SUMMARY

2014/57 Non-guaranteed overtime must be included in statutory holiday pay but the scope for retrospective claims has been limited (UK)

<p>The Employment Appeal Tribunal (‘EAT’) has held that workers should be paid “normal remuneration” for their four week holiday entitlement under the Working Time Directive (the ‘Directive’). Normal remuneration includes payments for overtime which the employee must work if required by the employer but the employer is not obliged to offer (non-guaranteed overtime). The EAT also held that the Working Time Regulations 1998 (the ‘Regulations’), which implement the Directive into UK law, can be read purposively in order to achieve this, despite the fact that on the face of the wording they do not provide for such payments to form part of holiday pay.</p>

<p>In a blow for employees, however, the EAT has limited the extent to which employees can claim retrospectively for under-paid holiday by deciding that workers cannot bring claims for a series of “unlawful deductions” from holiday pay where there was a break of at least three months between successive underpayments.</p>

<p>Further, the additional 1.6 weeks’ annual leave

provided by the Regulations but not required by the Directive does not have to be paid at the rate of normal remuneration but can be paid at the rate set out in the Regulations.</p>

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Background

This case arose from a number of different claims which were joined to be heard together because they all raised similar issues. There were several cases because there has been an ongoing conflict between UK law (the Regulations) and EU law as to how holiday pay should be calculated.

The Directive states that workers have a right to at least four weeks' paid annual leave but it does not say how holiday pay should be assessed. The European Court of Justice (ECJ), however, ruled in the case of *Williams v British Airways plc* (2011) that holiday pay must be based upon "normal remuneration", which includes any payments linked intrinsically to the performance of the worker's tasks.

The Regulations, the UK implementation of the Directive, state that workers are entitled to 5.6

weeks' annual leave; that is, four weeks derived from the Directive and an additional 1.6 weeks equivalent to the eight days' traditional public holidays that employers often gave in the UK (such as Christmas Day). Under the Regulations, holiday pay is determined in accordance with the rules on calculating a week's pay in the Employment Rights Act 1996 (the 'ERA'), under which pay for employees who have "normal working hours" is based upon basic pay only, excluding other payments such as commission and overtime.

Workers can bring an 'unlawful deduction from wages' claim under the ERA if they are paid less than the wages to which they were entitled (including holiday pay), on that occasion. Normally a claim must be brought within three months of the deduction but if there has been a series of deductions the worker can bring a claim for the whole series,

provided that they bring the claim within three months of the last deduction in the series.

In the last few years there have been several employment tribunal decisions allowing holiday pay claims on the basis that workers were not receiving their full entitlement for their four-week EU annual leave entitlement, in breach of the Directive.

Judgment

The conjoined cases raised three key issues relevant to this case report. These were:

1.Is it required by the Directive that non-guaranteed overtime and allowances be included in holiday pay?

2.Could the Regulations and the provisions on a week's pay in the ERA be interpreted to give effect to the EU holiday pay entitlement?

3.If the answers to the first two questions showed that workers had not been paid their full holiday pay, could they bring claims for a 'series of deductions' from holiday pay dating back to

the implementation of the Regulations or the beginning of employment, if later?

The EAT held in answer to the first question that the Directive does require that holiday pay must include non-guaranteed overtime payments because they are intrinsically linked to the performance of tasks required under the workers' contracts of employment. Holiday pay must also include allowances that are more than expenses and which are directly linked to the worker's work. However, this only applies to the four weeks of EU-derived holiday and not to the additional 1.6 weeks' leave given by the Regulations, or to any additional contractual holiday on top of that.

The EAT then went on to consider whether the Regulations could be read in line with EU law or whether the two were simply inconsistent. The EAT accepted that it was obliged by the ECJ case of *Marleasing SA* v *La Comercial Internacional de Alimentacion SA* (C-106/89) to interpret UK law as far as possible in light of the wording and purpose of EU law in order to achieve the result pursued by the Directive. In light of this, it held that it could read words into the Regulations in order to give effect to EU law.

The EAT, however, then limited the amount of retrospective holiday pay that could be recovered by finding that any deduction or series of deductions separated from any subsequent deduction by a gap of more than three months falls outside the tribunal's jurisdiction. It is quite possible that for many employees there will have been gaps of more than three months between underpayments. For some, there will simply have been a gap of more than three months between any holidays but this would probably be relatively unusual, particularly for parents, who often have to take time off during school holidays in order to care for their children. (There are school holidays at Christmas, Easter and in the summer and also three "half-term" holidays a year between the longer holidays.) Even employees without children at school often take time off at these times of the year (when there are also public holidays).

In addition, however, given that holiday pay for the 1.6 weeks' additional UK-specific leave does not have to include anything other than basic pay for employees with normal working hours, it is likely that some holidays will not have been underpaid and so there will have been no deduction on those occasions. This makes it more likely that employees will have gaps of longer than three months between deductions from wages. The EAT said that employees would not be able to retrospectively designate whether or not a holiday was 'EU' or 'UK' holiday in an attempt to be able to construct a series of deductions that were still within the limitation period. The EAT thought that instead the UK's additional 1.6 weeks' leave would be the last to be agreed in any holiday year.

Commentary

This case had something for everyone – the workers won a finding that their holiday pay should include overtime pay and allowances and the employers succeeded in limiting the extent to which their workers could claim for holiday pay underpayments going back years.

The EAT gave the parties permission to appeal its findings to the Court of Appeal but, surprisingly, neither party has chosen to do so. However, other cases which had been stayed awaiting the outcome of this one are now likely to proceed to a hearing and these cases will probably raise very similar issues. It is therefore likely that the question of how to calculate

holiday pay will be considered again soon at appeal level with the possibility of a different decision being reached by the EAT or a higher court. So, whilst the aspects of this ruling restricting the scope for retrospective claims are helpful to employers, there is an ongoing risk that these findings may be overturned and employers may still face claims relating to past periods of annual leave.

In a further development, the UK government announced on 18 December 2014 that it would impose a two-year limitation on claims for retrospective holiday pay to further protect businesses from the impact of the decision and to give certainty to workers on their rights to holiday pay.

Draft Regulations have been published which will amend the unlawful deduction from wages provisions in the ERA. The two year limitation will apply in relation to unlawful deduction from wages claims made to the Employment Tribunal on or after 1 July 2015. This could mean that employers face claims before this date from workers hoping that this EAT decision will be overturned (because, based on this decision, most claims would be unlikely to extend back beyond this two year period in any event). The draft Regulations also provide that the right to pay for annual leave under the Working Time Regulations 1998 does not confer any contractual rights. This will prevent claims for underpayment of holiday pay being brought as breach of contract claims (which are normally subject to a six year limitation period).

Whilst the government's intervention goes some way to mitigate the effects of the EAT's decision, the issues and current uncertainty around calculating holiday pay remain complex and present real challenges for employers.

Comments from other jurisdictions

Austria (Hans Georg Laimer and Martina Hunger): In Austria, employees are basically entitled to five weeks' vacation per year. The employee must not suffer any loss of income during the vacation. Therefore, the employee must receive regular remuneration during holidays. Overtime must be calculated based on a 13-week average if the employee habitually performs overtime or if he would have worked overtime had he not gone on holiday, provided the overtime is normally paid in money, as opposed to in kind.

In principle, an employee's entitlement to pay is subject to a statutory limitation period of three years. Therefore, an employee may claim entitlement to vacation pay for three years from its accrual unless the applicable collective bargaining agreement or employment contract provides a shorter limit. If there is a shorter limit (at least three months), the employee must claim within that limit. If he fails to do so the entitlements will be forfeited.

Germany (Dagmar Hellenkemper): The EAT's legal findings are in line with German law. Holiday pay is calculated based on a loss-of- pay-principle. Pay is calculated based on the salary for the 13 weeks preceding the vacation. Payment for overtime is not included in the calculation. However, the law in Germany differentiates between the 'pay factor' and the 'time factor'. If the employee – much like in the British case – would have worked overtime if he had been working instead of going on holiday, this hypothetical overtime must be paid for. Hence, the pay factor does not include overtime pay for the past 13 weeks, but the time factor includes hypothetical overtime during the holidays. This provision is part of the Federal Leave Act, which only applies to statutory holidays. It is theoretically possible to opt out of this rule in employment contracts, but this is highly uncommon and I have personally never seen this done.

There is no statute of limitation, so the general statutory rule (three years) applies if the parties have not agreed on a contractual forfeiture clause (usually three months).

Ireland (Orla O'Leary): In Ireland, the Organisation of Working Time Act 1997 implemented the Working Time Directive. As with the UK, employees are entitled to paid time off of up to four working weeks per annum plus public holidays. Under the 1997 Act, employees are entitled to be paid "at the normal weekly rate" in respect of their annual leave.

In terms of what this constitutes in respect of pay for annual leave, there are two separate calculations set out under the Organisation of Working Time Act (Determination of Pay for Holidays) Regulation 1997, the '1997 Regulations'). These provide that:

| (1) where the employee's pay is calculated wholly by reference to a time rate or a fixed rate of salary or any other rate which does not vary in relation to the work done by him or her, the "normal weekly rate" of pay *"shall be the sum (including any regular bonus or allowance the amount of which does not vary in relation to the work done by the employee but excluding any pay for overtime) that is paid in respect of the normal weekly working hours last worked by the employee before the annual leave commences [...]*"; or

| (2) if the employee's pay is not calculated wholly by reference to any of the matters referred to in (a) above, then "normal weekly rate" of pay "*shall be the sum that is equal to the average weekly pay (excluding any pay for overtime) of the employee calculated over the last period of 13 weeks worked before the annual leave commences [...]*".

Notwithstanding the above, whilst the 1997 Regulations are clear insofar as overtime is specifically excluded from the calculation of pay for annual leave, it should be noted that the situation could be different where the overtime is obligatory. The Labour Court's general view appears to be that where overtime is "regular and rostered", then it should be taken into

account when calculating holiday pay. In the case of *Wyeth Medica Holiday* – v - *SIPTU*, the employee was "contractually obliged to work for up to four hours overtime per week" and the Labour Court took the view that these hours should be taken into account in calculating holiday pay.

In contrast therefore to the situation which has developed in the UK whereby non-guaranteed overtime must be included in the statutory holiday pay, overtime is specifically excluded from the definition of normal weekly rate of pay in Ireland. However where, in reality, that overtime is part of the employee's normal working hours, then it is likely that that overtime should be taken into account in calculating the employee's entitlement to paid annual leave.

The Netherlands (Eugenie Nunes and Annemarie Roukema): The ruling of the Employment Appeal Tribunal of 4 November 2014 sheds new and more detailed light on the value of holidays. Following the Working Time Directive and various case law from the European Court of Justice (*Williams/British Airways*), the basic assumption is that holiday pay over the legal minimum number of holidays must include all salary components intrinsically linked to the performance of the tasks by the employee under the employment contract. During holidays the employee should be in a comparable (financial) situation as he or she would be whilst working.

In the Netherlands similar cases have been brought to the court, however there have been no cases specifically relating to (non- guaranteed) overtime payments. Claims relating to underpayment of holiday pay are not brought forward very often, and when they do, they generally concern the final settlement following termination of employment, including payment of holidays not taken. Although the Supreme Court in 1990 confirmed a broad wage definition, a couple of cases before district courts led to a more detailed analysis of holiday pay.

Article 7:639 Dutch Civil Code stipulates that an employee remains entitled to salary during holidays. In addition, the employee is entitled to a holiday allowance of 8% of the agreed basic salary provided for in the employment agreement (section 15, Minimum Wage and Minimum Holiday Allowance Act).

In 2013 the Court of Appeals in the Hague ruled1 that insofar as the requirements following *Williams/British Airways* are met, an irregular hours allowance paid on a continuous basis should be included in holiday pay. The Court also confirmed that all compensation intrinsically linked to the performance of tasks by employees, must be included in regular salary, including that paid during holidays. Insofar as the employee would be entitled to an

irregular hours allowance if he worked during holidays, this must be included in holiday pay.

2012: The District Court in Amsterdam granted a claim that continuous bonus payments should be taken into account in determining the exact entitlement to holiday pay2. The case concerned an employee who had received substantial and continuous bonus payments during his long term employment with the employer. These bonuses were granted in relation to his personal performance as well as a team performance, the team performance also partly depending on the efforts of this employee as the manager of the team. On the basis of these facts, the intrinsic link between the continuous bonus payments and the employee's performance was assumed. The extent to which bonus payments need to be taken into account in relation to holiday pay depends on the average bonus paid during a qualifying period. The judge held that one calendar year as a qualifying period was not representative in relation to the normal salary of the employee, and took five years as the qualifying period.

The trend in Dutch case law is that the salary component is the correct compensation for performance of the agreed tasks if the employee would have worked had he or she not gone on holiday. Continuous performance-related allowances and bonus payments may be included under certain specific circumstances, but profit sharing, for example, would not be considered to be compensation for the employee's performance as such.

This means that based on Dutch case law, the test of what should be included in holiday pay is what the nature of the specific payment is, whether it is related to performance of the tasks set out in the employment contract and/or whether the employee would be required to perform these tasks if he was working. In terms of non-guaranteed overtime, the following criteria must (in each case) be met: there must

(i)be a link to the employee's performance, (ii) the overtime payment should have occurred on a continuous basis, and (iii) the employee would normally have been obliged to work overtime for payment, had he worked during holidays. The extent of the overtime the employee is required to work during a certain period should also be considered and what the average overtime was during a qualifying period (which, of course, will be case-specific). Finally, it should be noted that the compensation calculated in this way only relates to the legal minimum number of days of leave entitlement.

The requirement that compensation be intrinsically linked to performance of the tasks required by the employee, leaves loose ends. Looking at the approach of the UK Employment Appeal Tribunal and the (limited) Dutch case law on this subject thus far, this particular case might well lead to some interesting case law in other jurisdictions.

EELA EUROPEAN EMPLOYMENT LAWYERS ASSOCIATION

Subject: Working time

Parties: Bear Scotland Ltd and others - v - Fulton and others

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