

Holiday Pay Calculations

Guidance on whether to include commission payments in the calculation

Introduction

This guidance document is for use by APSCo members only. The facts, information, and opinions contained herein are correct to the best of APSCo's knowledge as at time of publication. However, it should be noted that this guide is based on APSCo's opinion and interpretation of the available facts.

The aim of this guide is to help members understand the decision of the Court of Justice of the European Union ("CJEU") in the case of *Lock v British Gas Trading Limited*, and consequently whether or not members need to review their holiday pay calculations.

APSCo can take no responsibility or liability for any reliance on the information contained within this guidance document.

Holiday Pay – Current Calculation

The Working Time Regulations ("WTRs") came into effect on 1st October 1998. These regulations are derived from the European Directive of the same name.

Under the WTRs workers are entitled to 5.6 weeks' paid annual leave per year, which equates to 28 days per annum for a worker that works a 5 day week). It should be noted that the European Working Time Directive provides for a minimum of 4 weeks per annum, so the UK statutory amount is above this level.

The WTRs state that "*a worker is entitled to be paid in respect of any period of annual leave to which he is entitled...at the rate of a week's pay in respect of each week of leave*".

A Week's Pay – normal working hours –& no variation in pay:

To define a week's pay the WTRs use the definition already laid out in the Section 221 of the Employment Rights Act ("ERA"), being:

"where there are normal working hours for the employee...if the employee's remuneration for employment in normal working...does not vary with the amount of work done in the period, the amount of a week's pay is the amount which is payable...if the employee works throughout his normal working hours in a week".

In other words, if the worker's normal working hours and pay don't vary with amount of work done, then the worker is entitled to a week's pay calculated on basic salary only.

A Week's Pay – normal working hours – varied pay:

Where a worker's pay *does* vary with the amount of work done Section 221 of the ERA defines the amount of a week's pay as:

"...calculated at the average hourly rate of remuneration...in respect of the period of twelve weeks..."

So, if the worker's pay does vary with the amount of work done, then their holiday pay calculation will include all payments – i.e. basic salary plus commission, bonuses, and overtime etc., – calculated as an average over the previous 12 working weeks.

A Week's Pay – no normal working hours or pay:

Section 222 of the ERA defines the calculation of a week's pay for workers whose normal working hours differ from week to week as:

"...the amount of remuneration for the average number of weekly normal working hours at the average hourly rate of remuneration... in respect of the relevant period of twelve weeks"

Therefore, if the worker's hours and pay vary each week, then their holiday pay calculation will include an average hourly rate and an average number of hours in a week, calculated over the previous 12 working weeks. Obviously, this average will include all payments – i.e. basic salary plus commission, bonuses, and overtime etc.

Does pay vary with amount of work done?

Normal Working Hours

The question is, does commission form part of a worker's entitlement for working those normal hours, or is it "something extra"?

If any payment (such as commission) is intrinsically linked to the performance of the tasks of the worker, then it should be considered that pay varies with the amount of work done in normal working hours, and holiday pay should be calculated including that payment.

However, if payments (such as commission) are given as a reward for success rather than being linked to the amount of work done, then there is an argument to say that pay does not vary with the amount of work done, only with a worker's success, and as such it would not need to be included in the holiday pay calculation.

Success v Effort

Below are two cases that illustrate the difference between payments made to reward success versus payments, which are intrinsically linked to the amount of work done.

Evans v Malley Organisation Limited (2003):

- Malley Organisation, trading as First Business Support provided employment law and H&S advice.
- Mr Evans had the right to commission when the client had paid a quarter of the overall fee under the contract (usually around 9 months in).
- He was paid holiday pay based on basic salary only, and any commission that fell due during the holiday period.
- Mr Evans contended he should be paid holiday pay based on salary including his average rate of commission.
- The Employment Tribunal rejected his claim because it found that Mr Evans **remuneration did not vary with the amount of work done in the period**. Therefore, his holiday pay was rightly calculated on basic salary.
- The Employment Appeal Tribunal overturned this decision.
- However, the original decision was upheld by the Court of Appeal.
- The judge was unable to conclude that Mr Evan's remuneration varied with the amount of work done. *"Work is done and the amount of work does not depend on the number of contracts obtained. Time spent attempting unsuccessfully to persuade a client to sign a contract is as much work as a successful encounter with the client."*

May Gurney Limited v Adshead (2006):

- Mr Adshead (and others) argued that they should be paid holiday pay including a fixed and a variable bonus.
- Both the Employment Tribunal and the Employment Appeal Tribunal found that the fixed bonus was in effect an attendance bonus, which was always paid if a full week was worked, and that the variable bonus was essentially a productivity bonus, which was clearly linked to the amount of work done.
- Therefore, both tribunals ruled in favour of Mr Adshead, because both bonuses were clearly linked to the amount of work done, and therefore pay varied with the amount of work done, and the holiday pay calculation should include these amounts.

The above cases illustrate the different types of commission/bonus payments, and the Evans case suggests that it can be argued that commission (which is a reward for success) shouldn't be included in calculation of holiday pay.

New Developments in Europe

In May 2014 the Court of Justice of the European Union ("CJEU") ruled in the case of Lock v British Gas Trading Ltd. The English Tribunal hearing decided to stay the proceedings and to refer certain questions to the CJEU for a preliminary ruling.

- Mr Lock works as an Internal Energy Sales Consultant. His task is to persuade business clients to buy his employer's energy products.
- Mr Lock is paid basic salary & commission.
- During his holiday he was paid basic salary only plus commission that fell due.
- No new sales were generated during his annual leave resulting in a reduced income in months after his holiday.
- The CJEU held that holiday pay should have reflected the commission Mr Lock would have earned had he not taken annual leave.
- The Court found that *"the commission received by Mr Lock is directly linked to his work within the company. Consequently, there is an intrinsic link between the commission received each month by Mr Lock and the performance of the tasks he is required to carry out under his contract of employment."*
- The Court also noted that notwithstanding the pay received by Mr Lock during his holiday, it felt that *"he may be deterred from exercising his right to annual leave, given the financial disadvantage which, although deferred, is nonetheless genuinely suffered by him during the period following that of his annual leave."*

Effect of the CJEU Decision in the UK

The CJEU ruling in the case of Lock v British Gas Trading will now need to be taken into consideration by the English Tribunal that referred this case to Europe.

The CJEU ruling does not state how the Tribunal should rule on the compensation of Mr Lock, which will be up to the English tribunal to decide. It is possible that the tribunal will use the current 12 week relevant period, which is enshrined within the WTRs. However, we will have to wait for that decision.

Whatever the decision of the Tribunal, it will only apply to the 4 week entitlement contained within the European Directive, not the full 5.6 weeks required by the WTRs.

What about Success v Effort?

This is a complex legal question. There is an argument to suggest that Mr Lock was working in more of a telesales type role, where the more phone calls he made the likely he was to make sales and earn commission. It is also fairly clear that when on annual leave Mr Lock will not earn commission.

However, there are sales environments, like recruitment, which arguably are much more bespoke, and where, like Mr Evans, commission can be closely linked to success, and not effort. Recruitment is a specialist sales role, and a sales consultant is likely to expend as much time and energy finding unsuccessful candidates as they will successful ones.

It is also less clear that when recruitment consultants are on holiday they will suffer financial loss through loss of commission. Due to the personal nature of the client relationships consultants will normally have support staff/resources or other colleagues who will continue to service accounts in the consultant's absence. Conversely, it might be possible to argue that sales pipelines could be affected by leave, particularly where consultants don't have a large or established client base, and rely more heavily on cold-calling techniques.

Threat of Historical Claims

It is theoretically possible that an employee could make a historical claim in relation to the calculation of their holiday pay going back to 1998, when the WTRs were brought in.

An employment tribunal claim for the unlawful deduction of wages must be made within three months of the last allegedly incorrect payment, therefore, once a correct payment has been made, the exposure to a historical claim will only last for three months.

However, until the English tribunal has ruled on the Lock case it may not be possible to determine what the correct calculation should be.

What should members do now?

You should consider whether or not to take immediate action, or await clarification from the Lock tribunal.

In any event it would be sensible to consider the following issues:

- Should commission be included in your holiday pay calculations because it's forms part of normal pay? This may apply to some roles/employees and not others.
- Assess your potential financial liability.
- Your review of your potential liability should include any agency workers who receive commission as part of normal pay, and how to approach this issue with any relevant clients.
- Consider whether an alternative commission scheme or other ways to reward staff might be appropriate.
- Consider how you would operational go about undertaking individual calculations for holiday for those employees and agency workers likely to be affected.
- Consider how you will communicate any decisions made to affected employees.

APSCo would like to thank Oliver Weiss from Blake Morgan, an APSCo affiliate member, for their advice on this issue.