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Client Alert Commentary

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Important New Case on Holiday Pay: 7 Things UK Employers Need to Know

UK Employment Appeal Tribunal's decision could expose UK employers to claims of underpaying holiday pay in the past.

1. What are all the headlines about?

On Tuesday, 4 November 2014, the UK Employment Appeal Tribunal (EAT) issued its decision in *Bear Scotland Ltd & ors. v Fulton & ors.* and other consolidated appeals. The EAT ruled that voluntary overtime pay should be included in employee holiday pay. The EAT decision has wider implications on the complex question of how employers should calculate the amount of pay that employees receive during periods of holiday absence. Many employers, relying on the UK rules, have limited holiday pay to basic salary (excluding overtime, commission and other allowances). This week's EAT decision confirms that this approach is not always adequate and employers could now face retrospective claims for the underpayment of holiday pay.

2. What did the case determine?

The EAT ruled on four key points as follows:

(i) Non-guaranteed overtime should be taken into account when calculating employees' holiday pay.

(ii) Certain allowances (*e.g.* travel time payments which are not expense reimbursements) should also be taken into account when calculating employees' holiday pay.

(iii) These requirements to include overtime pay and allowances only apply to the mandatory four weeks' holiday required by the European Working Time Directive (the EU Directive) (and not the additional 1.6 weeks' leave that UK employees are entitled to under the UK Working Time Regulations (the WTR)).

(iv) Any claim for unpaid holiday pay must be brought within three months of the underpayment (or the last in a series of underpayments) and any interval of three months or longer between vacation periods will break the chain in any "series" of underpayment.

3. Is this decision unexpected?

No. The EAT decision follows the recent European Court of Justice (ECJ) cases which held that certain allowances and commission payments formed part of the employees' "normal pay" and therefore should be included in any calculation of their holiday pay.

4. Where are we now?

In the recent cases of *Lock* and *Williams*[1] the ECJ ruled that employees must receive their "normal remuneration" during holiday which includes:

- Any remuneration which is either intrinsically linked to the performance of tasks which the worker is contractually required to perform
- Remuneration relating to the worker's personal or professional status

These ECJ decisions related specifically to the inclusion of certain allowances and commission payments in holiday pay calculations but this week's EAT decision confirms that the same principle should apply to voluntary overtime pay too.

5. What does this mean for other pay components like bonus and commission payments?

Although *Lock* has been referred back to the UK employment tribunal to determine exactly how holiday pay should be calculated to include commission payments, it now seems certain that employers should be including all "normal" pay components in holiday pay including commission, overtime and allowances linked to status or performance. The inclusion of annual or discretionary bonus payments is still a grey area as an employer could argue that these are "extraordinary" elements of pay and therefore not necessarily intrinsic to the employee fulfilling his contractual duties. Note that the WTR apply to workers as well as employees so this decision will affect a wide population of workers.

6. Is there any good news for employers?

Yes. The EAT clarified that employees must claim for the underpayment of holiday pay within three months of taking their last holiday. If more than three months have elapsed since their last holiday, they cannot bring a claim. This restriction should significantly minimise the value of many employees' claims. Although in theory, an employee can still claim for the underpayment of holiday pay as far back as the earlier of the date their employment commenced or the introduction of the WTR (October 1998), if more than three months lapsed between vacation periods, any claim in relation to the earlier period will be out of time.

7. What should employers do next?

The EAT has given the parties leave to appeal its decision, so there could still be further developments on this issue. In addition, the UK government (which intervened in this case, arguing against the inclusion of voluntary overtime in holiday pay) has announced the creation of a "task-force" which will analyse the case in more detail with a view to limiting the impact of this decision on employers. How the government will achieve this remains to be seen, but in the meantime employers should calculate future holiday pay to include voluntary overtime pay, commission and allowances which are intrinsically linked to the employee's duties or status.

Employers should also consider amending employment contracts and holiday policies to clarify which periods of leave will be treated as the mandatory four weeks' leave required by EU law (for which holiday pay must now include overtime, commission, etc.) and which periods of leave will be treated as additional UK leave (for which holiday pay can be calculated under the more conservative interpretation of the UK WTR rules).

If you have questions about this *Client Alert*, please contact one of the authors listed below or the Latham lawyer with whom you normally consult:

Stephen M. Brown
stephen.brown@lw.com
+44.20.7710.1066
London

Sarah Gadd
sarah.gadd@lw.com
+44.20.7710.1858
London

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Endnotes

[1] *Lock v British Gas Trading Ltd 2014 ICR 813* and *British Airways plc v Williams and ors 2012 ICR 847*.