 of the Working Time Directive (2003/88/EC) (the "**Directive**"). Discussed below is the most recent of those cases.

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Article 7

Article 7 of the Directive provides that member states must *"ensure that every worker is entitled to paid annual leave of **at least four weeks** in accordance with the conditions for entitlement to, and granting of, such leave laid down by national legislation and/or practice".*

There is nothing in the Directive to prevent national law providing for paid annual leave entitlement of greater than four weeks. Regulations 13-16 of the Working Time Regulations 1998 ("**WTR**") implement this Article 7 into UK law and the current statutory holiday entitlement under the WTR in the UK is 5.6 weeks/28 days (which includes any paid leave for public holidays).

NHS Leeds v Larner [2012]

In the recent case of *NHS Leeds v Larner*, the Court of Appeal has upheld earlier Employment Appeal Tribunal ("**EAT**") and Employment Tribunal decisions that a worker who is absent on long-term sick leave for an entire holiday year, and who does not take or request holiday during that period, is entitled on termination of employment to receive a payment in lieu of accrued and unused statutory holiday entitlement for that year. The fact that the employee does not request that their holiday entitlement be carried over into the next holiday year does not affect the right to receive this payment.

In reaching its decision, the Court of Appeal summarised the general propositions to be derived from previous rulings of the Court of Justice of the European Union (the "**ECJ**") as to the interpretation of Article 7 of the Directive:

- Holiday pay continues to accrue during periods of sickness absence.
- The Claimant in *Larner* was prevented from, and did not have the opportunity to, take her paid holiday entitlement in the relevant holiday year because of her sickness.

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- She was therefore entitled to take her statutory paid holiday at a time when she was not sick, even if this fell outside of the relevant holiday year, without having to make any prior request to do so.
- Article 7 of the Directive provides that every worker is entitled to at least four weeks of paid annual leave and nothing in Article 7 states that a worker must make a formal request to take or carry forward paid holiday entitlement which they have not been able to use due to sickness. In addition, no previous Court rulings have established the requirement for such request.
- Article 7 has direct effect and so the Claimant (as a public sector worker) could enforce Article 7 directly against NHS Leeds as an emanation of the state (i.e. a public sector body).

This decision in *Larner* is in line with the reasoning in the earlier ECJ cases of *Stringer* and *Pereda* in 2009. Likewise, the decision reached by the ECJ in *ANGED v FASGA* on 21 June 2012 is also in line with this earlier case law. In this case the ECJ held that Article 7 must be interpreted such that a worker who is sick during a period of annual leave is entitled to take such annual leave at another time when they are not sick.

Fraser v South West London St George's Mental Health Trust [2012]

However, following the decision in *Larner*, the EAT reached a different decision in *Fraser*, ruling that a worker was only entitled to paid statutory holiday under the WTR where they have taken, or given notice of their intention to take, such holiday. *Fraser* was, however, distinguished on its facts as being different to *Larner*, on the basis that the Claimant in *Fraser* had been certified as fit to return to work, and had had the opportunity to take annual leave prior to the termination of her employment. By comparison, in *Larner*, the Claimant had not been fit to return to work at any point prior to her dismissal. This distinction makes it clear that the question of opportunity will be key to any determination as to holiday carry over or payment in lieu.

Private sector employees

The general position remains that unless an employer is an "emanation of the state" a worker in Great Britain will not necessarily be able to enforce a directive against their employer.

One thing that is now clear from *Larner* is that, following the Court of Appeal's express confirmation that "*it would be possible to interpret the 1998 Regulations so as to be comparable with Article 7 as interpreted in the rulings of the Court of Justice*", the decision in *Larner* impacts not only public sector employers but also private sector employers, who will also now need to allow employees who have been on long-term sick leave, and who as a result have not had the opportunity to take their statutory paid holiday entitlement, to carry over any accrued but unused statutory holiday entitlement.

Which holiday entitlement?

It is important to note that these decisions only apply to statutory holiday entitlement and not to contractual holiday entitlement. In practice, this means that there is no obligation on an employer to allow an employee to carry over any accrued contractual holiday entitlement (over and above statutory entitlement) and instead, it is acceptable for accrued contractual holiday entitlement to be lost at the end of the leave year if it is not used.

However, in light of the fact that the WTR provides for a statutory holiday entitlement of 1.6 weeks more than the minimum four weeks required by the Directive, there remains an outstanding question for the UK as to whether the above case law applies (i) only in respect of the first four weeks of holiday entitlement under Regulation 13(1) of the WTR that gives effect to the Directive or (ii) whether it applies in respect of the full UK statutory entitlement of 5.6 weeks?

In the case of *Neidel v Stadt Frankfurt am Main [2012]*, the ECJ held that where a national law provides employees with a statutory holiday entitlement that exceeds the four weeks required by the Directive, there is no requirement that the national law also entitle those employees, on termination, to payment in lieu of that additional statutory holiday entitlement above the four weeks which they were unable to take due to sickness. In this case the ECJ said that the Directive must be interpreted "*as not precluding provisions of national law conferring on a public servant an entitlement to further paid leave in addition to the entitlement to a minimum paid annual leave of four weeks, which do not provide for the payment of an allowance in lieu if a public servant who is retiring has been unable to use that additional entitlement because he was prevented from working by sickness*".

The Court of Appeal in *Larner* considered the case of *Neidel* and explained that "*until another case crops up, in which it is necessary to reach a decision on the additional paid annual leave, the ETs and their users can derive assistance from the Judgment in Neidel*". *Neidel* has not yet been considered in any other domestic or European case.

Where to draw the line?

These decisions could potentially lead to the opening of something of a 'Pandora's box' for employers, particularly in cases where employees have been on long-term sick leave for a number of years and whose statutory holiday entitlement, on the basis of the above decisions, would continue to roll over from one year to the next. Whilst it is clear from the line of case law that a worker must be allowed to take their paid holiday entitlement at a time when they are not sick, the question remains as to whether there can be a cut-off point by which time holiday must be used or else lost. The risk otherwise is that employers could be liable to make payments in lieu of holiday entitlement that has accrued over several years of sickness absence. This is a potential problem that was acknowledged by the ECJ in the case of *KHS AG v Schulte [2012]*.

In the case of *Schulte*, a collective agreement under German law provided that in the case of sickness absence, all holiday entitlement must be used within 15 months of the end of the relevant holiday year or it would be lost. The ECJ found that this provision of the collective agreement was not inconsistent with the Directive.

As the ECJ noted, member states are not precluded from imposing a time limit at which point holiday entitlement will be lost if not used. Whilst this is subject to the proviso that a worker must be allowed to take their holiday at a time when they are not sick, this must be qualified "*otherwise, a worker…who is unfit for work for several consecutive reference periods, would be entitled to accumulate, without any limit, all the entitlements to paid annual leave that are acquired during his absence from work*". The ECJ concluded that if a worker is allowed to carry over holiday entitlement indefinitely, then paid annual leave eventually "*ceases to have its positive effect for the worker as a rest period and is merely a period of relaxation and leisure*".

In contrast, the ECJ in *Neidel* held that a German law which required that any leave that was not taken in the nine months after the end of the leave year be forfeited, was incompatible with the Directive because the period of nine months was "*shorter than the reference period to which it relates*".

The ECJ offered no guidance in *Neidel* as to what would be an appropriate carry over period to apply generally. Whilst there is no definitive guidance on this point, it is clear that any carry over period must be at least as long as the reference period to which the holiday entitlement relates, which in most cases will be 12 months. It seems that, for the meantime at least, the 15 month carry over period approved in *Schulte* may be a good guide as to what would be acceptable.

What next – Government consultation

Whilst the line of case law above has sought to improve the position of employees who, through no fault of their own, are unable to take their statutory holiday entitlement because of sickness, it has at the same time created a minefield of uncertainty for employers. As a result, the UK Government has made proposals to amend the WTR in order to reflect the ECJ case law in this area. These proposals are detailed in the paper entitled *Consultation on Modern Workplaces*, May 2011.

It is proposed that the WTR be amended so that "*where a worker has been unable to take his annual leave due to sickness absence and it is not possible to schedule the leave in the current leave year, he will be able to carry over annual leave into the following leave year. Similarly, where a worker falls sick during scheduled annual leave he will be able to reschedule the annual leave at a later date, including carrying it over if it is not possible to reschedule in the current leave year*". What is important to note about this proposal is that it will only apply in respect of the minimum four week holiday entitlement which is provided for by the Directive rather than the additional 1.6 weeks under the WTR.

However, the consultation paper makes no reference to introducing a time limit by which holiday entitlement that is carried over must be used. Whilst it is likely that the above proposal will be welcomed by employers who see the need for clarity in this area, they will likely also want to know where they are to draw the line.

The UK Government has not yet published a response to this consultation and so it remains to be seen the extent to which these proposals are implemented, whether they will lead to any further proposals (for example, in respect of time limits) and how any proposals that are implemented will work in practice.

Practical Tips for Employers:

1. In any acquisition, it is important to undertake appropriate due diligence in order to identify any long-term sickness absences, the length of such absences and the potential accrual of statutory holiday entitlement. A buyer should consider the appropriate apportionment of accrued holiday entitlements up to and after completion, and possibly seek indemnity protection from the seller in circumstances, for example, where employees have been on long-term sickness absence for a number of years.

2. In contracts of employment, employers should consider introducing a long-stop date for the use of accrued holiday entitlement in cases of long-term sickness absences. As discussed above, 15 months after the end of the relevant holiday year appears to be a good guide as to what is appropriate.

3. Employers should check with providers of any Permanent Health Insurance ("PHI") or Long Term Disability benefits ("LTD") as to whether paid holiday entitlement will compromise receipt of on-going benefits under such schemes.

4. It may be possible to ask employees to waive claims for accrued holiday entitlement under the WTR by entering into a compromise agreement. An employee may be willing to do this if accrued holiday entitlement could compromise their receipt of benefits under any PHI or LTD scheme.

5. It is important that a distinction is made between contractual and statutory holiday entitlement in any policy or contractual provisions relating to carry over and payment in lieu.

Cases and other materials

NHS Leeds v Larner [2012] EWCA 1034

Fraser v South West London St George's Mental Health Trust [2012] IRLR 100

Asociación Nacional de Grandes Empresas de Distribución (ANGED) v Federación de Asociaciones Sinidicales (GASFA) and others [2012] IRLR 779

KHS AG v Schulte [2012] IRLR 156

Neidel v Stadt Frankfurt am Main [2012] IRLR 607

Pereda v Madrid Movilidad SA [2009] IRLR 959

HMRC v Stringer and others [2009] IRLR 677

Stringer and others v HMNRC; Schultz-Hoff v Deutsche Rentenversicherung Bund [2009] IRLR 214

HM Government, Consultation on Modern Workplaces, May 2011