King & Spalding
Client Alert

FEBRUARY 2022

For more information, contact:

Jules Quinn

+44 20 7551 2135
jmquinn@kslaw.com

Marie Hoolihan

+44 20 7551 7587
mhoolihan@kslaw.com

King & Spalding

Important Court of Appeal Decision on Historic Holiday Pay Claims

Key Takeaways for Employers

The UK's Court of Appeal has issued a significant holiday pay decision, *Smith v Pimlico Plumbers* [2022] EWCA Civ 70, ruling that workers who were misclassified as independent contractors can recover compensation for holiday pay for the whole period of their engagement. This reversed the decision of the lower tribunals, which found that any claim for unpaid holiday pay had to be made within three months of the last period of holiday and did not carry over until the end of the engagement.

The decision is significant not only for businesses who operate in the gig economy, but for all organisations who engage the services of independent contractors and workers. The case puts employers with contingent workers at increased risk of holiday pay claims. This month's alert summarises the implications of the long-running case as well as another recent development for gig economy employers, a new EU directive on digital platform workers.

PIMLICO PLUMBERS PART TWO – THE FACTS

The Pimlico Plumbers case is the latest ruling in a long-running legal battle between a plumbing engineer and Pimlico Plumbers. Mr Smith worked for Pimlico as an independent contractor for six years until his contract was terminated in 2011. Mr Smith then alleged that he had been unfairly dismissed and discriminated against, and that he was owed holiday pay. The question of Mr Smith's employment status made it all the way to the Supreme Court, which found Mr Smith to be a worker rather than a self-employed contractor.

After the Supreme Court had the fourth and final say on the preliminary issue of Mr Smith's status in 2018, the case was returned back to the Employment Tribunal to determine the compensation payable as a result of Mr Smith's misclassification, including for unpaid holiday. The case

has now made its way back up through the Employment Appeal Tribunal (**EAT**) to the Court of Appeal.

At the Court of Appeal hearing, Pimlico accepted that Mr Smith was entitled to paid leave as a result of his worker status, but argued that he was out of time to enforce his rights. Mr Smith had taken unpaid leave during his engagement and had taken no steps to invoke his right to paid leave until after his contract was terminated.

Mr Smith argued that the previous decision of the European Court of Justice (**ECJ)** in *King v Sash Window Workshop* entitled him to bring a claim on the termination of his engagement in respect of all unpaid annual leave accrued throughout his engagement. In that case, the ECJ ruled that where a worker has been denied paid holiday, they will be entitled to carry over paid annual leave rights under the European Working Time Directive and can claim a payment in lieu back to the start of the engagement. This was notwithstanding that carry over of leave is generally not permitted in the UK.

The EAT in *Pimlico* had found that the principle in *King* only applied if the worker had not taken holiday at all. Overturning the EAT's decision, the Court of Appeal has confirmed that the principle in *King* is not limited to circumstances where the employee has not taken annual leave, but applies equally where annual leave has been taken but is unpaid because the employer refused to remunerate it. The proceedings were commenced before the completion of Brexit on 31 December 2020 which means that the UK courts must still follow existing ECJ case law.

This ruling is significant because it means that workers can effectively avoid the two-year backstop on holiday pay claims to which employees are subject under the Employment Rights Act 1996 (**ERA**). Note that this decision only applies to the four weeks' of EU-derived annual leave, not the additional 1.6 weeks of leave provided in the UK's domestic Working Time Regulations (or any enhanced contractual annual leave).

It remains to be seen whether we will see the parties back in the Supreme Court for an appeal of this decision.

USE THE "THREE-MONTHS' RULE" WITH CAUTION

Pimlico unsuccessfully argued that the EAT's decision in *Bear Scotland* should be followed. The *Bear Scotland* decision found that a claim for unpaid holiday can be brought as a claim for unlawful deductions from wages under the ERA. In general, such a claim must be made within three months of the date of payment of the wages from which the deduction was made. Where a complaint is made about a "series of deductions", the three months' period runs from the last deduction in the series. In *Bear Scotland* it was held that a gap of more than three months between failures to pay correct holiday pay would "break" a series of deductions, leaving workers and employees out of time to challenge earlier holiday pay.

The Court of Appeal gave a "strong provisional view" that *Bear Scotland* was wrong. The Court of Appeal opined that the existence of a three-months' time limit for bringing claims was a "weak basis" for inferring that Parliament did not intend to link similar payments occurring more than three months apart. The Court of Appeal did actually not overrule the EAT on this point because Mr Smith was out of time to bring any deduction from wages claims and therefore the issue did not actually arise. However, this opinion is likely to be persuasive in future holiday pay cases. Employers should be aware that they may no longer be able to rely on a three months' gap in holidays to prevent claims from being brought.

THE COSTS OF GETTING IT WRONG

The Pimlico legal battle is a stark reminder of the costs of getting employment status wrong. Obtaining worker status is a 'gateway right' and misclassified workers will become entitled to more than just holiday pay. The rights which flow from being categorised as a "worker" include:

- the national minimum wage for work done;

- paid annual leave, statutory minimum rest breaks and statutory sick pay;
- protection from unlawful deduction from wages;
- the right to a written statement of terms and the right to apply for statutory recognition for collective bargaining purposes;
- the right to be accompanied at disciplinary and grievance hearings;
- pension auto-enrolment;
- the right not to be treated less favourably for working part-time; and
- protection for 'whistleblowing' and from unlawful discrimination.

Unlike employees, workers do not have the right not to be unfairly dismissed. They also have no entitlement to statutory minimum notice periods or statutory redundancy pay. In addition to the costs of the above worker rights, businesses will incur tax/payroll costs (including national insurance costs) and potentially, related penalties, interest and filing costs.

IDENTIFY YOUR RISK EXPOSURE

If your workforce contains self-employed contractors, you will want to be confident in their status and categorisation. Businesses should review contractor agreements for misclassification risks and look out for any "red flags" which may indicate worker status (summarised below). Assess whether any self-employed contractors may in fact be workers, having regard to the working relationship in practice.

If there is a risk that your workforce has been misclassified, quantify historic holiday pay liability for your worker population. Exposure is limited to the four weeks' of paid leave per year under the European Working Time Directive (not 5.6 weeks). For example, any worker who has been with the company for 10 years, can pursue a claim for 40-weeks of holiday pay upon termination of their engagement. Any former contractors whose arrangements terminated over three months ago can be disregarded as their claims should now be time-barred.

These claims are a key risk to be considered as part of any M&A due diligence. Buyers should ensure they protect themselves against potential holiday pay liabilities with warranties and indemnities, whether in relation to misclassified contractors or other workers generally.

REVIEW YOUR CONTRACTOR ARRANGEMENTS – A REMINDER OF THE TESTS

Each status assessment will depend on its own facts and can be a difficult balancing exercise. Recent case law such as last year's *Uber* decision has highlighted the problems with the existing state of the law on employment status and how difficult it can be to determine whether someone is a worker or self-employed contractor.

In 2018, the UK government released its policy paper, the Good Work Plan, which recognised the lack of clarity faced by individuals and employers due to the existing employment status tests. The government committed to refining the tests to improve clarity and to reflect the reality of modern working relationships. Unfortunately, no progress has yet been made to do so. Until then, businesses must rely on the various tests developed by case law.

Businesses should review the status of their contractors and look out for the following "red flags" which may indicate worker status:

- **Control**: Exercising a high degree of control over the way in which a contractor performs their services is inconsistent with him or her being a self-employed contractor in business on his or her own account. Factors which point to control include:

- Inequality of bargaining power, with the contractor having no or very limited ability to deviate from the standard terms set by the organisation;
- The absence of negotiation in pay, with the contractor having limited ability to improve their economic position (other than by choosing to work longer hours);
- Monitoring the activity of the contractors and subjecting them to a penalty if work is declined;
- The contractor not being free to develop their own relationship or client base due to the control of interactions by the business;
- Using customer ratings to manage performance; and
- Prescribing how tasks are to be performed and when or where they must be performed.

- **Personal service**: There being a requirement for the contractor to perform the services personally or a fettered right to provide a substitute. This is a necessary ingredient of being a worker.
- **Mutuality of obligation**: There being an obligation or expectation for the contractor to accept the work offered (with consequences for declining work) or an obligation on the part of the business to provide any level of work.
- **Exclusivity**: The contractor only working for the principal organisation, with limited opportunities to work for several different clients or customers.
- **Integration**: The contractor has been recruited to work as an integral part of the business as opposed to actively marketing their services to the world. Factors that suggest integration into the business include:
  - The individual performing a role which is an integral part of the business rather than merely being an accessory to it;
  - The individual being "part and parcel" of the organisation, for example they are responsible for the management of staff;
  - The contractor is required to wear a uniform; and
  - The contractor is subject to employment policies and procedures and is on telephone and email lists.
- **The dominant purpose test:** If the dominant feature of the contract is the obligation personally to perform work, this will indicate employment or worker status. If, on the other hand, the dominant feature is a particular outcome or objective, and the obligation to provide personal service is incidental or secondary to this, the contract will lie in the business field.

Other factors that may be taken into account include the term of the engagement, the contractor being provided with the necessary equipment to provide the services, the contractor assuming no risk and receiving payment of a fixed wage or salary.

NEW EU PROPOSALS ON DIGITAL PLATFORM WORKERS

The Pimlico holiday pay case is not the only development causing concern for employers with contingent workforces. On 9 December 2021, the European Commission proposed a new directive aimed at harmonising the legal status and working conditions of platform workers in the European Union.

The draft Directive would introduce a legal presumption that the platform worker is in an employment relationship when a digital labour platform 'controls' the work of the platform worker. A platform would be presumed to be "controlling the performance of the work", when at least two of the following criteria are satisfied:

a. "effectively determining, or setting upper limits for the level of remuneration;

b. requiring the person performing platform work to respect specific binding rules with regard to appearance, conduct towards the recipient of the service or performance of the work;

c. supervising the performance of work or verifying the quality of the results of the work including by electronic means;

d. effectively restricting the freedom, including through sanctions, to organise one's work, in particular the discretion to choose one's working hours or periods of absence, to accept or to refuse tasks or to use subcontractors or substitutes;

e. effectively restricting the possibility to build a client base or to perform work for any third party."

Where two or more of these conditions are satisfied, the platform worker can presume they are an employee regardless of what their contract says. The presumption of employment would be rebuttable by the platform, which would have to prove that the relationship was not actually an employment relationship as defined in domestic law.

In addition, the draft Directive also aims to enhance transparency in any automated system used to monitor or supervise work to ensure fairness and accountability of any decisions taken or supported by automated systems. The platforms would have to provide workers with specific information on the monitoring and decision-making systems used and the impact these systems have on working conditions, such as their access to work assignments, earnings, working time, occupational health and safety, and any restriction, suspension or termination of their account.

There is currently no timeline for the draft Directive to become binding and it still needs to be negotiated by governments of Member States. The Directive may well be watered down before it is implemented.

The Commission's proposal notes that nine out of ten platforms that are active in the EU are estimated to classify the people working for them as self-employed. The Commission has reported that between 1.72 million and 4.1 million people across Europe are wrongly classified as self-employed.

The draft Directive divides working status between employed and self-employed. It does not follow or incorporate the third in-between category of worker, as exists in the UK. As a result of Brexit, the UK will not have to adopt this Directive, but it will have significant implications for digital platforms with wider EU operations. The UK Government may well take the Directive into account when it circles back to its own Good Work Plan.