ALLEN & OVERY

Holiday pay

Where are we now?

July 2018

Holiday pay – where are we now?

The right to paid holiday has become the most litigated aspect of working time rules, in particular the extent to which holiday pay should take account of commission, bonuses and overtime payments. Several ECJ rulings have clarified the general principles, but UK rules are not yet settled on the practicalities of calculating holiday pay. Piecing together the ECJ and UK court rulings, we outline the rules as they stand and highlight grey areas still to be resolved.

Regulation 13

First four weeks' holiday guaranteed by **EU law**

Regulation 13A

1.6 weeks' additional holiday given by **UK law**

KEY			
WTR	Working Time Regulations 1998	Regulation 13 holiday	First four weeks of holiday
ERA	Employment Rights Act 1996	Regulation 13A holiday	Additional 1.6 weeks of holiday
ECJ	European Court of Justice	Contractual holiday	Any holiday in excess of 5.6 weeks
EAT	Employment Appeal Tribunal		

The basics

The starting point – "a week's pay" for a week's holiday

The WTR give UK workers 5.6 weeks' holiday, made up of the minimum four weeks' holiday guaranteed by the EU Working Time Directive (Regulation 13 holiday) and an additional 1.6 weeks of holiday given by UK law (Regulation 13A holiday). This holiday is paid at the rate of "a week's pay" as calculated under the ERA.

The ERA rules prescribe different calculation approaches depending on whether workers have normal working hours and, if so, on whether their hours and pay fluctuate.

The EU law gloss

The ERA rules permit holiday pay for workers with normal working hours who earn a fixed salary (regardless of the hours worked or amount of work done) to be based on pay for their normal hours which usually means basic salary only, disregarding any commission payments, bonuses or overtime premiums.

In the case of *Lock* v *British Gas Trading Ltd* (2014), the ECJ confirmed its earlier view (in *Williams and others* v *British Airways*) that pay for the minimum four weeks' holiday under the Directive should be based on "normal remuneration", which includes any payments that are directly and intrinsically linked to the performance of a worker's contractual tasks and any payments relating to his or her personal and professional status. It ruled that ERA rules permitting Regulation 13 holiday pay to be based on basic salary only are therefore incompatible with the Directive as they do not take into account commission earned.

Following these rulings, the EAT confirmed in *Bear Scotland* v *Fulton* (2014) and the Court of Appeal in *Lock* (2016) that Regulation 13 holiday pay must be based on pay that is normally received, to include any commission, bonuses and overtime directly and intrinsically linked to the work that the worker is required to do. The Court of Appeal agreed that Lock should have his contractual results-based commission taken into account but confined its ruling to his specific circumstances. The outcome in other cases will also depend on their facts – the worker concerned, their working pattern and remuneration structure.

What is included in holiday pay?

The first stage of a holiday pay calculation involves identifying a worker's pay and working pattern, checking the correct ERA calculation approach for that worker and then determining which pay components should be factored into their holiday pay.

Workers with normal hours and fixed pay: These workers get paid at different rates for their Regulation 13 holiday (which must be based on the more generous ECJ principles) and for their Regulation 13A holiday (to which the normal ERA rules apply). Their Regulation 13A holiday pay will be their contractual pay for a normal working week, meaning that only commission and bonuses to which they are entitled for working their normal hours will be included.

Workers with normal hours whose pay fluctuates with the amount of work done: For these workers, a week's pay is based on their average weekly pay in the preceding 12-week period, including bonuses, overtime and commission. This approach is likely to be compliant with ECJ rulings for Regulation 13 holiday pay (assuming future case rulings accept 12 weeks as an appropriate reference period). However, only bonuses and commission which vary with the amount of work they do count towards their Regulation 13A holiday pay.

Workers with normal but variable hours: The same approach – average weekly pay in the preceding 12-week period, including bonuses, overtime and commission – applies, except that average pay is based on the average normal weekly working hours over the 12-week period.

Workers with no normal working hours: The 12-week averaging approach also applies for workers with no normal working hours (for example, casual, zero-hours or other part-time staff). However, weeks in which a worker has no entitlement to remuneration are disregarded.

12 weeks

The reference period for averaging pay for workers with irregular hours

Two years

The backstop period which applies to claims brought after **1 July 2015**

At a glance: When does holiday pay include overtime, commission and bonuses?

This table summarises the current position based on ECJ and domestic case rulings.

Pay component	Reg 13 WTR holiday (the first four weeks)	Reg 13A WTR holiday (additional 1.6 weeks)	Contractual holiday (days in excess of 5.6 weeks)
Guaranteed overtime (overtime which the employer is required to offer and the employee is required to work)	Yes.	Yes, as such overtime counts as normal working hours (according to the 2004 Court of Appeal ruling in *Bamsey*).	No, unless contractually agreed.
Non-guaranteed overtime (overtime which the employer is not required to offer but which, if offered, the employee is required to work)	Yes, if it is paid for a sufficient period of time to justify the label of "normal remuneration". Further case law guidance is awaited on the application of this test.	No, unless contractually agreed.	No, unless contractually agreed.
Voluntary overtime (overtime which the employer is not required to offer and which the employee is not required to work)	Yes, if it is paid regularly or repeatedly for a sufficient period of time to justify the label of "normal remuneration". Further case law guidance is awaited on the application of these tests.	No, unless contractually agreed.	No, unless contractually agreed.
Commission	Yes, if it is intrinsically or directly linked to work that the employee is required to do. Sales-based commission would be included, unless the scheme effectively compensates for holidays.	This depends on the structure of the scheme. No, if the commission is not part of the entitlement for normal working hours and does not vary with amount of work done (results-based sales commission would be excluded).	No, unless contractually agreed.
Bonuses	Bonuses are a particular grey area on which further case law guidance is awaited. Arguably any bonus based on employee performance is included, unless genuinely discretionary or calculated over a longer period (for example, an annual bonus).	This depends on the structure of the scheme. No, if the bonus is not part of the entitlement for normal working hours and does not vary with amount of work done (performance bonuses linked to employee output would probably be included).	No, unless contractually agreed.
Allowances	Yes, if the allowance is more in the nature of a bonus and is intrinsically or directly linked to work that the employee is required to do. No, if it is to reimburse the employee for costs incurred. Tribunals will scrutinise allowances to determine on which side of the line they fall.	This depends on the purpose and terms of the allowance. If it is akin to a bonus, no, if it is not part of the entitlement for normal working hours and does not vary with amount of work done. If it is an expenses allowance, no.	No, unless contractually agreed.

Taking a uniform approach

How do you deal with the administrative challenge of applying and calculating different holiday pay rates for Regulation 13, Regulation 13A and contractual holiday? One approach is to pay all holiday at a uniform rate. However, as Regulation 13 holiday must be paid at the minimum rates required by EU law, and you may have agreed contractually to pay Regulation 13A and contractual holiday at a higher rate, levelling up will mean a higher holiday pay bill. Ultimately, any such increase is likely to be factored into pay increase negotiations.

If you do choose to pay holiday at different rates, you should consider which periods of holiday the higher rate will apply to. The law does not specify which periods qualify as Regulation 13 holiday and which qualify as Regulation 13A holiday. There is reason to assume that Regulation 13A holiday follows Regulation 13 holiday since it is described as "additional leave". Helpfully, the EAT also suggested in *Bear Scotland* that it is for an employer to choose which type of holiday is taken when. You could therefore consider limiting your liability by specifying in your policy that holiday taken during and immediately after busy periods (when more overtime has been worked) is Regulation 13A or additional contractual holiday (which is not subject to EU law payment constraints).

How should holiday pay be calculated?

Having identified the components of holiday pay, the next stage is to calculate the amounts. How do you go about this, particularly where amounts of commission or overtime fluctuate? It is still a grey area but, unpicking the case rulings, there are some general principles which you can work with.

Employees with a settled pattern of work

In *Bear Scotland*, the approach for calculating the EAT's view is that Regulation 13 holiday pay will depend on whether the worker in question has a settled pattern of work (which is likely to cover those with normal working hours whose pay and hours do not fluctuate). For those with a settled pattern of work, then the amounts should be based on pay which they normally receive. The same principles apply for Regulation 13A holiday pay.

Employees with no settled pattern of work

If the worker has no settled pattern of work, then the EAT's view is that Regulation 13 holiday pay should be calculated by averaging pay over an appropriate reference period determined by national law. The ECJ also ruled that holiday pay should be an average amount based on a reference period considered to be "representative" under national law.

What is the appropriate reference period for averaging Regulation 13 holiday pay? There is not yet any definitive case law guidance on this issue. As explained on page 4, the ERA provisions already use a 12-week reference period to calculate holiday pay for some categories of workers. Also, the Court of Appeal approved the Employment Tribunal's decision in *Lock* categorising the claimant as equivalent to a piece worker for whom a 12-week reference period would apply; the EAT similarly appeared to endorse the use of a 12-week reference period in *Dudley Metropolitan Council* v *Willetts and Others* when calculating holiday pay that included payments for additional voluntary work.

Pending further guidance, you can therefore use a 12-week reference period to calculate commission, overtime or other variable payments. It remains to be seen whether Tribunals will re-write the WTR provisions in future cases to use longer reference periods where appropriate, for example, if commission or overtime payments fluctuate considerably during the year but are nevertheless part of a settled pattern of work. This would require you to flex your approach but, in the meantime, a 12-week period is a logical starting point.

The 12-week reference period should also be used when calculating Regulation 13A holiday pay, in accordance with the ERA rules. You could, however, choose to confine any stricter reference period requirements imposed by future case rulings to Regulation 13 holiday pay only.

How can employers manage historical liability?

Risk of historical liability

A worker claiming underpaid statutory holiday pay must bring an unlawful deduction from wages claim within a three-month time limit. As claims can also be brought in respect of a "series of deductions" from wages, there was initial concern about the potential for significant exposure to back-pay claims from workers who could argue that their holiday pay shortfall over a period of years amounted to a continuing series of deductions.

Reassuringly, the EAT's ruling in *Bear Scotland* and the statutory limit on retrospective unlawful deduction from wages claims have significantly mitigated this risk.

Bear Scotland – the "three-month rule"

The EAT in *Bear Scotland* confirmed that if there is a break between underpayments of more than three months, this breaks the series of deductions. In other words, if you pay the correct holiday amount at least three months after the last underpayment, this will extinguish claims for past underpayments. On the assumption that the 1.6 weeks' Regulation 13A holiday follows the four weeks' Regulation 13 holiday, a correct Regulation 13A holiday payment (the calculation of which is not constrained by EU law rules) would serve to remove historical liability.

The EAT's ruling on this point was confined to underpayments of non-guaranteed overtime but should, by analogy, be extended to commission underpayments (although that has still to be confirmed in future litigation). On this basis, by factoring commission correctly into holiday pay calculations going forward, you can reduce your risk exposure in respect of past underpayments (assuming a three-month period has elapsed), and can manage your risk of future claims.

There will be no further appeal in *Bear Scotland* and so, at least for now, the three-month rule remains valid.

Two-year backstop period

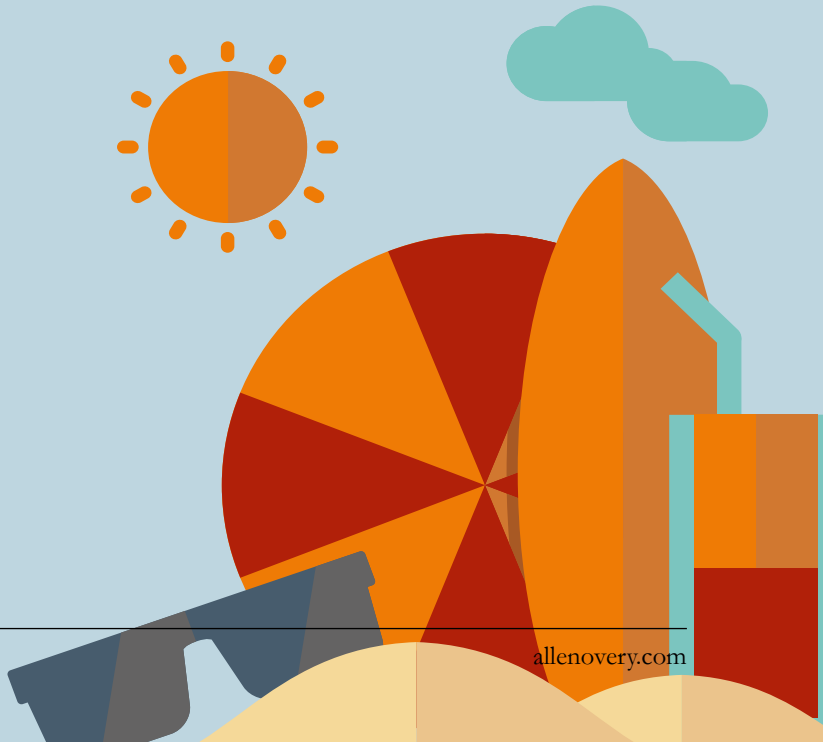
The Deduction from Wages (Limitation) Regulations 2014 (intended by the Government to limit the impact of the *Bear Scotland* ruling) impose a two-year backstop period on unlawful deductions from wages claims for holiday pay (and most other unlawful deduction claims). This applies to claims presented on or after 1 July 2015.

The future

Might we see any relaxation in holiday pay rules as a result of Brexit? We doubt it, at least in the short- to medium-term. UK courts and Tribunals must continue to apply ECJ rulings until the UK's withdrawal from the EU and during the post-Brexit transition period (until the end of 2020). The Government has pledged to protect workers' EU law rights and, in its recent White Paper, proposes that current employment laws be safeguarded (by the UK and EU) as part of any Brexit deal. Even in the longer term, ECJ case rulings are so embedded in our holiday pay case law that they are likely to remain influential.

The WTR and holiday pay rules are, however, considered by employers to be one of the most burdensome pieces of EU legislation. In the longer term, Brexit could provide a perfect platform from which to scale back some of the more costly and impractical aspects of the rules.

For the time being, the rules are much clearer than they once were – but they remain a moving target. Given the volume of holiday pay litigation before the Tribunals, it may be some time before we reach our final destination.



Key contacts

Rachel Reeves
Counsel
Tel +44 20 3088 2970
rachel.reeves@allenovery.com

Charlie Bowden
Associate
Tel +44 20 3088 7452
charlie.bowden@allenovery.com

Felicity Gemson
Senior PSL
Tel +44 20 3088 3628
felicity.gemson@allenovery.com

FOR MORE INFORMATION, PLEASE CONTACT:

London

Allen & Overy LLP
One Bishops Square
London E1 6AD
United Kingdom

Tel +44 20 3088 0000
Fax +44 20 3088 0088

GLOBAL PRESENCE

Allen & Overy is an international legal practice with approximately 5,400 people, including some 554 partners, working in 44 offices worldwide. Allen & Overy LLP or an affiliated undertaking has an office in each of:

Abu Dhabi
Amsterdam
Antwerp
Bangkok
Barcelona
Beijing
Belfast
Bratislava
Brussels
Bucharest (associated office)
Budapest
Casablanca
Doha
Dubai
Düsseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Istanbul
Jakarta (associated office)
Johannesburg
London
Luxembourg
Madrid
Milan
Moscow
Munich
New York
Paris
Perth
Prague
Riyadh (cooperation office)
Rome
São Paulo
Seoul
Shanghai
Singapore
Sydney
Tokyo
Warsaw
Washington, D.C.
Yangon

Allen & Overy means Allen & Overy LLP and/or its affiliated undertakings. The term **partner** is used to refer to a member of Allen & Overy LLP or an employee or consultant with equivalent standing and qualifications or an individual with equivalent status in one of Allen & Overy LLP's affiliated undertakings.