

## Court of Appeal overturns decision on discretionary payments

### Employers nationwide will be breathing a sigh of relief that the Court of Appeal has reversed a controversial decision which found that incentive payments attracted holiday pay, (sometimes referred to as the "rich get richer" decision)

The Court of Appeal's highly anticipated decision in *Metropolitan Glass & Glazing Limited v Labour Inspector, Minister of Business and Innovation and Employment*<sup>1</sup>, has confirmed the Employment Court got it wrong when it held Metropolitan's incentive payments fell under the definition of "gross earnings" in the Holidays Act 2003 (Act).

Business New Zealand, who appeared as an intervener, said if the Employment Court decision had been upheld, businesses across the country could have been forced to back pay a minimum of \$500 million in holiday pay.

#### The Holidays Act

The decision essentially turned on whether the incentive payments were discretionary or not.

Under the Act, an employer must pay holiday pay on an employee's gross earnings. Under section 14 of the Act, gross earnings includes payments that the employer is required by the employee's employment agreement to make, but excludes any payments that the employer is not bound to pay, such as discretionary payments. The Act is clear that a payment will not be discretionary just because the amount isn't specified or can be determined by the employer, or if conditions have to be met for the payment to be paid.

<sup>1</sup> *Metropolitan Glass & Glazing Limited v Labour Inspector, Minister of Business and Innovation and Employment* [2021] NZCA 560 ("Metropolitan")

#### Metropolitan's incentive scheme

Metropolitan's incentive scheme was not actually contained within the written employment agreement, but set out in a separate letter. The letters outlined conditions attaching to the incentive payments, but also stated that the payments under the scheme were totally at the discretion of the Board of Directors and that there was no guarantee of any payment, even if the performance targets were achieved. The letters specifically stated that any bonus payments made under the Scheme would not come within the definition of "total gross earnings" for the purposes of holiday pay calculations. Metropolitan accordingly treated its incentive payments as discretionary and therefore did not include the payments when calculating holiday pay.

#### The Employment Court decision

Despite this, the Labour Inspector considered the payments should have been included in holiday pay calculations. This was upheld by the Employment Court who found that the incentive payments were required to be paid under the employment agreement and the letters formed part of that employment agreement. The Employment Court further found that the payments were not discretionary, and that the "scheme of section 14 is to capture all remuneration for an employee's job". The Court also held the definition of gross earnings under the Act was intended to capture productivity and incentive based payments. Such payments were contrasted with truly gratuitous payments such as a Christmas bonus on an employer's own initiative to an employee where there is no provision for it in the employment agreement.

#### The Court of Appeal decision

In the Court of Appeal, Metropolitan argued the payments were not made under an employment agreement, and the employer was not required to make

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## Court of Appeal overturns decision on discretionary payments (Continued)

the payments since they were stated as being discretionary.

Metropolitan were unsuccessful on the first argument. The Court of Appeal agreed with the Employment Court that a contract of employment may comprise terms arising from a number of different sources, and the formal written employment agreement will never be the entire contract of service. Regardless of the fact that the incentive clause was not actually in the written employment agreement, it still formed part of the wider employment agreement.

Importantly however, the Court of Appeal agreed with Metropolitan on the second argument. It found the Employment Court was wrong for not considering whether the existence of a residual discretion to not make any payment at all, even if the conditions were met, took the payment "outside the scope of gross earnings and into the territory of a discretionary payment". That error overlooked the key element of the definition of gross earnings: that a payment must be one the employer is contractually bound to pay.

The Court of Appeal went on to say Metropolitan did more than just label its incentive scheme discretionary. It included an express term that even if all the conditions were met, it retained the discretion not to make any payment. On the basis, holiday pay was not payable on the incentive scheme payments.

The Court of Appeal also stated that any discretion not to pay a bonus would have to be exercised fairly and reasonably and failure to do so could be grounds for a grievance. The terms and conditions covering the Metropolitan incentive scheme set out some specific examples where Metropolitan may have chosen to exercise its discretion not to make payment, such as when the employee had been subjected to disciplinary action, involved in a health and safety breach or their overall performance had been assessed as needing improvement.

### Key takeaway

It will be timely for employers to review any documentation relating to bonuses or incentive payments. The key question is whether an incentive payment is one that the employer is contractually bound to pay, or whether there is discretion to pay. To ensure incentive payments are truly discretionary, employers should ensure that any provision clearly states that the employer has the discretion not to make payment at all, even if certain conditions are met. It will not be sufficient to simply state that certain criteria or conditions have to be met, or that the amount payable is at the discretion of the employer. Where it is clearly discretionary, an incentive payment or bonus can be excluded from a gross earnings calculation.

### Further potential changes?

At the time of writing, it does not appear that the Labour Inspector has appealed the decision to the Supreme Court. However, while employers may be celebrating this win, if proposed changes to the Holidays Act go ahead, the decision may be effectively reversed. The Holidays Act taskforce recommended that the definition of gross earnings be amended to include all cash payments received by the employee, except direct reimbursements. This would remove the discretionary payments exception and any incentive or bonus payments would fall under the definition of gross earnings. The Government has accepted the Taskforce's recommendation, but we are yet to see whether this change will form part of the new Act. The Government has signalled it expects to introduce legislation in early 2022.

### Want to know more?

If you have any questions about this decision, please contact our specialist [Employment Team](#).