BRYAN CAVE
A Broader Perspective
Bulletin

Labour and Employment Client Service Group

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Holiday pay must include commission payments

The European Court of Justice (**ECJ**) has recently held that if a worker is paid basic salary and sales commission, the commission element of the salary must be included in the calculation of holiday pay (*Lock v British Gas Trading Limited*).

Background

The European Working Time Directive provides that workers have the right to four weeks' paid holiday. However, the Directive does not state which elements of a worker's remuneration should be included in holiday pay, or how it should be calculated each time leave is taken. Each European Member State has implemented the Directive into domestic law and there are variations amongst the different jurisdictions. This case was brought under UK law, but the ECJ decision will have implications across all Member States. This bulletin discusses the implications of this decision under UK, German, French and Italian law.

Mr Lock was employed as a Sales Consultant in the UK. His remuneration was made up of two components: a basic salary and a monthly sales-based commission payment. The commission was variable and was usually paid several weeks, or months, after the sale to which it related was achieved. Whilst Mr Lock was on annual leave he was unable to generate commission for that period which, in turn, would be paid in the subsequent weeks or months. As a result, his income in the months following his holiday was reduced.

Mr Lock presented a claim in the UK Employment Tribunal for unpaid holiday pay. In the UK, holiday pay is calculated on the basis of a week's pay which is stated to be basic salary only, excluding payments such as working allowances, expenses, overtime, commission and bonus payments. The question to be determined by the ECJ was whether holiday pay should include the commission payments that the Mr Lock would have accrued had he not been on annual leave.

Decision

The ECJ held that where variable elements of pay are "intrinsically linked" to work done under the contract of employment, holiday pay should be calculated to include those payments. For there to be an "intrinsic link" there needs to be a direct link to the performance of the tasks that the worker is contractually required to do, and a certain degree of permanence.

As a result of this decision, commission payments now need to be taken into account when calculating how much holiday pay is due to a worker if the commission is 'intrinsically linked' to the work done. The court reaffirmed the position that holiday pay should be paid on the basis that a worker receives pay comparable to normal pay whilst on holiday, and is therefore not deterred from taking annual leave by financial considerations. This decision applies to the European statutory minimum holiday of four weeks per year. The ECJ left the question of how to calculate holiday pay for individual Member States to decide (at least with regard to the four weeks' leave required by the Directive).

Application in the UK

This case has been referred back to the UK Employment Tribunal to decide how to calculate holiday pay and we await that decision. It will be interesting to see whether the Tribunal is able to interpret the UK's Working Time Regulations in a way that is compatible with the ECJ's ruling. A possible outcome is that the UK Tribunal decides to use a 12 week reference period for calculating commission and other variable payments which is the period used elsewhere under the Working Time Regulations, for example where working hours are irregular.

This decision will have a significant impact for employers who remunerate their workers by way of commission payments. Ultimately, employers may need to make additional payments to their workers to ensure that holiday pay includes an amount in respect of commission. One limiting factor is that the ECJ ruling only applies to the four week annual leave entitlement under European Law and not the additional 1.6 weeks provided by UK law. Moreover, it should not affect contractual holiday pay over and above the statutory minimum.

The key questions for employers are:

1. **Whether and to what extent employers should be amending their holiday pay practice and policies**

   It is likely that many employers will await the final decision of the Employment Tribunal (and no doubt, subsequent appeals to the Employment Appeal Tribunal and beyond) before considering making adjustments to holiday pay and policies. However, employers may wish to take advice now on whether they need to approach a recalculation of holiday pay and to establish whether there is a way to calculate any additional holiday pay element on an interim basis to limit exposure to potential claims (see below).

2. **To what extent this decision could result in expensive claims for under-paid holiday pay**

   Claims for holiday pay can be brought within three months from the last series of underpayments and could, potentially, go back 6 years. Employers may look to limit their liability by paying a higher rate of holiday pay immediately. This would start time running to bring claims and workers would then have just three months from the date of the calculation change in which to bring a claim for previous underpayments. Employers could thereby break the chain of underpayments, thereby crystallising their liability. However, there is a risk that this change would prompt employees to become aware of their potential claims upon receiving a higher payment and of paying too much before the UK courts have made their decision.

This will also be of a concern to buyers and service providers in the context of a transfer under the UK's Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). Pursuant to TUPE, where there is an asset sale or service provision change, all of the employees working for the business, or the client, which is transferring automatically pass to the buyer / new provider. In addition, all of the seller's / old provider's rights, powers, duties and liabilities under or in connection with the transferring employees' contracts pass to the buyer / new provider. Therefore, any accrued underpayments for holiday pay which can give rise to claims and accrued debts owed to the employee will pass from the seller/old provider to the buyer/new provider.

It is also worth noting that the UK Employment Appeal Tribunal is also due to hear two cases on the related issue of whether overtime payments should be included in the calculation of holiday pay (*Neal v Freightliner Ltd; Fulton and anor v Bear Scotland Ltd*).

Application in Germany

According to section 11 of the German Federal Vacation Act (Bundesurlaubsgesetz – BUrlG) holiday pay is calculated in accordance with the average employment earnings received by the employee during the last 13 weeks prior to the commencement of vacation. This also includes commission payments. German employees are therefore not only entitled to claim their fixed salary and commission they have actually acquired, but they also have to be paid compensation for commission, which cannot be acquired because of the holiday leave.

The current situation in Germany therefore seems to be the same as the view of the ECJ regarding variable pay during annual leave. Hence, the legal situation in Germany is not altered by the ECJ judgment.

However, in practice, very often employees will not be paid a theoretical commission as part of their holiday pay. Therefore, the decision from the ECJ might cause a higher public awareness of such claims. As a consequence, German employers could face (retrospective) claims concerning higher holiday pay. This could result in significant financial consequences for German employers who have to pay theoretical commissions where no consideration has been rendered, especially no revenue.

The ECJ decision only applies to the statutory minimum holiday of four weeks per calendar year. Hence, it might be worth implementing a clause in employment contracts that changes the provisions concerning commission payments by stating that for holiday periods beyond the statutory minimum holiday, the employee is not entitled to a theoretical commission. In the event that employers should be faced with retrospective claims relating to previous periods of annual leave they should double-check whether such exclusion periods might apply.

Application in France

Holiday pay in France is equal to the more employee-favourable of: (i) one-tenth of the total remuneration received by the employee during his preceding annual employed reference period (between 1 June of the previous year and 31 May of the current year); and (ii) the remuneration that the employee would have received if he had worked during his holiday (article L. 3141-22 of the Labor Code).

This method of calculation of holiday pay applies to all salaried employees, including those who are remunerated by a fixed base salary and a variable component made up of commissions on sales. For the latter, however, French case law has held that a travelling salesman ("VRP") who received only the fixed component of his salary during his holiday was entitled to further compensation (consisting of commissions on orders received directly by the employer during the reference period) to take account of a right to theoretical commissions otherwise "lost" by the employee during his holiday (Cass. Soc. 18-3-1975 n° 74-40-021). This solution is applicable a fortiori to VRPs paid exclusively by commissions (Cass. Soc. 28-10-1963 n° 61-40.573; Cass. Soc. 30-5-2000 n° 97-45.946).

More generally, French case law has recognised the possibility (in keeping with the decision that an employee must not be deterred from taking his holidays)for an employee and his employer to enter into a contractual clause providing for the inclusion of holiday pay in the employee's fixed monthly remuneration, on condition that such clause is "transparent and comprehensible". By virtue of such a clause, the fixed component of the employee's monthly remuneration would be increased so as to integrate the holiday pay allowance otherwise due during the employee's holiday (Cass. Soc. 14-11-2013 n° 12-14-070).

As a result, while the ECJ does not significantly alter the legal situation in France, we may in practice expect to see an increase of "transparent and comprehensible" clauses providing for the inclusion of a theoretical commission for salesmen during their holidays.

Application in Italy

Sections 36 of the Italian Constitution and 2109 of the Italian Civil Code provides the right for all subordinate employees to an annual period of paid holidays. The amount of such pay is left to the parties' free negotiation and therefore is provided by the various applicable National Collective Bargaining Agreements ("NCBA") in force, from time to time, for the various categories of workers (industry, commerce, etc.)

For example, for employees who normally receive both a "fixed" salary and a "variable" part of additional compensation (normally sales commissions), the Italian NCBA for the Commercial Sector currently provides that such employees shall be paid during their holiday period, in addition to the normal fixed salary, also an amount of variable compensation calculated as the average of the commissions received by their colleagues at work during the same period. In case all the employees are on holiday during such a period, or if there is only one employee entitled to a variable part of his/her compensation, than the variable part of the holiday pay shall be calculated as the monthly average of the commissions received by such employee during the 12-month period immediately preceding the holiday.

In theory some less "commercially oriented" Italian NCBAs may exclude the variable part of the affected employees' compensation (in the relevant sector of activity) from the calculation of holiday pay; this is in fact compatible with the general principles of Italian law on this aspect (see above).

Thus, the ECJ decision, whereby the variable part of an employee's compensation must be included in the calculation of holiday pay (according to criteria to be established at the national level), may be effectively invoked by employees in Italy to challenge the provisions of any such NCBAs excluding entirely such variable part from holiday pay calculation.

Obviously, a collective challenge at the Unions' level may prove much more forceful for the purpose not only of recovering past dues "lost", but also introducing changes in the relevant NCBAs (excluding, in any event, the Italian NCBA applicable to the Commercial Sector, as noted above).

To discuss any of these issues further, please direct your queries to **the authors below, your contact at Bryan Cave or to any member of the Labour and Employment team in Europe.**

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