



# European Employment Law ALERT

## UK Employees Entitled To Extra Pay During Annual Leave

### Statutory Holiday Pay Should Include Variable Pay and Allowances

In a highly significant decision, the European Court of Justice (“ECJ”) has decided in the case of *Lock v. British Gas Trading Ltd.* that an employee should receive “normal pay” during their five weeks of UK statutory annual leave. “Normal pay” is not limited to base pay, but includes compensation for commission and allowances which the employee would have received had they been working during the leave. This decision has major implications for employers who operate variable pay programs, or pay overtime or attendance allowances. Employees could potentially bring claims for the difference between their base pay and these additional elements of their total pay package for accrued leave as far back as 1998, when the UK Working Time Regulations became law.

#### Background

The case concerned a salesman whose pay consisted of basic salary plus variable commission worth around 60% of his overall package. He claimed that UK rules allowing employers to pay base salary only during annual leave breached the European Working Time Directive. Under the UK rules, he was worse off, because his commission payments suffered when he took his statutory annual leave, and UK law did not require his employer to compensate him for this.

The ECJ agreed that UK law was in breach of the European Directive. Pay during the statutory annual leave period should reflect the employee’s total pay which is directly linked to work done under their contract. If the employee lost out on commission either during the leave period, or following the return from leave because of a loss of “pipeline” sales, this could deter employees from exercising their right to take their statutory holiday under the European Directive.

#### Where are we now?

The case has now been sent back to the UK courts to make a decision based on the guidance from the ECJ. The UK courts are increasingly willing to “bend” UK rules to fit them within European law—even reversing a provision of the Equality Act recently where they decided it contained a mistake. If the courts are not willing to “re-write” the current UK rules, employees will be left without any recourse against their employers until the UK government amends current legislation.

## What are the risks for employers?

Potential liability for extra holiday pay could date back to 1998, and can only be closed down in very limited circumstances. Whether employees can sue their employers now, or whether they will have to wait for the UK government to change the legislation, will depend on the approach the UK courts take when they re-hear the *Lock* case in the next few months.

Although the ECJ decision is clear on the broad legal principle to be applied, questions remain as to the amount of the extra holiday pay due, such as:

- **What pay or allowances count towards an employee's "normal pay"?** The ECJ has held that "normal pay" includes those elements which are intrinsically linked to the performance of the employee's duties. It is clear that for an employee in a sales-based role this will usually include commission; it is likely also to include regular overtime, shift and other attendance allowances regularly paid to the employee when in work. Our view is that it should exclude pure "ex gratia" payments or expenses. Further court decisions due in July 2014 in two overtime cases (the Employment Appeals Tribunal in *Neal v. Freightliner Ltd.* and *Fulton v. Bear Scotland Ltd.*) should provide more guidance.
- **If employees do miss out on sales opportunities while on leave, how is this quantified?** The ECJ suggested a reference period of 12 months to assess usual earnings, compared with a usual reference period of 12 weeks under English law. Both of these could be misleading, however, where sales are cyclical or vary year to year. The loss in commission relates not only to the annual leave period itself, but any knock-on effect following the return to work.

## Next steps for employers

Employers should assess which of their employees would be covered by this ruling, whether because of variable pay, overtime or other allowances. Employers may want to begin assessing the potential extra costs involved, and take advice as to whether they can pursue the limited options available to close off liability.

Going forward, employers may need to consider these extra annual leave costs when agreeing to extra pay elements such as variable pay, paid overtime or allowances.

We will closely monitor the developments in this area and will issue a further Alert in the coming months.

For more information or advice, please contact:

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