IN THE COURT OF APPEAL OF NEW ZEALAND

I TE KŌTI PĪRA O AOTEAROA

CA246/2020
[2021] NZCA 560

BETWEEN	METROPOLITAN GLASS & GLAZING LIMITED Appellant
AND	LABOUR INSPECTOR, MINISTRY OF BUSINESS AND INNOVATION AND EMPLOYMENT Respondent

Hearing:	15 July 2021
Court:	French, Cooper and Clifford JJ
Counsel:	J M Roberts and E H Callister-Baker for Appellant A E Scott-Howman for Respondent P T Kiely and S R Worthy for BusinessNZ as Intervenor
Judgment:	26 October 2021 at 9 am

JUDGMENT OF THE COURT

A The appeal is allowed.

B We answer the question of law submitted for determination by this Court:

Did the Employment Court err in law by concluding that payments made by the appellant from its short term incentive bonus schemes were "payments that the employer is required to pay to the employee under the employee's employment agreement" and therefore fell within the definition of "gross earnings" under s 14 of the Holidays Act 2003?

Answer: Yes

C The respondent must pay the appellant costs for a standard appeal on a band A basis with usual disbursements.

D Leave is reserved to the parties to come back to the Court on the issue of costs in the Employment Relations Authority and the Employment Court.

REASONS OF THE COURT

(Given by French J)

Introduction

[1] The appellant Metropolitan Glass & Glazing Ltd (Metropolitan) implemented discretionary bonus schemes for its employees in 2016 and 2017. The schemes were called Short Term Incentive Bonus schemes (STIB schemes).

[2] Metropolitan considered payments made under its STIB schemes were discretionary payments for the purposes of s 14 of the Holidays Act 2003, and therefore not required to be taken into account when calculating the amount of holiday pay it was obliged to pay its employees during annual leave. The Labour Inspector took a different view. The Inspector said the payments were gross earnings, not discretionary payments.

[3] The dispute began in the Employment Relations Authority but following a joint application was removed to the Employment Court because it was considered to raise an important question of law.[1] The Employment Court then convened a full Court to hear the matter. The Court found in favour of the Inspector.[2]

[4] Dissatisfied with that outcome, Metropolitan then sought and obtained leave to appeal from this Court on the following question of law:[3]

> Did the Employment Court err in law by concluding that payments made by the [appellant] from its short term incentive bonus scheme were "payments that the employer is required to pay to the employee under the employee's

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1 *Metropolitan Glass & Glazing Ltd v Labour Inspector* [2019] NZERA Auckland 188. See Employment Relations Act 2000, s 178.

2 *Metropolitan Glass & Glazing Ltd v Labour Inspector, Ministry of Business and Innovation and Employment* [2020] NZEmpC 39, (2020) 17 NZELR 331 [Employment Court decision]. The Employment Court determined another question of law relating to the treatment of annual holidays when there is a closedown period. This issue is not before this Court.

3 *Metropolitan Glass & Glazing Ltd v Labour Inspector, Ministry of Business, Innovation and Employment* [2020] NZCA 264.

> employment agreement", and therefore fell within the definition of "gross earnings" under s 14 of the Holidays Act 2003?

[5] This Court also granted leave to BusinessNZ to participate in the appeal hearing as an intervenor. BusinessNZ is concerned about the wider implications of the Employment Court decision. It contends if allowed to stand, the decision is likely to result in backpay obligations amounting to hundreds of millions of dollars for New Zealand employers throughout the country who believed they were acting lawfully and in accordance with the Holidays Act.

The key statutory provisions in the Holidays Act

[6] Under the Holidays Act, employees are entitled to four weeks paid annual leave.[4] The Act stipulates how the amount of the holiday pay is to be calculated.[5] For present purposes, the detail of the calculation is not relevant. What is critical however is the statutory definition of "gross earnings" and "discretionary payment". If the payments made by Metropolitan under the STIB schemes came within the definition of "gross earnings" then they should have formed part of the holiday pay calculation. But if they were within the definition of "discretionary payments" then Metropolitan was correct in not taking them into account.

[7] "Gross earnings" is defined in s 14 of the Holidays Act in the following way:

> **14 Meaning of gross earnings**
>
> In this Act, unless the context otherwise requires, **gross earnings**, in relation to an employee for the period during which the earnings are being assessed,—
>
> (a) means all payments that the employer is required to pay to the employee under the employee's employment agreement, including, for example—
>
> (i) salary or wages:
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> (ii) allowances (except non-taxable payments to reimburse the employee for any actual costs incurred by the employee related to his or her employment):
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> (iii) payment for an annual holiday, a public holiday, an alternative holiday, sick leave, bereavement leave, or family violence leave taken by the employee during the period:

4 Holidays Act 2003, s 16.
5 Section 21.

(iv) productivity or incentive-based payments (including commission):

(v) payments for overtime:

(vi) the cash value of any board or lodgings provided by the employer as agreed or determined under section 10:

(vii) first week compensation payable by the employer under section 97 of the Accident Compensation Act 2001 or former Act; but

(b) excludes any payments that the employer is not bound, by the terms of the employee's employment agreement, to pay the employee, for example—

(i) any discretionary payments:

(ii) any weekly compensation payable under the Accident Compensation Act 2001 or former Act:

(iii) any payment for absence from work while the employee is on volunteers leave within the meaning of the Volunteers Employment Protection Act 1973; and

(c) also excludes—

(i) any payment to reimburse the employee for any actual costs incurred by the employee related to his or her employment:

(ii) any payment of a reasonably assessed amount to reimburse the employee for any costs incurred by the employee related to his or her employment:

(iii) any payment of any employer contribution to a superannuation scheme for the benefit of the employee:

(iv) any payment made in accordance with section 28B.

[8] As will be seen, excluded from the concept of "gross earnings" are payments that the employer is not bound by the terms of the employee's employment agreement to pay. A discretionary payment is then cited as an example of such a payment.

[9] The term "discretionary payment" is itself separately defined in s 5(1) of the Holidays Act:

discretionary payment—

(a) means a payment that the employer is not bound, by the employee's employment agreement, to pay the employee; but

(b) does not include a payment that the employer is bound, by the employee's employment agreement, to pay the employee, even though—

(i) the amount to be paid is not specified in that employment agreement and the employer may determine the amount to be paid; or

(ii) the employer is required under that employment agreement to make the payment only if certain conditions are met

[10] The effect of this definition is to make clear that a payment will still be considered a payment that the employer is bound by the terms of the employment agreement to pay and so not a discretionary payment even although:

(a) the amount to be paid is not specified in the employment agreement and may be determined unilaterally by the employer; or

(b) the employer's obligation to make the payment under the employment agreement is subject to certain conditions being met, that is to say is conditional.

Metropolitan's STIB schemes

[11] In January 2016, Metropolitan sent a letter to certain senior employees inviting them to participate in what the letter described as a discretionary bonus scheme.

[12] The salient features of the letter and the scheme are conveniently summarised in the Employment Court decision:[6]

[7] The letter advises that the basics of the [STIB] Scheme for 2016 were:

1. The Scheme has a non-negotiable condition that there must be no significant health and safety incidents which result in death or permanent material disability of any worker or that are caused by any worker of [Metropolitan].

2. The Scheme will be aligned to the achievement of three key deliverable targets:

a) EBIT targets - 75% weighting

6 Employment Court decision, above n 2.

b) Retrofit Sales Revenue - 12.5% weighting

c) DIFOT - 12.5% weighting

3. The targets in point two are independent of one another, therefore if one target is not met, the employee may still receive payment under the Scheme upon achievement of one or more of the remaining targets.

4. Any payment made under the Scheme will be based on a full 12 months of your base salary (assuming you have been employed since at least 1 April 2015).

5. If you have been employed after 1 April 2015 any payment will be pro-rated for the number of months employed.

6. For those who are based in the regions and their roles have a regional only focus, any bonus payment will be based on the regional financial performance.

7. Any payments made under this Scheme this year will have a maximum payment amount of 120% based on achieving 110% of the relevant target deliverables.

8. Any 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 DIFOT, Retrofit & EBIT performance targets are achieved.

[8] The letter outlined the targets for that year's [STIB] Scheme, with incentive payments calculated as a percentage of base salary where the targets were met.

[9] The letter also attached the terms and conditions of the [STIB] Scheme. Those terms and conditions include:

> Any payments made under this Scheme are totally at the discretion of [Metropolitan] and there is no guarantee of any payment in any year. [Metropolitan] 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.
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> 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.

[10] The terms and conditions go on:

> The payment of any amounts pursuant to this Scheme are subject to various conditions which may be amended by [Metropolitan] from time to time…

[11] Some conditions are listed including that:

> Following the completion of the year-end financial statements [Metropolitan] will calculate any bonus and determine whether a bonus payment will be made. If [Metropolitan] decides to make a bonus payment, this will not occur until the Board of Directors has approved the bonus payment.

[12] The terms and conditions again say that the [STIB] Scheme is discretionary and therefore that Metropolitan Glass may choose to make, or not make, payments under the [STIB] Scheme at its discretion. Metropolitan Glass also was able to amend, revoke or discontinue the [STIB] Scheme at any time at its sole discretion, including during a fiscal year.

[13] The terms and conditions gave some examples of when Metropolitan Glass might choose to exercise its discretion to change the terms of the scheme and/or not make payments, even where criteria are met, being:

> • The employee has been subject to disciplinary action during the period of the Scheme.
>
> • The employee has been involved in, responsible for or failed to prevent a significant Health & Safety incident or breach.
>
> • The employee's overall performance appraisal result was Needs Improvement.

[14] When accepting the offer, the employee signed the letter of invitation acknowledging that payment under the [STIB] Scheme:

> … is completely discretionary and [Metropolitan] can at its sole discretion decide not [to] make any payment under this scheme, or amend, revoke or discontinue this Scheme at any time. …

[13] As already mentioned, Metropolitan implemented a second STIB scheme in 2017. It contained a provision that in consideration for the invitation to participate in the scheme the employee agreed to an extended restraint of trade clause. In all other respects, the terms and conditions of the 2017 STIB scheme were substantially the same as the 2016 scheme.

Grounds of appeal

[14] Metropolitan advances two key grounds. Both relate to the definition of gross earnings which it will be recalled is "all payments that the employer is required to pay to the employee under the employee's employment agreement". Metropolitan submits

the definition comprises two elements, neither of which is satisfied in the case of the STIB schemes.

(a) The payment must be made under the employment agreement. Correctly interpreted, the phrase "employment agreement" as it appears in s 14 of the Holidays Act means a narrowly defined written contractual document that complies with the various requirements under the Employment Relationship Act 2000. The employees in question had comprehensive individual employment agreements which complied with the requirements of the Employment Relations Act both as to content and pre-contractual process. The STIB schemes were not mentioned in those formal agreements. They were contained in an entirely separate, stand alone document. Therefore the payments were not made under the employment agreement.

(b) The payment must be a payment the employer is required to make. Here, the making of any payment under the STIB scheme was wholly discretionary.

[15] These two key arguments were also raised in the Employment Court. It is therefore convenient to structure our discussion around each issue separately.

What is the meaning of "employment agreement"?

The Employment Court decision

[16] In rejecting Metropolitan's contention, the Employment Court held that an employment agreement may be comprised of components in more than one place. Policies may be incorporated into an employment agreement not only by express reference but also by inference. As regards the latter mode of incorporation, the Court said the test to be applied was whether it is reasonable to infer from the circumstances that the parties must have intended the relevant terms to have contractual force. [7]

[7] Employment Court decision, above n 2, at [24].

[17] Applying that test to the STIB schemes, the Court held that the schemes were designed to incentivise employees and the payments were thus remuneration for effort. The fact the parties intended the schemes to have contractual force was, the Court found, reinforced by consideration of the fact that in 2017 the STIB scheme involved an extension of the restraint of trade clause.[8]

[18] The Court went on to hold that "[i]n any event at least in the context of s 14" the narrow approach argued by Metropolitan cannot have been intended by Parliament. That was evidenced by the express inclusion of productivity and incentive payments in s 14(a)(iv). That provision clearly contemplated that such payments are captured whether the payments arise out of a written individual agreement or from policy documents or contained in a separate document.[9]

Metropolitan's arguments on appeal

[19] Counsel for Metropolitan, Mr Roberts submitted the Court's reasoning was based on interpreting the term "employment agreement" in s 14 as if it included all of the rights, benefits and obligations arising out of the employment relationship. However, in his submission, that interpretation was contrary to the distinction between employment agreement and terms and conditions of employment that has been drawn in the caselaw, including a decision of this Court.[10] It was also contrary to a number of statutory provisions.

[20] Developing that submission, Mr Roberts argued that "employment agreement" under the Holidays Act has the same meaning as it has under the Employment Relations Act. He then referred us to a number of sections in the Holidays Act and the Employment Relations Act which use the phrase "employment agreement" and which because of the subject matter can only be using that phrase in the sense of the formal

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8 At [25].

9 At [26].

10 *Tranz Rail Ltd v Rail & Maritime Transport Union (Inc)* [1999] 1 ERNZ 460(CA). See also *Elston v State Services Commission (No 3)* [1979] 1 NZLR 218 (SC) at 234–235, citing *Stock v Frank Jones (Tipton) Ltd* [1978] 1 WLR 231 (HL) and *British Broadcasting Corp v Hearn* [1977] 1 WLR 1004 (CA); *ANZ National Bank Ltd v Doidge* [2005] ERNZ 518 (EmpC) at [45]; *Johnson v Chief of the New Zealand Defence Force* [2019] NZEmpC 192, (2019) 17 NZELR 137 at [72]–[79]; and *Spotless Facility Services NZ Ltd v Mackay* [2017] NZEmpC 15 at [49]–[50].

written employment contract, not the different concept of terms and conditions of employment.[11]

[21] Mr Roberts accepted it was possible to incorporate another document into an employment agreement if the employment agreement contained an express reference to that other document. But in this case the STIB schemes were not mentioned in the relevant employment agreements. As for the Employment Court's reliance on incorporation into the employment agreement by inference, Mr Roberts argued that could not apply in this case either because each STIB scheme contained an express provision that the scheme did not form part of the employment agreement.

Our assessment

[22] The starting point of the textual analysis must be s 5(2)(a) of the Holidays Act. It provides that certain specified terms in the Act are to have the same meanings as in s 5 of the Employment Relations Act. One of those specified terms is "employment agreement."

[23] However, that is not all that s 5(2) says about adopting Employment Relations Act definitions for the purposes of the Holidays Act. It adds a qualifier "unless the context otherwise requires". Further and in any event, when one goes to the definition of "employment agreement" in the Employment Relations Act itself, it too is expressly subject to the context otherwise requiring. That explains why the Inspector was able to point us to provisions in the Employment Relations Act where "employment agreement" did not have the narrow meaning attributed to it by Metropolitan.[12] The usage is not consistent.

[24] Moreover, looking at the wording of the Employment Relations Act definition, it is significant that the core element of the definition of "employment agreement" is "means a contract of service". References to collective and individual employment agreements in the definition are prefaced with the word "includes".

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11 Employment Relations Act, ss 4(4)(a)–(bb), 5, 32, 54, 63A(1), 63A(2)(a)–(d), 64(1)–(2) and (6), 65, 66(4) and (6), 67A(2)(a), 67D(1), 67E, 67F(2)(b) and (3) 67G(2), 69OJ, 103(1)(a)–(b), (h) and (4)(b), 104(1), 106(4), 108(1), 108A, 109, 110, 110A, 118, 123(d), 130(1B)(b) and (c); and Holidays Act ss 5(2)(a), 28C, 28D, 44A, 44B, 52 and 53.

12 Employment Relations Act, ss 61, 62(2), and 238. Holidays Act, s 6.

[25] In short, it is wrong in our view to assume that the term "employment agreement" will always have the same meaning wherever it appears in the legislation.

[26] That leads us to the well-established principle that a contract of employment (service) between employer and employee may comprise terms arising from a number of different sources. Indeed, that is virtually always the case given the ongoing and dynamic nature of the employment relationship. To put it another way, the formal written employment agreement is never the entire contract of service. It is only one source (albeit often the main source) of contractually binding terms.[13]

[27] Drawing all those threads together, our view is that what meaning is to be attributed to the phrase "employment agreement" as it appears in s 14 and s 5 turns on context and the underlying purpose and policy justifications.

[28] It is we consider noteworthy that Mr Roberts was unable to identify any policy reason why Parliament would have wanted to limit the meaning of "employment agreement" in a narrow way in the context of s 14. If his interpretation were correct, it would mean that an incentive payment would be regarded as gross earnings if it were contained in the main employment agreement, but a discretionary payment if it was in a separate document even although the terms of the incentive payment were exactly the same. That in our view would be a nonsensical result which Parliament is most unlikely to have intended.

[29] In our view, the meaning of the provisions is clear. The hallmark of a discretionary payment and what distinguishes it from gross earnings is that it is a payment the employer is not contractually bound to make. If the employer was contractually bound to make the payment, then subject to a limited number of specified exceptions, it is gross earnings. The source of the employer's contractual obligation is irrelevant.

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13 *NZ Meat Workers and Related Trades Union Inc v AFFCO (NZ) Ltd* (2009) 6 NZELR 643 (EmpC) at [45].

[30] Contrary to a submission made by Mr Roberts, that interpretation does not render the reference to "under the employee's employment agreement" meaningless or surplusage. The reference makes clear that the sort of obligations that are relevant are contractual obligations.

[31] The interpretation we adopt is entirely consistent with the legislative purpose which is to ensure that employees are not financially disadvantaged when they take annual leave. They should generally be in no worse position than if they were working. Otherwise there is a disincentive to take the leave.

[32] It follows we agree with the Employment Court that the mere fact the STIB schemes were in separate documents to the individual employment agreements does not of itself take them outside the category of gross earnings.

[33] In our view this case turns on whether Metropolitan had a contractual obligation to make the payment however that obligation arose. And it is to that issue and the meaning of discretionary payment that we now turn.

Meaning of discretionary payment

The Employment Court decision

[34] The Court held that the scheme of s 14, especially when considered with the words and purpose of the s 5 definition of discretionary payment, was to capture all remuneration for an employee's job.[14] That this included productivity and incentive based payments was made clear by s 14(a)(iv).[15] It will be recalled that s 14(a)(iv) gives as an example of gross earnings "productivity or incentive-based payments (including commission)". Such payments were the Court said to be contrasted with truly gratuitous payments such as Christmas bonuses that were paid on an employer's own initiative.[16]

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14 Employment Court decision, above n 2, at [33].
15 At [34].
16 At [33].

[35] Applying that interpretation of s 14 to Metropolitan's STIB scheme, the Court said that as the name of the scheme suggested the payments under the schemes are to provide an incentive for performance and were tied to productivity targets. They therefore fell within s14(a)(iv).[17] It went on to say that Metropolitan could not avoid its responsibility as it was trying to do by labelling the scheme as discretionary and by making the payments variable or conditional.[18] Under the statutory definition of "discretionary payment" neither the variability of the amount of the payment nor the conditional nature of it makes the payment a discretionary payment for the purposes of the Act.[19]

[36] The Court drew support for its interpretation of the statutory provisions from a Select Committee report presented to Parliament when the Holidays Act was amended in 2010 to include the current definition of "discretionary payment".[20]

Our view

[37] As we understand the Employment Court's decision, the central premise and the effect of it is that an incentive or productivity based payment will always be gross earnings within the meaning of the Act and can never be a discretionary payment.

[38] As a result of taking that approach to the statutory regime, the Court never proceeded to consider whether the existence of a residual discretion under the STIB scheme not to make any payment even if all conditions were met took it outside the scope of gross earnings and into the territory of a discretionary payment.

[39] In our view, that was an error because it overlooked that the key element of the definition of gross earnings is that the payment at issue must be one the employer is contractually bound to pay. Conversely the definition of discretionary payment is a payment the employer is not contractually bound to pay. As already mentioned, that is the dividing line between them. Section 14 does not say all employment related remuneration for the job is gross earnings, something it could easily have said.

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17 At [35].
18 At [36]–[37].
19 At [38].
20 At [31] citing Holidays Amendment Bill 2010 (195-2) (select committee report) at 2–3.

[40] It is of course correct that conditional payments are outside the definition of discretionary payments but in our view that is only where the employer is contractually bound to make the payment if the conditions are met. We are reinforced in that interpretation by reference to the same passage in the Select Committee report which the Employment Court cited and from which it drew its Christmas bonus example. What the Select Committee said was:[21]

> … employees may have agreements with their employer that they will receive a yearly bonus providing certain conditions are met. The amount of the bonus may be a set amount or a variable amount; and it may not be payable every year because the employee may not meet the conditions every year. It should be included in the calculation of an employee's gross earnings (and therefore not treated as a discretionary payment) because it is part of the employment agreement, *and it will be paid if the employee meets the conditions*. An example of a discretionary payment by contrast is a Christmas bonus paid on an employer's own initiative to an employee where there is no provision for it in the employment agreement. Such a payment should not be included in an employee's gross earnings.
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> (emphasis added)

[41] Metropolitan did more than just label its scheme discretionary. It included an express term that even if all of the conditions were met, it retained the discretion not to make any payment. It would of course be under an obligation to exercise that discretion fairly and reasonably,[22] and a failure to do so could be grounds for a personal grievance, but in our view being neither guaranteed nor conditional the payment would still retain the character of a discretionary payment for the purposes of the Holidays Act.[23]

[42] We have considered whether a residual discretion to make no payment at all is the equivalent of a provision empowering the employer to determine the amount of the payment thereby bringing the scheme within subs (b)(i) of the s 5 definition of "discretionary payment". However it is a pre-requisite to the application of subs (b)(i)

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21 Holidays Amendment Bill 2010 (195-2) (select committee report) at 2–3.

22 The obligation of an employer to act fairly and reasonably consistent with its statutory obligation of good faith is well established and has been applied in cases involving bonus payments: *Jamieson v Fortlock Security Systems (2008) Ltd* [2019] NZERA Auckland 408; and *Gordon v Adshel New Zealand Ltd* [2014] NZERA Auckland 159.

23 For completeness, we record that in our view the fact that one of the STIB schemes was tied up with employees agreeing to an extension of a restraint of trade covenant does not render the payment non-discretionary. In our view, correctly analysed the consideration given by Metropolitan to the employees for agreeing to the extension was the right to be part of the STIB scheme, that is to say the right to be considered.

that the amount to be paid is not specified in the agreement. The STIB schemes do specify amounts.

[43] Finally we have also considered the submission made on behalf of the Inspector that if we were to uphold the appeal, that would enable an employer to pay an employee a deliberately low salary and top it up with regular so-called discretionary payments. As a result, the holiday pay would be much less than regular remuneration and the employee thereby disincentivised from taking holidays.

[44] We consider that to be an extreme example that cannot detract from what we consider to be a correct interpretation of existing provisions. Moreover if BusinessNZ is right and our interpretation restores what has always been the settled understanding of its members prior to the Employment Court decision under appeal, there would be evidence of such a practice. Yet, there is none.

Outcome

[45] The appeal is allowed.

[46] We answer the question of law submitted for determination by this Court:

> Did the Employment Court err in law by concluding that payments made by the appellant from its short term incentive bonus schemes were "payments that the employer is required to pay to the employee under the employee's employment agreement" and therefore fell within the definition of "gross earnings" under s 14 of the Holidays Act 2003?
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> Answer: Yes

Costs

[47] In the event the appeal was successful Mr Roberts sought costs for a standard appeal on a band A basis with usual disbursements. There is no reason why costs should not follow the event and we so order.

[48] Mr Roberts also asked that costs in the Employment Relations Authority and the Employment Court should lie where they fall. We are not aware of any costs award being made in either forum and therefore there does not seem to be any need for us to make any order. In the event we are wrong about that, then leave is reserved to the parties to come back to this Court on that issue.

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