Back to the future: in the latest round of *Smith v Pimlico Plumbers*, the Court of Appeal confirmed the correct approach to holiday pay claims – but some confusion remains

Tribunals have been facing a large number of claims for back holiday pay by workers seeking to rely on *King v Sash Window Workshop* and claim a payment in lieu of unpaid holiday pay on termination of employment. The EAT decision in *Smith v Pimlico Plumbers* in March 2021 greatly restricted the value of such claims by holding that they could not be brought in cases where the worker had taken some leave, albeit unpaid. The Court of Appeal has now overturned the EAT decision and restored some welcome certainty to this area. However, the judgment throws up further difficulties.

BACKGROUND

1. *Smith v Pimlico Plumbers* has been rumbling along for over a decade and will be familiar to most employment practitioners. Mr Smith's employment terminated in early May 2011. He brought various claims in an ET1 lodged (within three months of termination) on 1 August 2011, including for holiday pay.

2. The question of Mr Smith's employment status was considered by the Tribunal as a preliminary issue. It found that he was a "worker" for the purposes of the Working Time Regulations 1998, although he was not working under a contract of employment. Mr Smith also brought a claims of disability discrimination and he was held to be in "employment" under the confusing terminology used in s.83 Equality Act 2010. However, this alerter is not concerned with this element of Mr Smith's claim.

3. The Tribunal's decision on worker status was upheld at every stage of appeal up to and including the Supreme Court, which delivered its judgment in June 2018. However, that was not the end of the matter, as Mr Smith's claim was then remitted to the Tribunal to consider his substantive complaints – seven years after he had left.

4. This required the Tribunal to consider the effect on Mr Smith's claim of the ECJ decision in *King v Sash Window Workshop Ltd* (C-214/16) [2018] 2 CMLR 10, [2018] ICR 693 ("*King*"). It is necessary to summarise the significance of the decision in *King* in order to make clear what the Court of Appeal's recent decision in *Smith* actually decided.

5. Mr King was a salesman who was categorised and treated by his employer as self-employed; he was never paid any holiday pay. Mr King brought various claims when his employment was terminated in 2012, including for holiday pay which he claimed right back to the commencement of his employment in 1999. That claim was divided into three by the Tribunal in Mr King's case as follows:

   (a) Accrued but untaken leave in the final (incomplete) leave year (described as "Holiday Pay 1");

   (b) Payment for unpaid leave actually taken over the 13 years ("Holiday Pay 2"); and

   (c) Payment for leave to which Mr King was entitled during the whole period of his employment but did not in fact take ("Holiday Pay 3"). (Note that Mr King claimed not just the 4 weeks mandated by the Directive, but also the 1.6 weeks per year of additional annual leave to which he was entitled under the domestic legislation, the WTR, from 2007 onwards; the Respondent did not dispute this.)

6. Mr King succeeded in full before the Tribunal on all three elements of his holiday pay claim, and recovered the equivalent of 4 or 5.6 weeks' pay for each year he had worked. The Respondent appealed, but only on Holiday Pay 3. They would have been better advised to appeal on Holiday Pay 2 as well, which was (in effect) addressed by the EAT in the separate case of *Bear Scotland v Fulton* [2015] ICR 221 (*"Bear Scotland"*), with complex consequences for employment practitioners. The way that the issues were split meant that when the *King* case reached the ECJ (via the EAT and Court of Appeal), only Holiday Pay 3 remained in issue.

7. The ECJ in essence upheld the decision of the Tribunal in *King*, and confirmed that where a worker was unable to take paid annual leave because his employer miscategorised him and refused to pay him for it, he could recover a payment in lieu on termination right back to the start of his employment – with the applicable limitation period running from termination. Although the ECJ was

only considering the leave which Mr King had not taken, most practitioners took the view that the ECJ's forthright judgment was also applicable to unpaid leave which had been taken – because, as the ECJ repeated in *King,* under the Working Time Directive *"the right to annual leave and to a payment on that account [are] two aspects of a single right."*

8. However, a number of loose ends in King were not resolved as the case settled shortly before it was due back in the Court of Appeal after the ECJ decision.

THE DECISIONS OF THE TRIBUNAL AND THE EAT IN *SMITH*

9. In March 2019, the Employment Tribunal considered and rejected Mr Smith's claim for unpaid holiday pay. It held (in summary) that:

   (a) Mr Smith had brought a claim to be paid for (unpaid) leave that he had taken, but had not brought a claim for (paid) leave to which he was entitled but did not take;

   (b) his last period of unpaid leave ended on 4 January 2011 and should have been paid for on 5 February 2011 when Mr Smith received his payslip; and

   (c) his claim should therefore have been presented by 4 May 2011 but was not. It was therefore almost three months out of time and there was no basis on which to extend time.

10. Mr Smith sought a reconsideration, which was rejected. He then appealed to the EAT. On 17 March 2021, the EAT (Choudhury P) dismissed that appeal. The judgment was lengthy but it essentially upheld the reasoning of the Tribunal, and came as a surprise to many employment lawyers familiar with this area. It greatly reduced the effect of *King* for claimants: most people take a few weeks of holiday a year even if they are not paid for it. The EAT decision in *Smith* effectively meant that a miscategorised worker could not seek to claim the money he should have been paid for those holidays as a payment in lieu in termination, but could only claim them by way of claims during employment (either under the WTR or as unlawful deductions under the ERA). The payment in lieu permitted by *King* (and the limitation period running from termination of employment) only related to leave that had not been taken at all.

11. This was bad news for claimants, but excellent news for employers – particularly non-compliant ones. An employer could now deliberately

miscategorise its staff and refuse to pay for holidays, safe in the knowledge that a claim on termination to recoup sums due for holidays actually taken would (mostly, and possibly entirely) be out of time. Since its supposedly "self-employed" workers would have no protection from unfair dismissal during employment, the likelihood of them risking their job to bring a Tribunal claim for a week or so's holiday pay while still employed was remote.

THE DECISION OF THE COURT OF APPEAL

12. The Court of Appeal handed down judgment last week, on 1 February. The only substantive judgment was delivered by Simler LJ (which whom Laing and King LJJ agreed). She addressed the appeal under three issues, as follows:

    (a) Issue 1: *"Did the tribunals below err in law in holding that Mr Smith's only pleaded claim was for pay for the holiday leave he actually took (without pay) during his engagement with the respondent?"* (Paragraphs 42-58.)

    (b) Issue 2: *"the proper scope of King and its application to Mr Smith's case"* (Paragraphs 59-90)

    (c) Issue 3: *"is a 'series of deductions' within the meaning of section 23(3)(a) ERA broken by a gap of three months or more?"* (Paragraphs 91-101)

13. On Issue 1, the Court of Appeal upheld the decisions below and agreed that Mr Smith had not brought a claim for holiday pay in relation to leave which he never took: he was only claiming to be paid for the unpaid leave he had taken. This was based on a review of Mr Smith's ET1 (which he had not applied to amend, even after the *King* decision) and certain other documents. Interestingly, the Court of Appeal considered that his claim for payment in lieu in relation to leave not taken should have been brought under Regulation 14 WTR, whether or not he specifically referred to that provision. We return to this point below. The effect of the finding on Issue 1 was that Mr Smith had to establish that *King* applied to (unpaid) holidays he had actually taken, since Issue 1 knocked out his claim in relation to untaken leave.

14. On Issue 2, Simler LJ carefully analysed the ECJ judgment in *King* and concluded that it applied not just to leave taken, but to leave not taken as well. In other words, the right to payment for the leave taken continued to roll over during Mr Smith's employment until he could exercise those rights; and since he could not exercise them during the employment relationship, they only became

capable of being exercised when his employment terminated and he was entitled to claim a payment in lieu. The appeal was therefore allowed. Simler LJ summarised the position at §89:

> *[T]he respondent's approach meant Mr Smith was prevented by reasons beyond his control from exercising the right throughout his employment. Since he could only lose the right to paid annual leave if he actually had the opportunity to exercise the right to paid annual leave under article 7(1) WTD… those rights accumulated and crystallised on termination.*

15. Given her conclusion on Issue 2, it was not necessary for Simler LJ to consider Issue 3, which would only have arisen if she had concluded that Mr Smith's claim for payment for the leave he took could not be framed as a payment in lieu on termination and instead had to be presented as a claim for a series of unlawful deductions. But after hearing argument on the point, and no doubt aware of the continuing importance of the decision in *Bear Scotland*, Simler LJ did express her *"strong provisional view"* in an obiter passage from para 91.

16. In summary, she preferred the analysis of the NICA in *Chief Constable of Police v Agnew* [2019] NICA 32 (*"Agnew"*) and indicated that there was no requirement that there should be a gap of not more than 3 months between deductions for them to form part of a series for the purposes of s.23(3) ERA 1996: a "series" could involve longer gaps. However, the lawfulness of the two-year longstop for unlawful deductions claims in s.23(4A) ERA 1996, was introduced after Mr Smith's claim was begun and was not considered. The powerful arguments against that particular restriction will have to wait for another day.

COMMENT

17. There are two important, positive aspects of the judgment. First, the Court of Appeal overturned the EAT and confirmed that the principles in *King* (and the possibility of bringing a payment in lieu on termination) apply not just to leave that was not taken, but to the whole entitlement to paid leave.

18. This is a welcome and overdue development on which Simler LJ's analysis is clearly correct. What is surprising is that this issue had to get to the Court of Appeal before being corrected. The short point is simply that *"the taking of unpaid leave could not and did not discharge the obligation to provide paid annual leave"* (as Simler LJ put it at §89). It was the EAT's failure to grasp this which led

it into error. The *status quo ante* has been restored, and it has been confirmed that the significance of *King* goes beyond cases involving *"holiday pay 3"*.

19. Part of the problem, of course, is the bizarre drafting of the Working Time Regulations, which split the single right to paid annual leave set out in the Directive into two separate rights: to take leave (WTR 13) and to be paid for it (WTR 16), with distinct remedies for each in WTR 30. For employees, in a relationship where both parties are aware of the right to paid annual leave, this arrangement will generally work. But for mere "workers", who are often miscategorised and/or unaware of their employment rights, it often does not.

20. The Court of Appeal also confirmed (at §72 and §86) that there is no need for a worker to show that he was actually deterred from taking leave because he was not paid for it: the mere uncertainty of whether or not the leave would be paid is "liable" to deter the worker from taking leave, and that is sufficient. On this point too the Court of Appeal was (correctly) applying the decision in *King*.

21. The second significant point is Simler LJ's obiter remarks about *Bear Scotland* and the much-criticised requirement it laid down that for any deductions to be recoverable there had to no gap of more than three months. Now that *Agnew* has been stayed for mediation and is no longer pending before the Supreme Court, this guidance is welcome (although in most claims for a payment in lieu, unlikely to be significant, since time only runs from termination).

22. However, the Court of Appeal decision remains unsatisfactory because of its approach to Issue 1, i.e. the nature of the claim that Mr Smith had brought. Since it correctly found that the right to paid leave was a *"single right"*, and that *King* established that a payment in lieu could apply to both taken and untaken leave, it is odd that the Court of Appeal distinguished between taken and untaken leave in its analysis of what Mr Smith was claiming in his ET1 in 2011.

23. At paragraph 89, Simler LJ said this (entirely correctly, with added emphasis):

> *Mr Smith's claim form was lodged with the employment tribunal within three months of his date of termination. His pleaded claim was that he was denied "paid holidays from the outset". That is consistent with the fact that his contract precluded paid annual leave, and his employer failed to recognise his status as a worker who had such rights. He alleged that the failure to allow his entitlement to paid holidays continued each year up to the date of termination. Accordingly, a claim that he was denied the single right to paid*

> *annual leave because his employer disputed the right and refused to remunerate leave was inherent in Mr Smith's pleaded claim. It was not necessary for him to specify whether the leave was untaken or taken but not paid. His case was that unpaid leave breached his rights.*

24. However, when considering Issue 1 earlier in her judgment, Simler LJ said this:

> *55. It is true that the claim for "paid annual leave" each year was pursued as a deduction from wages claim. That does not exclude a claim for pay in lieu of untaken leave, but if that is what was being claimed, the substance of that claim could and should have been pleaded. It was not necessary for Mr Smith to refer expressly to regulation 14 (although he was legally advised throughout, and repeated references to regulations 13 and 16 suggest that such a reference would have been made if it was relied on). However, it was incumbent on him to identify the substance of his claim. After all, he must have known whether or not he took the full leave entitlement each year, and could have been expected to plead the basis of a claim that some leave was not taken, even if he did not have the records to identify precisely when and in what amount.*
>
> *56. In those circumstances, I agree with the tribunals below that the pleaded case was not clear enough and entitled them to conclude that, in substance a claim on termination, pursuant to regulation 14, for pay in lieu of leave which had not been taken (whether throughout the engagement or its final year), was not pleaded.*

25. This led to what is a rather unsatisfactory conclusion to the judgment:

> *103. A claim to payment for all the leave which Mr Smith took but for which he was not paid in breach of his right to paid annual leave was inherent in Mr Smith's pleaded case. It follows that the tribunals below erred in law in deciding otherwise. Moreover, this claim was in time because he was denied the opportunity to exercise the right to paid annual leave throughout his engagement with the respondent. The respondent could not discharge the relevant burden. The right did not therefore lapse but carried over and accumulated until termination of the contract, at which point Mr Smith was and remains entitled to a payment in respect of the unpaid leave.*
>
> *104. However, for the reasons I have given, the tribunals below did not err in holding that Mr Smith did not plead a claim, either, for payment in respect of*

> *the paid leave to which he was entitled during his employment but which he did not take, or for a remedy under regulation 14 of the WTR on termination.*

26. Having (correctly) found that the employer had infringed Mr Smith's single right to paid leave, any breach of which would entitle him to a single payment in lieu, the Court of Appeal should have found that a claim for a payment in lieu in relation to leave not taken was just as much "inherent" in the pleaded case as the same claim in relation to leave he did take.

27. In taking such a prescriptive approach to Tribunal pleadings in this area, it is submitted that the Court of Appeal has introduced an unnecessary and unwelcome new complexity. For many miscategorised workers, neither they nor their employer will keep accurate records of their annual leave. Since they are not paid for it, there is no need to do so – and very often it might not even be "leave" in any event, since there may be no need to distinguish between (for example) holidays, time off sick, or time when no work is available.

28. Many such workers will be unaware of their rights during employment and (if unrepresented) even when bringing a Tribunal claim: they cannot be expected to know whether they are bringing a claim for leave taken or leave not taken, or why this matters – and as the ECJ has made clear, it doesn't matter for the purposes of the Directive. What these workers <u>do</u> generally know is that they were never paid for their holidays, and once the employment has terminated they can do something about it with nothing to lose.

29. There is no reason to force claimants to articulate which aspect of the single right they are relying on. To do so would be inconsistent with the Directive and *King* (as correctly read by the Court of Appeal): there is a single right to paid leave. It is also inconsistent, it is suggested, with the approach generally taken to discrimination claims, where all the claimant usually needs to do is set out a factual outline (often without even explicitly claiming discrimination) and the appropriate labels under the Equality Act will be applied at the first PH.

30. A further oddity in the Court of Appeal's judgment is its clear suggestion (e.g. at §§46, 55, 56 and 104) that a claim for a payment in lieu on termination for untaken annual leave must be brought under WTR 14. But that is far from clear. Regulation 14 applies to the *pro rata* calculation of a payment in lieu only for the final (incomplete) leave year of the employment. It does not give any

substantive entitlement, or prescribe any calculation, for a payment in lieu in relation to earlier years.

31. Recent ECJ jurisprudence has made clear that Article 7 of the Directive (via Article 31 of the EU Charter of Fundamental Rights) can, effectively, have horizontal direct effect. Since these cases were decided before Brexit Day, they should form part of retained EU law. As a result, there is now less pressure on litigants and the Tribunal to find an interpretation of the WTR which conforms to the Directive. However, should any such interpretation be required, the correct source of the right to a payment in lieu in the domestic legislation is not WTR 14 but WTR 13(9), which provides as follows:

> *Leave to which a worker is entitled under this regulation may be taken in instalments, but—*
> *(a) [subject to the specific coronavirus exceptions in paragraphs (10) and (11),] it may only be taken in the leave year in respect of which it is due, and*
> *(b) it may not be replaced by a payment in lieu except where the worker's employment is terminated.*

32. Whilst Mr Smith's ET1 could no doubt have been clearer, it is odd that he has been shut out of his claim for leave he did not take on what amounts to a pleading point. This does not simply affect Mr Smith's case. The fact that his claim for untaken leave cannot proceed sends a message to employers: the risk of deliberately miscategorising staff who should be workers as *"self-employed contractors"* is worth it. Whilst they are employed, the employer pays no holiday pay and gains a significant advantage over its competitors. On termination, it might have to cough up – but only if a claim is brought and very precisely pleaded. Even then, there is still no explicit jurisdiction to award interest, so the employer obtains (at the very least) a major cashflow advantage. And Tribunals still appear to assume that *King* does not apply to *"additional annual leave"* under WTR 13A – potentially wrongly, but that is a separate debate. So for now employers would be well advised not to pay for annual leave for any staff of remotely uncertain employment status, since even if they are found out it is still cheaper than compliance.

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James Williams acted for Mr King at all stages in King v Sash Window Workshop.