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Federal Court Decision in FWO v Woolworths & Coles

What You Need To Know About Annualised Salaries and Set-off Arrangements

Australia – September 2025

On Friday 5 September 2025, the Federal Court of Australia handed down a significant ruling on employers' use of salary set-off clauses in *Fair Work Ombudsman v Woolworths Group Limited & Ors*.[1]

In a detailed 195 page ruling, the court clarified that statutory provisions under the *Fair Work Act 2009* (Cth) (*FW Act*) and relevant modern awards impose strict limits on the operation of such set-off clauses, mandating full and timely payment of entitlements in each pay period without cross-period pooling or deduction.

The implications of this Federal Court ruling extend well beyond the immediate respondents, Woolworths and Coles, and carry significant ramifications for employers with modern-award-covered employees within their businesses.

Background

What Are Set-off Clauses?

Set-off clauses are an optional (but highly recommended) part of an employment contract, which mean the employee agrees to receive a higher base salary instead of any separate payments that they would otherwise be entitled to (usually under a modern award), for penalty rates, allowances, loadings or overtime. Legally, "set-off" means offsetting one payment against another with the result that the employer can offset extra payments made in one pay period with any underpayments in another, as long as the higher annual salary is sufficient to cover and absorb all of the required payments.

The provision is a practical way to manage pay without needing to calculate each entitlement separately for each pay period.

What Was the FWO v Woolworths case about?

The judgment concerned four separate actions which were heard in parallel. The Fair Work Ombudsman (FWO) initiated legal proceedings against Woolworths and separately against Coles, and Adero Law brought class actions by employees against Woolworths and separately against Coles. All four actions alleged underpayments under the *FW Act* and the *General Retail Industry Award 2010* (GRIA).

The case involved salaried managers working in Woolworths and Coles stores whose salaries were subject to annualised payment arrangements. The annualised salaries purported to cover penalty rates, overtime, allowances and loadings under the GRIA.

While both parties had attempted to remediate these underpayments, backdated to 2013, (Coles to the tune of over AU$7 million and Woolworths AU$300 million) the FWO and class action applicants alleged they were insufficient.

Set-off Provisions in Contracts of Employment

Central to the dispute was the use of set-off clauses in employment contracts used by Woolworths and Coles, which aimed to pool over-award payments in one pay period and offset these against shortfalls in another.

For Woolworths, the pay period for set-off was defined as 26 weeks, though salary was paid at fortnightly intervals with the wording in the relevant employment contract being:

> "As part of this, your Base Salary and any allowance outlined in your Letter of Offer includes payment for:
>
> (a) all hours you work over a 26-week period (whether part of your ordinary working hours or not);
>
> (b) public holidays and substitute public holidays (whether you work on those days or not)."

Federal Court's Ruling on Set-off Clauses

In considering the validity of set-off clauses, the Federal Court provided several key rulings on the application and validity of set-off clauses.

The most significant of the rulings concerned the relevance of certain provisions in the *FW Act* and their interaction with the use of set-off clauses. The precise wording and operation of section 323 of the *FW Act*, which defines the method and frequency of valid payment of salaries, is as follows:

> "(1) An employer must pay an employee amounts payable to the employee in relation to the performance of work:
>
> (a) in full (except as provided by section 324); and
>
> (b) in money by one, or a combination, of the methods referred to in subsection (2); and
>
> (c) at least monthly."

1 *Fair Work Ombudsman v Woolworths Group Limited*; *Fair Work Ombudsman v Coles Supermarkets Australia Pty Ltd*; *Baker v Woolworths Group Limited*; *Pabalan v Coles Supermarkets Australia Pty Ltd* [2025] FCA 1092

In a detailed ruling, the Federal Court found that in operation, this provision requires that employees be paid all entitlements "in full" at least monthly – meaning that payments in one pay period cannot be set off against future or past pay periods.

Similarly, the court rejected that the use of bonus payments could offset underpayments, noting that these are distinct entitlements and not related to entitlements triggered by hours worked.

Other Issues

Agreements Under Awards

Modern awards often provide for the variation of entitlements by "agreement" with employees. For example, an award might provide that pay frequency is fortnightly but can be monthly with the agreement of the employee. What constitutes "agreement" in this context was also considered in the *FWO v Woolworths* decision as it related to various relevant entitlements under the GRIA which impacted the pay outcomes for employees in the proceedings.

The decision provided further clarification on the responsibility of employers in coming to such agreement with an employee to vary or forego entitlements allowed for under the GRIA or similar industrial awards. The court ruled that such variations are only effective where an employee provides genuine and informed consent. An employee will not be taken to have provided their agreement by simply accepting or working a changed roster or pattern of hours without understanding the original entitlement and the effect of their agreement. For instance, agreeing to a 10-hour break between shifts will only be valid if the employee knows that the award otherwise provides a 12-hour minimum. Likewise, an increase to a part-time employee's hours of work will only be effective if the employee understands the impact of that change. For example, that the change may affect their entitlement to overtime. Often, such agreement is considered to have been gained by including provisions in the employment contract noting that the employee agrees to certain variations. It seems that this will now not be enough.

Record-keeping

Alongside these key findings, the court provided clarity on the obligation of employers to adequately record hours worked. The court found that both Woolworths and Coles did not adequately record overtime hours of salaried staff or when penalty rates and loadings would otherwise be due, and as such were in contravention of the employer record-keeping obligations in the FW Regulations. Relevant to the case, because of these contraventions, the burden of proof was on the respondents to demonstrate that there was no underpayment of employee salaries, rather than the onus to be on the employees to prove that additional payments were due. The court ruled that "logon/logoff" data did not sufficiently detail the nature of entitlements – specifying public holiday and overtime hours – to be a reliable record-keeping mechanism.

In remediating the issue caused by incomplete employee records, the court determined that a statistical method for calculating underpayments is appropriate. The methodology that the court said should be adopted was to use average overtime figures from employees with full records and apply these to others with incomplete records.

Takeaways

The decision in *FWO v Woolworths* is far-reaching and not limited to the retail industry. It has significant impacts for the majority of employers with award-covered employees who pay annualised salaries. There are a number of challenges arising, not least of all the potential for underpayment claims, and how to ensure compliance moving forward.

It appears that no cases have tested the validity of set-off clauses against section 323 of the *FW Act* prior to the recent ruling. Notably, earlier this year, the full bench of the High Court considered the question of set-off clauses in the *Corporate Air Charter Pty Ltd v Australian Federation of Air Pilots* [2025] FCAFC 45 (4 April 2025), yet did not consider section 323 and did not consider provision of set-off clauses as contentious.

While we are likely to see an appeal against the decision by either Coles or Woolworths, it is not clear at this stage what parts of the decision will be appealed and how long an appeal may take to be heard.

In the meantime, there is going to be the need for:

- Much more stringent record-keeping requirements for employers, and recording employees' working hours and relevant entitlements within a pay period
- A review of contractual set-off clauses to ensure that they are sufficiently drafted to allow for set-off (albeit only within a pay period) as against applicable award entitlements
- More regular pay reconciliations of an employee's actual hours and entitlements, and ensuring that any award entitlement shortfalls are identified and rectified immediately
- Consideration as to whether there is scope to implement longer pay periods (i.e. monthly) to allow for ongoing reconciliation of employees' entitlements against actual hours worked
- Consideration as to whether other approaches to remuneration arrangements could work for your organisation, such as utilising the annualised salary provisions in some awards, providing a guarantee of annual earnings, or entering into individual flexibility agreements (although noting that all have their limitations)
- A review of policies and practices relating to overtime, including the use of time off in lieu

The Labour & Employment team in Australia is well-versed in award interpretation, policy and contract drafting, and in supporting clients with pay remediation projects. We are here to provide advice and assistance to organisations impacted by this decision.

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