Holidays Act headaches: Court ruling on “discretionary” bonus payments and customary closedowns, 29 May 2020

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Recent years have seen an increase in Labour Inspector audits and Holidays Act remediation projects. There have also been calls for simplification of the Holidays Act. However, with the Holidays Act Taskforce having reported back to the Minister for Workplace Relations and Safety only in the latter part of 2019, and an overhaul of the legislation some time away, it remains as important as ever for employers to keep abreast of developments in the courts on Holidays Act issues.

The recent Employment Court decision of *Metropolitan Glass & Glazing Ltd* v *Labour Inspector* [2020] NZEmpC 39 is an important decision about payment of bonuses. The judgment serves as a reminder to employers to carefully consider their bonus scheme frameworks and closedown period practices.

The issues

The full court was required to resolve two questions. The first was whether payments made under Metropolitan Glass’ Short-Term Incentive Schemes (STI Schemes) ought to have been included in employees’ gross earnings for the purposes of s 14 of the Holidays Act. If the payments were included in gross earnings, this would mean employees would be paid a higher rate when they took holidays or on termination of employment for the 12 months following the date of payment.

The second issue was whether Metropolitan Glass’ system of allocating annual holidays to employees with less than one year’s service before its Christmas closedown complied with the closedown provisions of the Holidays Act.

The bonus issue

The judgment concerns Metropolitan Glass’ 2016 and 2017 STI Schemes.

The STI Schemes were not referred to in employees’ individual employment agreements.

Employees were invited to participate in the 2016 STI Scheme, described as a “discretionary bonus scheme”, by letter. That letter advised that the STI Scheme was aligned to the achievement of three key targets, with any payment to be based on the employee’s base salary up to a maximum percentage value. The letter advised that “[a]ny payments made under this Scheme are totally at the discretion of Metro’s Board of Directors and there is no guarantee of any payment even if the [three] performance targets are achieved”.

The terms and conditions of the STI Scheme, attached to the letter, also stated that "[a]ny payments made under this Scheme are totally at the discretion of [Metropolitan Glass] and there is no guarantee of any payment in any year. [Metropolitan Glass] has the sole discretion not to make any payment even where the criteria in this Scheme are met. This Scheme is not a term and condition of your employment agreement. Accordingly, any bonus payments made under this Scheme will not come within the definition of 'total gross earnings' for the purposes of holiday pay calculations under the Holidays Act 2003".

The terms and conditions also stated that any payments under the STI Scheme required Board approval, that Metropolitan Glass could choose to make, or not to make, payments at its discretion, and that the STI Scheme could be amended, revoked or discontinued at any time. Employees were required to sign the letter to indicate acceptance of these conditions.

The Court observed that the terms and conditions of the 2017 STI Scheme were "virtually identical" to the 2016 terms and conditions. Employees were also invited by letter to the 2017 STI Scheme, but they were required to agree to an extended restraint of trade provision in exchange for participation in that year's STI Scheme.

Metropolitan Glass argued that the payments made under its STI Schemes were not "payments that the employer is required to pay to the employee under the employee's employment agreement" within the meaning of s 14 of the Holidays Act. Rather, they were "discretionary payments" that could be excluded from gross earnings and from holiday pay calculations.

The Court did not agree. It found that the STI Schemes formed part of the employees' employment agreements. It found that "[a]n employment agreement may be comprised of components in more than one place" so that an employment agreement can be made up of several different documents. The Court also noted that Metropolitan Glass employees had to agree an extension to their restraint of trade as consideration for inclusion in the 2017 STI Scheme.

In addition, the Court did not accept that payments under Metropolitan Glass' STI Schemes were "discretionary payments" as defined in the Holidays Act. The Court found that this argument was counter to the purpose of the Act, particularly when the legislative history was considered. The Court noted that the definition is clear that bonus payments cannot be excluded as "discretionary payments" by virtue of the fact that they are only payable upon certain criteria being met or that their amount is to be determined by the employer. It noted that the Select Committee had contrasted payments of this kind with "truly gratuitous payments" such as Christmas bonuses.

The Court found that Metropolitan Glass' STI Schemes provided an incentive for performance and fell within the meaning of "productivity or incentive-based payments", which s 14 requires be included in gross earnings. It observed that Metropolitan Glass "cannot avoid responsibility simply by labelling the STI Schemes as "discretionary" and that the addition of the definition of "discretionary payments" to the Holidays Act was "directed to concerns about employers avoiding including variable and conditional payments that formed part of an employee's remuneration, which is precisely what Metropolitan Glass is trying to do here".

The closedown issue

The Court was required to consider Metropolitan Glass' treatment of annual holidays during its end of year closedown period for employees with less than 12 months' service.

Section 34 of the Holidays Act governs how employees, who are not entitled to annual holidays, must be paid during closedown periods. It provides:

> **34 Calculation of pay during closedown period for employee not entitled to annual holidays**
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> …
> (2) An employer must, in respect of the closedown period, pay the employee 8% of the employee's gross earnings since the commencement of the employee's employment or since the employee last became entitled to annual holidays (as the case may be), less any amount—
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> (a) paid to the employee for annual holidays taken in advance; or
> (b) paid in accordance with section 28.

(3) An employee who is paid annual holiday pay calculated in accordance with subsection (2) is not otherwise entitled—

(a) to any annual holidays for the period of employment up to the date of the beginning of the closedown period; or

(b) to any remuneration for the period of the closure or discontinuance of work.

(4) This section does not prevent an employer and employee from agreeing that the employee may take the period of the closedown as annual holidays in advance under section 20 and be paid for the period in accordance with section 22.

Metropolitan Glass' practice was to provide an "annual holiday entitlement" to employees in their first year of service, proportionate to the time they had each been working for the company, which they could apply to take during the closedown period and which would remain available to them if not used up during the closedown. Where that "annual holiday entitlement" was insufficient to cover the closedown, Metropolitan Glass allowed these employees to apply to take annual holidays in advance, but otherwise leave at this time would be unpaid. Under this system, Metropolitan Glass did not pay employees 8% of their gross earnings as per s 34(2).

The Court acknowledged that s 34 is "not entirely clear" and that this had been noted by the Holidays Act Taskforce.

However, it found that subsections (2) and (4) of s 34 are "not alternatives, the correct approach is that s 34(4) applies in addition to s 34(2)".

So, in accordance with s 34(2), employers must pay to these employees 8% of their gross earnings. Employers must also reset the anniversary date of these employees to the start of the closedown period, in accordance with s 35. But, in addition to this, s 34(4) allows the employee and employer to agree that the employee may also take annual holidays in advance. The Court presumed this may occur where an employee's 8% payment is less than the amount he or she would otherwise be paid during the closedown.

Accordingly, the Court found that Metropolitan Glass' approach was not compliant with s 34.

Implications for employers

While an assessment of whether or not bonus payments fall within the definition of gross earnings will depend on the particular circumstances of every case, many employers will recognise features of Metropolitan Glass' STI Scheme as existing within their own bonus frameworks. In particular, many employers' schemes may provide for variable and conditional "discretionary" payments and many will clearly state, as did Metropolitan Glass' schemes, that the employer retains discretion not to make payments at all even if targets are met.

Employers should be wary of assuming that the decision stands for broad principles that are necessarily applicable to their own factual circumstances. However, employers should give consideration to their own schemes in light of the judgment, particularly where their own schemes have terms that are similar to the terms of Metropolitan Glass' scheme.

Similarly, employers should give careful consideration to whether their closedown period practices comply with the closedown provisions in the Holidays Act. The guidance the full court provides on the interpretation of those sections makes it clear that payment of 8% of gross earnings to employees not yet entitled to annual holidays is mandatory and that any agreement to take annual holidays in advance is an optional extra, not a substitute for the 8% payment.

Given the potentially wide-reaching implications of the Court's conclusions, an appeal is possible and employers should follow closely the case's progress in the Court of Appeal if an appeal eventuates.