Money matters

A recent ECJ decision found that commission should be taken into account for those who earn it when calculating holiday pay

THE EUROPEAN COURT OF JUSTICE (ECJ) has recently issued an important judgment about the calculation of holiday pay. The case of *Lock v British Gas Trading Ltd* C-539/12 (22 May 2014) concerned a UK-based salesman who was found to have been underpaid because commission was not fully factored into his holiday pay. This judgment is relevant throughout Europe, although the precise effect will depend on the rules already in place for calculating holiday pay in each jurisdiction. The case will be particularly relevant to any jurisdictions that currently allow certain payments to be excluded from the calculation of holiday pay or that provide for holiday pay to be based on basic salary only.

European and national legislation

The Working Time Directive (WTD) gives workers in the EU the following right: "every worker is entitled to paid annual leave of at least four weeks in accordance with the conditions for entitlement to, and granting of, such leave laid down by national legislation and/or practice" (Article 7). It goes on to say that this entitlement to paid annual leave cannot be replaced by an allowance in lieu, except on the termination of the employment relationship.

There is no mention of how holiday pay is to be calculated – except that this is a matter for national law. When interpreting this right, the ECJ has also had regard to the Charter of Fundamental Rights of the EU (which includes a right to an annual period of paid leave) and Article 7 of the International Labour Organisation Convention on Holidays with Pay. This convention states that a worker on annual leave shall receive "at least his normal or average remuneration" during that leave.

In the UK, the WTD was implemented by the Working Time Regulations 1998 (WTR). The WTR provide for each week of annual leave to be paid at the rate of a week's pay. A "week's pay" is a concept in UK law that is also used in other contexts, and the provisions for calculating this are complex. However, for workers with normal working hours, the legislation allows holiday pay to be based on basic salary, rather than including other variable elements such as commission.

ECJ cases on holiday pay

The ECJ has interpreted the meaning of paid annual leave in a number of cases. In the 2000s, it made comments that holiday pay should be "comparable to" normal pay. However, the leading case on calculation of holiday pay is *Williams v British Airways plc* C-155/10 (15 September 2011). This actually concerned the holiday pay of airline pilots under a separate Directive for the civil aviation sector, but the ECJ made it clear that the same principles apply to cases under the WTD. The main point of the decision was that any element of total remuneration that is "linked intrinsically to the performance of the tasks which the worker is required to carry out under his contract of employment" must be taken into account in calculating holiday pay. Only amounts that are intended exclusively to cover occasional or ancillary costs (such as expenses) need not be factored into this calculation.

This decision therefore requires workers to be paid their "normal" pay during periods of holiday, so essentially the same as during periods of work. "Comparable" pay is no longer considered sufficient. The *Lock* case applied that principle to workers earning commission.

Facts of the case

Mr Lock was a sales consultant employed by British Gas to sell its energy products. His pay was composed of a fixed monthly salary and variable commission linked to the sales he achieved. He was paid on a monthly basis. However, commission was payable only once a contract had been actually entered into with British Gas, not when a sale was made.

Commission payments generally represented more than 60% of Mr Lock's normal pay. When he took two weeks' annual leave in December 2012, he was paid his basic salary. He also received commission from previous sales that fell due during that period. However, he did not generate any new sales while he was on holiday, which meant that in the period after his holiday he had a reduced income owing to lack of commission payments. He brought a claim alleging that he had been underpaid in relation to holiday pay in breach of the WTR.

The UK employment tribunal decided to refer certain questions to the ECJ for a definitive ruling on the position under EU law. It asked:

1. Does the WTD require member states to ensure that a worker is paid in respect of periods of annual leave by reference to the commission payments he would have earned during that period, had he not taken leave, as well as his basic pay?

2. If so, what principles should member states adopt when calculating the sum payable?

Employers may end up having to change the way they calculate holiday pay to include commission that would have been earned had the worker not been on holiday

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The UK government intervened to support British Gas' view that there had been no breach of the WTD or WTR because Mr Lock had received both basic pay and commission that fell due while he was on annual leave.

The ECJ decision

The ECJ decided that the WTD did require member states to take steps to ensure that a worker was paid in respect of annual leave by reference to commission that he would otherwise have earned during that period. It said that the WTD precludes a national law that limits a worker's holiday pay in these circumstances to basic pay. Applying *BA v Williams*, the ECJ decided that Mr Lock's commission payment was "intrinsically linked" to the performance of his contractual tasks. This meant that his holiday pay must take account of his total remuneration, including commission.

The ECJ repeated the principle that paid holiday was a fundamental right, which must reflect normal pay. It emphasised that the purpose of fully paid holiday is to ensure that workers are not deterred from taking leave. In this case, the fact that the financial disadvantage was deferred to after the leave period did not change the decision – the arrangement might still discourage workers from taking their leave, as they would earn less after returning from holiday.

Unfortunately, the ECJ did not give a clear answer to the second question about how holiday pay should be calculated. The court indicated that the average amount of commission received by a worker will need to be determined over a reference period. The Attorney General's preliminary opinion on this case did discuss specific reference periods for calculating average remuneration and suggested that a 12-month reference period might be appropriate. However, the ECJ simply referred to a reference period "which is considered to be representative, under national law".

The case has now been referred back to the UK employment tribunal to determine whether national law can be interpreted consistently with EU law and, if it can, how the amount of holiday pay should be calculated to take account of commission. The WTR in the UK currently provides for a 12-week reference period for calculating holiday pay for certain types of workers, so it may be that the tribunal decides to use a 12-week period in Mr Lock's case as well.

Implications for businesses throughout Europe

The ECJ's ruling may have major financial consequences on businesses throughout the EU that pay commission to their workers. Employers may end up having to change the way they calculate holiday pay to include commission that would have been earned had the worker not been on holiday, and could face retrospective claims relating to previous periods of annual leave. The decision may also have a wider impact in relation to other payments that are not currently included in holiday pay under national law but form part of "normal remuneration", such as overtime or bonuses. A number of cases are currently going through the UK courts about whether regular overtime payments should be reflected in holiday pay.

Until there are more rulings from the ECJ and national courts about precisely how holiday pay should be calculated, it may be too early for employers to change all of their holiday pay calculations. However, there are some helpful steps that businesses can take now: see below.

It is worth noting that the ECJ's ruling applies only to the four-week annual leave entitlement under the WTD and not any additional holiday provided for under national legislation. For example, the UK provides for 5.6 weeks of paid annual leave, which is 1.6 weeks in excess of the minimum EU entitlement. However, in practice, it may be difficult for employers to calculate different amounts of holiday pay depending on whether a worker is taking basic annual leave under the WTD or additional national holiday entitlement.

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Tips for employers

- Assess your current payment arrangements and consider which ones may expose the business to additional liability – what is not currently factored into holiday pay? Consider: commission, bonuses, overtime, shift pay, allowances and any other payments relevant to your business.
- Seek legal advice about what national law requires in relation to calculation of holiday pay in respect of each potential area of exposure for your business (identified above) and how this differs (if at all) from EU law.
- Understand the potential risks and financial exposure and any options available, which will depend on national laws about claiming underpaid holiday pay.
- Where potential financial exposure is large, consider making a reserve entry in the company's accounts for this.
- It is likely to be too early to change holiday pay arrangements or enter into negotiations about backdated compensation for workers at this stage.
- Keep a close watching brief on further developments.