

Calculating holiday pay – when is a discretionary payment not discretionary?

[Hamish Kynaston](#), [Peter Chemis](#), [Sherridan Cook](#), [Susan Rowe](#), [Nicola Cuervo](#), [Alastair Sherriff](#), [Mere King](#), [Holly Hedley](#), [Shaun Brookes](#), [Lorraine Hercus](#), [Emma von Veh](#)

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The Employment Court – three judges sitting as a Full Court – recently issued a decision on two key holiday pay issues involving Metropolitan Glass.^[1] The most far-reaching of those addresses the application of holiday pay to so-called ‘discretionary payments’, such as bonuses.

The Court found that a bonus that was expressed to be discretionary was not, so had to be factored into the employees’ holiday pay. We haven’t seen all of the evidence, but have a different view to the Court.

The second issue concerned the payment of employees during ‘closedown periods’, which we also question.

The STI scheme

The Holidays Act requires “productivity or incentive-based payments” to be taken into account when calculating holiday pay. There are exceptions. Relevant here, holiday pay is not payable on “any payments that the employer is not bound, by the terms of the employee’s employment agreement, to pay the employee, for example any discretionary payments”.

In this case, Metropolitan Glass operated a short-term incentive (STI) scheme, which sat completely apart from the employees’ employment agreements.

The scheme set targets which, if met, could give rise to bonus payments based on a percentage of salary. Metropolitan Glass was not ‘bound’ however to pay bonuses. The scheme wording stated expressly that payment was “totally at the discretion of Metro’s Board... and there is no guarantee of payment even if the... performance targets are achieved”. The other provisions of the scheme were consistent with this level of discretion. There was no ambiguity.

The Full Court’s decision – not discretionary

The Court held that the scheme formed part of the employment agreement. We agree. It does not matter whether the terms of a scheme are captured in a separate document, as employment agreements can be and typically are made up of more than just the core document labelled ‘employment agreement’.

The Court also found that the STI payments were not discretionary and were instead ‘productivity or incentive-based payments’, subject to holiday pay. The Court kept its reasoning relatively brief, but appears to have reached this decision for the following reasons:

- An inference could be drawn that the parties intended the scheme to have contractual force. The purpose of the scheme was to incentivise employees to meet key targets and remunerate them for effort put in if these targets were reached. Entry into the 2017 scheme was in exchange for extending existing restraints of trade
- The scheme referred to specific, albeit non-exhaustive, examples of when a discretion might be exercised to not pay a bonus
- The purpose of the Holidays Act, based on the Act itself and its history, was to “capture all remuneration for an employee’s job” and address “concerns about employers avoiding including variable and conditional payments that formed part of an employee’s remuneration”
- The Court contrasted the scheme to a “truly gratuitous payment”, such as a Christmas bonus paid at the employer’s initiative, which it said was what Parliament intended by ‘discretionary’.

In essence, the Court gave what it saw as the statutory purpose precedence.

Fundamentally, however, Metropolitan Glass was not “bound, by the terms of the employee’s employment agreement” to pay an STI bonus to a given employee in a given year. Further, if Parliament had intended only ‘truly gratuitous payments’ to be excluded, we think it would have used different wording when defining ‘discretionary payment’.

In our view, therefore, the plain wording of the Holidays Act reflected the statutory purpose, and the STI payments ought to have

been recognised as 'discretionary payments'.

Impact for other employers and employees

The Metropolitan Glass scheme is similar to that operated by many employers, and who have reserved a similar discretion - not to get around the Holidays Act, but so they can decide not to pay bonuses should they need or want to. This year is a prime example of when such a discretion might be applied.

In establishing these schemes, employers have set targets, percentages and budgets in reliance on the express wording of the Holidays Act. The Court's decision means they may now be liable for (substantial) arrears of holiday pay, and need to revisit their schemes.

Payment during closedown periods

The Court also took the view that Metropolitan Glass' treatment of annual holidays during closedown periods breached the Act.

Metropolitan Glass was allowing employees with no annual holiday entitlement to take leave in advance, rather than paying 8% of their gross earnings as at the closedown date. The Court acknowledged that the law was "not entirely clear", and gave Metropolitan Glass credit for its approach, but found that it had failed to pay employees correctly during closedown periods, when they did not have annual holidays owing.

The Court found that employees with no annual holiday entitlement must be paid 8% of their gross earnings as at the closedown date, and could agree to take holidays in advance in addition to that payment, and not, as Metropolitan Glass had done, as an alternative to that payment.

We question whether the Court applied the closedown provisions correctly. The Holidays Act expressly provides that the obligation to pay 8% does not prevent an employer and employee from agreeing to annual holidays being taken in advance and paid in the usual way. It appears to us to meet both the spirit and letter of the Act to view this as an alternative option, not an additional one.

Remediation

Because every scheme is different and must be considered on its own merits, other employers will not automatically be bound by this decision, even though practically it may be highly influential. Unless there is a need to make changes urgently, we recommend that employers in similar situations hold off making changes until at least the appeal deadline has passed on 12 May, and that they consider their options carefully after that. We are of course happy to assist.

[1] *Metropolitan Glass & Glazing Ltd v Labour Inspector, Ministry of Business and Innovation and Employment* [2020] NZEmpC 39.

Auckland

188 Quay Street
Auckland 1010

PO Box 1433
Auckland 1140
New Zealand

P: +64 9 358 2555
F: +64 9 358 2055

Wellington

Aon Centre
1 Willis Street
Wellington 6011

PO Box 2694
Wellington 6140
New Zealand

P: +64 4 499 4242
F: +64 4 499 4141

Christchurch

83 Victoria Street
Christchurch 8013

PO Box 322
Christchurch 8140
New Zealand

P: +64 3 379 1747
F: +64 3 379 5659