WHITE & CASE

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Landmark judgment in Employment Appeal Tribunal case paves the way for incremental increases in holiday pay

The important judgment of the UK's Employment Appeal Tribunal (the "EAT") in *Bear Scotland Ltd & ors v Fulton & ors*, considered alongside *Hertel (UK) Ltd v Wood & ors* and *Amec Group Ltd v Mr Law and ors*, casts new light on the question of whether payments for overtime work should be factored into the equation by employers when calculating the holiday pay of their employees and workers

The EAT ruled that Bear Scotland Ltd's failure to include payments for "non-guaranteed" overtime work when calculating their holiday pay constituted unauthorised deductions from wages.

In reaching its decision, the EAT considered the interaction between the EU Working Time Directive (the "Directive") and the UK's Working Time Regulations 1998 (the "Regulations") when interpreting regulation 13 of the Regulations concerning the calculation of holiday pay for annual leave. The EAT determined that payment for overtime should be viewed as normal remuneration and therefore to be included in the calculation of holiday pay.

The key points for employers are:

- regulation 13 of the Regulations provides that full-time workers are entitled to four weeks' (or 20 days') annual leave per annum in order to comply with the Directive, and this entitlement can include bank holidays. The EAT's decision therefore only relates to the calculation of holiday for this minimum entitlement, and does not apply to the method of calculation of holiday pay for the additional 1.6 weeks' (or 8 days') annual leave detailed in regulation 13A of the Regulations or any additional contractual holiday entitlement;
- claims for underpayment of holiday pay must be brought within three months of the most recent underpayment. Also, if there is any break of three months or more between each underpayment, an employee wishing to claim arrears of holiday pay will lose the right to bring a claim in respect of the underpayments made before the three month break. This should limit the number of claims which may date back for a full six years of alleged underpayments;
- the ruling applies in respect of payments for "non-guaranteed overtime" (where an employer is not obliged to offer overtime but an employee must accept overtime work if offered) rather than for "voluntary overtime" (where an employee has no contractual obligation to accept overtime if and when offered by the employer); and

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- although the decision is not definitive, it appears that the reference period for calculating an employee's normal remuneration (including non-guaranteed overtime pay) for the purposes of holiday pay is 12 weeks prior to the day's or week's holiday taken.

The EAT's decision in *Bear Scotland* dovetails with a recent decision of the Court of Justice of the European Union (the "ECJ") in *British Gas v Lock*. In that case, the ECJ ruled that commission payments earned by an employee should be taken into account when calculating the correct remuneration for an employee's paid annual leave in accordance with the Directive. The ECJ remitted the matter back to the UK tribunals to determine that particular case on its facts in line with the correct interpretation of the Directive and the Regulations.

Fluctuations in working patterns

Workers whose work patterns vary considerably might now seek to capitalise on the EAT's decision by seeking to take their holiday leave after particularly busy periods where they have worked substantial overtime hours in order to boost their holiday pay. Employers will need to take this into account when planning its staffing requirements and the budget for its staff costs throughout the year.

In particular, employers may wish to consider limits on overtime working even during busy periods and placing restrictions on when holiday can be taken in order to mitigate against the potential increased costs of holiday pay in these circumstances.

Implications for mergers and acquisitions

Buyers of UK businesses now face uncertainty regarding the potential liabilities of the target business for backdated underpaid holiday pay. Due diligence will be important to gain an understanding of the potential size of the problem, including whether the target business pays employees material sums of their overall remuneration by way of commission or overtime payments. Buyers will want to protect themselves and mitigate against any potential liability for the Seller's underpayments of holiday pay by negotiating well-drafted warranties and indemnities covering these liabilities into any sale and purchase agreement.

Conclusion

This is unlikely to be the end of the saga relating to the calculation of holiday pay, particularly pending any appeal to the Court of Appeal in the *Bear Scotland* case and the rehearing of the *British Gas* case in the UK tribunals. There are many important points for employers which remain to be fully clarified around the appropriate reference period for calculating normal remuneration, payments for the additional 1.6 week's annual leave under the Regulations and the approach to "voluntary overtime" payments. We anticipate further test cases in this area.

What is clear is that the EAT's decision will have deep and far-reaching implications for how holiday pay is calculated. The governmental task force which has been established to explore the potential is indicative of the importance for businesses of the judgment in *Bear Scotland v Fulton*.

If you have any questions about the issues arising out of this case, please contact Stephen Ravenscroft, Oliver Brettle or your usual White & Case contact.