

**IN THE EMPLOYMENT RELATIONS AUTHORITY  
WELLINGTON**

**WA 54/08  
5093816**

BETWEEN      ANDREW WATSON  
                         Applicant

AND              MICROSOFT      NEW      ZEALAND  
                         LIMITED  
                         Respondent

Member of Authority:      Leon Robinson

Representatives:          Michael Quigg, Counsel for Applicant  
                                 Doug Alderslade, Counsel for Respondent

Investigation Meeting:      20 November 2007

Determination:              1 May 2008

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**DETERMINATION OF THE AUTHORITY**

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**The problem**

[1] This is a dispute concerning Mr Andrew Watson's ("Mr Watson") entitlement to holiday pay in respect of bonus payments received from his former employer Microsoft New Zealand Limited ("Microsoft"). Mr Watson asks the Authority to clarify the dispute between the parties by determining that Microsoft is obliged to pay him holiday pay on certain elements of his remuneration that he was paid for the six years of his employment before his resignation.

[2] The parties were unable to resolve the differences between them by the use of mediation.

**The facts**

[3] Mr Watson was first employed by Microsoft as a senior account manager under the terms set out in a letter of offer dated 13 April 1999 ("the letter of offer").

[4] The letter of offer included this term:-

*3. You will be eligible to participate in Microsoft's performance-based system. This system is designed to reward employees that out-perform the requirements of the position and can represent a substantial amount, up to 15% of your base salary. Payment is not guaranteed, as it is subject to your level of performance, business needs and company performance.*

[5] Mr Watson's terms of employment were varied in October 2001. His title changed to major account manager in addition to other variations as recorded in a letter entitled "*Changes to terms and conditions of employment*" dated 18 October 2001 ("the variation letter"). Mr Watson signed the variation letter evidencing his agreement to the variations on 26 October 2001. The variation letter materially provided:-

*Further to our recent discussions we confirm that the segmentation of your accounts will change, and to reflect those changes your job title will now be Major Account Manager. This position is categorised as an "Integrated Solution Selling" (ISS) position otherwise, the functionality and level of your position with Microsoft New Zealand Limited (Microsoft) will essentially remain the same.*

*This letter sets out some variations to the terms and conditions of your employment as a result of these changes. Accordingly, this letter should be read in conjunction with your letter of offer dated 14 April 1999 provided that where there is any inconsistency between the two, the contents of this letter will prevail.*

*While your overall level of remuneration will not decrease, the method of calculating your remuneration will change. Effective from 1 July 2001, your remuneration will be determined on the following basis:*

- 1. Your base annual salary is gross \$97,650.00 per annum less tax.*
- 2. As a participant in the ISS Sales Incentive Plan, you will be eligible to receive a non-recoverable Revenue Based Incentive (RBI) award of 0-300% of your prorated target RBI. Your annual target RBI of \$39,857.00 will be prorated based on the number of days you are in an RBI eligible position. The RBI award will be based on overall individual or team performance during the fiscal year and will be reconciled in (March and) September. Future annual target RBI amounts will be determined at the beginning of each fiscal year. See your manager or HR Manager for further explanation of this bonus program. Microsoft reserves the right to amend the plan and quota for each fiscal year. Where in Microsoft's opinion the business climate requires a change to the plan during any fiscal year Microsoft reserves the right to amend the incentive amount and/or quota during the fiscal year after reasonable consultation with you.*
- 3. You may also be eligible to be considered for any additional target incentive if you achieve more than 100% of the quota. Details of any eligibility for additional target incentives will be advised.*

*Formal performance reviews will be held annually, to evaluate your performance, set new objectives and communicate any issues. Target Total Cash increases are awarded at Microsoft's discretion and subject to matters including your level of performance, market conditions and company performance.*

[6] ISS is an acronym for "Integrated Solution Selling". In full, the scheme is referred to variously as the *ISS Sales Incentive Plan* and also as *ISS Incentive Compensation Plan*. I prefer to refer to as it is titled in the variation letter, i.e, the ISS Sales Incentive Plan.

[7] The description of the *ISS Sales Incentive Plan* in the variation letter is deceptively simplistic. While the description states what it is, the operation of the plan is complicated as is apparent from the detail set out in each separate Plan Summary & Plan Participation Agreement Form that Mr Watson signed in respect of each payment.

[8] In addition to the RBI awards referred to in the variation letter, Mr Watson was also entitled to receive Commitment Based Incentive ("CBI") awards. The CBI award is a classic incentive scheme based on a performance appraisal system assessed on "soft" targets typically referred to as key performance indicators (KPIs). The parameters of the incentive scheme are advised to staff in July and August each year.

[9] The CBI payments are paid out of a fixed pool bonus. The amount available in the pool each year varies and consequently, the amount paid to an individual varies each year. At the end of each financial year in June or July, there is a performance review process. This process is fully documented and provides feedback to each employee on their commitments and individual performance. Managers perform a moderation process to ensure consistency.

[10] The bonus year ran from 1 July to 30 June of each year. Mr Watson received RBI and CBI awards for each of the years from 1999 to 2007.

[11] Mr Watson's employment with Microsoft ended as from 23 May 2007.

## The merits

[12] I agree with the submission that the central issue is whether the incentive payments (RBI and CBI) were payments Microsoft was contractually bound to make.

[13] Under the *Holidays Act 2003*, section 21 deals with the calculation of annual holidays taken during the course of employment and section 24 deals with holiday pay entitlements in relation to annual holiday entitlements not taken at the time the employment came to an end.

[14] Section 21(2)(b) provides that the rate of payment for an employee's annual holiday entitlement is to be calculated on the following basis:-

*... at a rate that is based on the greater of—*

- (i) the employee's ordinary weekly pay as at the beginning of the annual holiday; or*
- (ii) the employee's average weekly earnings for the 12 months immediately before the end of the last pay period before the annual holiday.*

[15] Section 24(2) outlines the rate of payment on equivalent terms in relation to annual holiday entitlements not taken at the time the employment of an employee comes to an end.

[16] The calculations involve determination of an employee's "ordinary weekly pay" and "average weekly earnings".

[17] Section 8 of the *Holidays Act 2003* defines "ordinary weekly pay":

*(a) means the amount of pay that the employee receives under his or her employment agreement for an ordinary working week; and*

*(b) includes—*

- (i) productivity or incentive-based payments (including commission) if those payments are a regular part of the employee's pay;*
- (ii) payments for overtime if those payments are a regular part of the employee's pay;*
- (iii) the cash value of any board or lodgings provided by the employer to the employee; but*

*(c) excludes—*

- (i) *productivity or incentive-based payments that are not a regular part of the employee's pay:*
- (ii) *payments for overtime that are not a regular part of the employee's pay:*
- (iii) *any one-off or exceptional payments:*
- (iv) *any discretionary payments that the employer is not bound, under the terms of the employee's employment agreement, to pay the employee:*
- (v) *any payment of any employer contribution to a superannuation scheme for the benefit of the employee.*

[18] Section 5 of the *Holidays Act 2003* defines “average weekly earnings” as “1/52 of an employee’s gross earnings”.

[19] Section 14 provides that “gross earnings”

*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:*
- (ii) *allowances:*
- (iii) *payment for an annual holiday, a public holiday, an alternative holiday, sick leave, or bereavement leave taken by the employee during the period:*
- (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 Injury Prevention, Rehabilitation, and 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 Injury Prevention, Rehabilitation, and 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.*

(emphasis added)

[20] Mr Watson maintains that the RBI and CBI payments made to him during his service with Microsoft were made on a non-recoverable basis in accordance with the terms and conditions of his employment. He maintains such payments were not discretionary payments within the meaning of section 14(b)(i) of the *Holidays Act 2003*, but rather, were clearly “productivity or incentive-based payments (including commission)” within the meaning of section 14(a)(iv) of the *Holidays Act 2003*. Accordingly, such payments were “gross earnings” for the purposes of the *Holidays Act 2003* and therefore attracted an entitlement to holiday pay. He has made demand from Microsoft for payment of holiday on this basis but Microsoft has refused to pay.

[21] Microsoft argues the converse position. It says that the variation letter read according to its plain ordinary meaning and the description of the *ISS Sales Incentive Plan* in the letter and the documents comprising the plan, do not permit an interpretation elevating the discretionary bonus scheme to an enforceable term of the employment agreement. It is said that the old bonus scheme set out in the letter of offer and the new bonus scheme referred to in the variation letter and better documented, clearly remained discretionary.

[22] The incentive payments were made throughout Mr Watson's employment with Microsoft and the arrangements in respect of them were never changed.

[23] So are the RBI and CBI payments included in gross earnings on which holiday pay must be paid? Gross earnings is defined as “all payments that the employer is required to pay to the employee under the employee’s employment agreement”. The *Holidays Act 2003* gives examples of inclusions and exclusions but what is critical is that the payment must be one which the employer is “required to pay” under the employment agreement.

[24] Microsoft relies on notifications set out in the ISS Incentive Compensation Plan Participation Agreements as evidencing the truly discretionary nature of the incentive payments. It says the notifications make it clear beyond doubt that the scheme is not contractual in any way.

[25] The 2002 Plan document has this notice at the footer of each and every page:-

*This Plan is effective for the entire 2002 Fiscal Year. Microsoft reserves the right to amend or terminate the ISS Incentive Compensation Plan at any time.*

[26] At the execution part of the Plan there is this notice:-

*This plan, like all plans related to compensation, is subject to being modified or discontinued by Microsoft at any time, in its sole discretion. As with all plans related to compensation, Microsoft retains sole and complete discretion to modify or discontinue this plan. Microsoft also reserves the right to adjust Quotas as necessary at anytime.*

[27] On the title page there is this footer:-

*...This document is not intended and shall not be read to create any express or implied promise or contract for employment, for any benefit, or for specific treatment in specific situations. Your employment relationship with Microsoft is at-will, meaning your employment is not for any minimum or set period, it is subject to the mutual consent of you and Microsoft, and either you or Microsoft can terminate your employment at any time, for any or no reason, with or without cause, notice of any kind of pre- or post-termination warning, discipline or procedure. In Microsoft's sole discretion, this document and the guidelines stated in it may be changed or discontinued at any time without prior notice.*

[28] The title page to the 2003 Plan has this notice:-

*Notice: This document and any verbal, written, or electronic communications related to the subject matter contained in this document are not intended and shall not be read to create any express or implied promise or contract for employment, for any benefit, or for specific treatment in specific situations. In Microsoft's sole discretion, this document and the guidelines stated in it may be changed or discontinued at any time without prior notice.*

[29] In the eligibility section of the 2003 Plan there is this statement:-

*... the company retains the right to modify or terminate the Plan, assign accounts, or adjust Quotas at any time. Microsoft has no obligation to treat the employee's*

*uniformly when setting quotas or Target RBI amounts or awarding year end onus(sic) payouts over 300%.*

[30] The execution of the Plan is by electronic signature in the same way as what are known as end-user licence agreements are executed. There is an acknowledgement at that execution as follows:-

*As with all plans related to compensation, Microsoft retains the sole and complete discretion to amend or terminate the FY03 ISS Plan at any time, without notice.*

[31] The 2004 Plan contains these statements on eligibility:-

*Your signature on this Plan Participation Agreement (PPA) enrolls(sic) you in the FY04 Sales Incentive Compensation Plan at Microsoft.*

*The business requirement of executing the PPA is not subject to negotiation and is a condition of participation in the Sales Incentive Compensation Plan.*

*Failure to sign this document will make you ineligible to receive any incentive compensation under the Sales Incentive Compensation Plan.*

[32] It is the various statements and notifications I have set out above that Microsoft refers to in support of its answer to Mr Watson's claim now that the incentive payments were entirely discretionary and Microsoft is not bound to pay.

[33] The context of the notifications I have cited is in terms of an "employment at will". That was not the nature of Mr Watson's engagement with Microsoft New Zealand Limited. It made no sense to have Mr Watson sign documentation electronically or otherwise premised in that context. That being the context of the documentation, I regard the various notifications repeated in them with caution.

[34] I do not agree that a prerogative to amend or terminate the ISS Sales Incentive Plan is the same as a discretion whether or not to pay. The various participation plans reserve to Microsoft a prerogative to amend or terminate a Plan. But where a Plan is in place, I do not agree that Microsoft can decide not to pay. A prerogative to amend or terminate a Plan in place is not the same as an obligation to pay under a Plan in place. They are two different things.

[35] The various participation plan agreements are subordinate documents to Mr Watson's individual employment agreement. The crucial document is the individual employment agreement because that is what the Holidays Act 2003 expressly refers to. The individual employment agreement is the letter of offer and supplemented by the variation letter.

[36] I find that the incentive payments were both payments Microsoft was required to pay to Mr Watson under Mr Watson's employment agreement. Microsoft was obliged to pay Mr Watson the incentive payments because they were by contract specified as a component of his remuneration in the variation letter. His remuneration is there determined to be his base salary and his eligibility as a participant in the ISS Sales Incentive Plan. That includes the RBI payment and the CBI payment

[37] The definition of Mr Watson's remuneration is decisive of the matter. It is enough in my view that Mr Watson's employment agreement (the letter of offer and the variation letter) specifies his remuneration as inclusive of entitlements under the ISS Sales Incentive Plan. That specification is sufficient to make the payments thereunder contractually enforceable. It is the fact of the specification that is enough to make the payments contractually enforceable. There was no discretion whether or not Mr Watson participated in the scheme. As such, the payments under the scheme are therefore payments Microsoft is bound to pay. That being so, they are not truly discretionary payments if by that Microsoft means it can unilaterally refuse to pay notwithstanding a clear entitlement by an employee.

[38] Mr Watson was entitled to the incentive payments by virtue of his entitlement to participate in the ISS Sales Incentive Plan. That entitlement is derived from his position. Therefore Microsoft was contractually bound to pay according to the terms of the various Performance Plan Agreements subsequently agreed. Having agreed to pay, Microsoft was therefore bound to pay. There cannot therefore be said to be a "discretion to pay".

[39] Nor can there be a "discretion not to pay" notwithstanding the various notifications or disclaimers endorsed on the various documentation. I do not agree

that Microsoft having reserved to itself the power of unilateral termination, has an unfettered power to do so, where it has already agreed to pay. Any action taken by Microsoft is subject to the statutory duty of good faith but also the test of justification set out section 103A of the *Employment Relations Act 2000*. The express contractual power of termination is subject to the relevant legislation provisions. Having agreed to pay, the discretion not to pay is fashioned significantly by the operation of the prevailing legislative provisions.

[40] I am satisfied that Mr Watson should be remunerated for periods of annual leave calculated on his base salary together as well as RBI and CBI earnings, because they were a significant and regular component of his earnings with Microsoft during his service.

[41] I therefore conclude that the both the RBI and CBI payments are payments that Microsoft were “required to pay” and also, that they were productively or incentive-based payments. I find they were not discretionary. They are therefore components of Mr Watson's gross earnings for the purposes of calculating annual leave entitlements.

[42] Microsoft submits the Authority's determination in *Ross & Compass Group NZ Limited* AA361/06, is similar to the present instance, and the Authority there found the payments in that case discretionary. The employment agreement itself in that case made it clear beyond doubt the participation in the incentive scheme was at the company's "absolute discretion". There is no such express provision in the present case. Mr Watson's right of participation is express and not qualified in any way, in the employment agreement.

[43] The New Zealand operation of the multi-national Microsoft group ought to have better documented its employment relationship with Mr Watson in terms of the New Zealand legislative environment. Remuneration entitlements and bonus or incentive payments in particular should always be carefully and comprehensively recorded because of the potential for dispute. The potential for dispute is increased because of the employee's expectation to maximise, and the employer's desire to minimise.

### The determination

[44] I determine that Mr Watson is entitled to receive holiday pay in respect of RBI and CBI awards that he received from Microsoft New Zealand Limited for the six years of his employment preceding the date of his resignation.

### Costs

[45] In the event that costs are sought, I invite the parties to resolve the matter between them, but failing agreement, Mr Quigg is to lodge and serve a memorandum as to costs within 14 days of the date of this Determination. Mr Alderslade is to lodge and serve a memorandum in reply thereafter but within 28 days of the date of this Determination. I will not consider any application outside that timeframe without leave.

Leon Robinson  
**Member of Employment Relations Authority**