

Review of the Holidays Act 2003

Office of the Minister of Labour - Cabinet Business Committee

Proposal

1. This paper seeks Cabinet's agreement to
 - the Government's response to the recommendations made by the Ministerial Advisory Group on the Holidays Act 2003, and
 - proposed amendments to the Holidays Act 2003.

Executive summary

2. In 2009, I set up a Ministerial Advisory Group (the Group) to review the Holidays Act 2003 (the Act). This fulfilled our pre-election commitment. The Group's objectives were to recommend ways to simplify the Act to make it easier for people to understand and apply, reflect current working arrangements and reduce direct and compliance costs. The Group's terms of reference signalled that radical changes to the Act were not being sought. The Group has made recommendations to me on seven areas of the Act which cause the most difficulties for employers and employees.
3. I have considered the policy options presented in the Group's report and assessed three different combinations of options based on the degree of change that would be achieved by each combination. My preferred combination of options represents a mix of recommendations from the Group (as a whole, or from the different representatives) and other policy options I have considered. These options make the changes necessary to achieve the best outcomes from the review. They provide a reasonable balance in meeting employers' and employees' interests.
4. My preferred package consists of:
 - allowing employees and employers to agree to cash up one week of an employee's minimum entitlement to annual holidays, at the employee's request
 - altering the payment of sick leave, bereavement leave, public holidays and alternative holidays from relevant daily pay to average daily pay
 - restoring the ability of employers and employees to agree to transfer public holidays
 - requiring that employers and employees agree on when alternative holidays are taken and, failing agreement, the employer may reasonably decide
 - altering the rules concerning proof of sickness or injury so that an employer can request a medical certificate without reasonable grounds to suspect that the sick leave is not genuine
 - making it easier for employers and employees to work out what is an "otherwise working day" for an employee by including an additional legislative tool
 - increasing penalties for non compliance with the Act
 - providing clearer legislative definitions of some of the components of gross earnings, and
 - no changes to the treatment and entitlements of casual employees, or the treatment of public holidays, or the status of Easter Sunday.

Background

5. In line with our pre-election commitments, I established a Ministerial Advisory Group (the Group) to review the Holidays Act 2003 (the Act) in June 2009. The Group represented both employers and unions and was independently chaired [CAB Min (09) 7/4 refers]^[1].
6. The Group were charged with recommending possible future policy options for amending the Act, without reducing current entitlements, in order to:
 - make the Act easier for businesses and employees to understand and apply
 - reduce direct and compliance costs, and
 - make the Act more readily applicable to a range of employment arrangements.

7. By requiring that the review should not result in a reduction to employee entitlements, the terms of reference signalled that radical changes to the legislation were not being sought.
8. The Group's terms of reference identified seven areas of interest.
 - a. trading part of an employee's minimum annual holiday entitlement for cash
 - b. the calculation of pay for holidays and leave
 - c. allowing employers and employees to agree to transfer the observance of public holidays to another day
 - d. the treatment and entitlements of "casual" employees
 - e. the accumulation of alternative holidays
 - f. the treatment of public holidays, and
 - g. whether Easter Sunday should be a public holiday.
9. The Group has carefully considered all of the issues and evidence including written public submissions, legislative settings in other countries, recent research by the Department of Labour and previous reviews of the holidays legislation.
10. In December 2009, the Group reported back to me on ways to improve the operation of the Act. They reached agreement on three areas: making no changes to the treatment of public holidays or the entitlements of casual employees and allowing the transfer of public holidays within set criteria. The Group did not reach agreement on the other areas reviewed.
11. The Group's members have significant experience in employment matters. Given the range of issues that the Group was required to address, it is unsurprising that they were not able to achieve unanimity on all aspects of their recommendations. However, where differences existed, these were clearly identified and various choices put forward. Their report provided me with a sound basis for arriving at my preferred package of recommendations.

Proposed amendments to the Holidays Act 2003

12. The Act affects all employers and employees. It is a significant piece of legislation but some parts of it have been criticised as being unclear, overly complex and lacking choice for both employers and employees. I consider that a lack of clarity in holiday provisions has a negative impact on employment relationships and productivity because employers and employees have to spend time and resources trying to establish what their rights and obligations are.
13. The changes I am seeking to achieve through my proposed recommendations aim to either increase choice and flexibility for employers and employees; ensure the balance of fairness in the legislation is appropriate for both groups; reduce compliance costs and unnecessary red tape, including when these might be unduly affecting workplace productivity; or improve the operation and efficiency of the legislation.
14. I consider that these objectives are best achieved by making discrete changes to the Act in areas where the legislation is not working well for some individuals or groups.
15. Groups that are most likely to experience difficulties with the current legislation are:
 - small businesses as they generally have fewer human resource and payroll resources and expertise. They also deal with some parts of the Act less frequently than larger businesses
 - sectors that work variable hours, days or shifts, such as manufacturing, some hospitality and seasonal industries (for example, horticulture and agriculture)
 - sectors that have variable rates of pay (e.g. piece rates and commission-based pay) such as the retail sector and the meat processing industry
 - employees who are already disadvantaged in the labour market as they are more likely to have low awareness of their rights, such as low skilled workers, Māori, Pacific people, and young workers, and
 - casual employees who may not be receiving holiday and leave entitlements.

16. I have considered the options presented in the Group's report to me and the Department of Labour's advice on each of the options. As the Group did not agree on all aspects of their recommendations, I have considered three different sets of recommendations based on the areas of interest on which the Group did or did not reach agreement and other policy options. The table below shows the degree of change that would be achieved by each set of recommendations.

Option A

Areas of interest on which the Group reached agreement

Low level of change to the Act

- Transfer of public holidays
- No changes to the treatment of public holidays
- No changes to the treatment and entitlements of casual employees

Option B

Areas of interest on which the Group did not reach agreement

High level of change to the Act

- Cash up of annual holidays
- Standard daily pay^[2] (replaces relevant daily pay for the calculation of public holidays, alternative holidays, sick leave and bereavement leave)
- Using standard daily pay to calculate annual holidays
- Accumulating and deducting entitlements for holidays and leave in work units (or hours)
- Adding alternative holidays to annual holiday balances
- Allowing employers and employees to agree to alternative methods for calculating payments and accruing entitlements
- Making Easter Sunday an additional 12th public holiday

Option C

Areas of interest on which the Group reached agreement and other policy options I have considered

Medium level of change to the Act

- Transfer of public holidays
- No changes to the treatment of public holidays
- No changes to the treatment and entitlements of casual employees
- Cash up of annual holidays
- Average daily pay (replaces relevant daily pay for the calculation of public holidays, alternative holidays, sick leave and bereavement leave)
- Codify the "but for" test for working out an otherwise working day^[3]
- Require that employers and employees agree on when alternative holidays are taken and, failing agreement, the employer may reasonably decide
- No changes to Easter Sunday
- Increase penalties for non-compliance
- Provide clearer legislative definitions of some of the components of gross earnings
- Provide employers with the ability to request medical certificates without reasonable grounds to suspect that the sick leave is not genuine at the employer's cost

Status quo

17. In addition to these three combinations, I also considered the implications of the status quo (not making any changes to the Act). I do not consider the status quo to be the best option as there are issues that can easily be fixed and problems that have been identified with the Act.

Option A

18. Option A contains only the recommendations where the Group reached agreement. This option would go a small way towards meeting the objective of making the Act more readily applicable to a range of employment arrangements. However, as most of the agreed recommendations are to retain the status quo, it will not address the other objectives of making the Act easier for businesses to understand and apply or reduce direct and compliance costs.
19. Overall, I consider that option A would only have a limited effect and does not go far enough to address concerns with the existing legislation.

Option B

20. Option B is made up of the recommendations that seek to make the greatest/most active changes to the Act. This option aims to simplify the Act and reduce direct costs by providing for one rate at which all leave is paid.
21. While there is some appeal to having one calculation for all types of holidays I am concerned that the benefits of this option are likely to be outweighed by the costs. The costs include increased compliance costs for all employers, a reduction to sick leave entitlements, a potential reduction to annual holiday entitlements, and a reduction in entitlements for employees on unpaid leave including ACC and parental leave.
22. I am aware that unions consider that workers will be unduly disadvantaged by the more active changes in this package, such as the additional proposed changes to annual holiday pay and the accumulation of entitlements.
23. Overall, package B is unlikely to reduce compliance costs or complexity. Instead it will significantly increase compliance costs for all employers as they will need to accumulate and deduct holiday and leave entitlements in a different way and renegotiate employment agreements. This option will go some way towards meeting the objective of making the Act more readily applicable to a range of employment arrangements and reducing direct costs, but it will not address the other objectives of making the Act easier for businesses to understand and apply, or reduce compliance costs. It is likely to have a negative impact on disadvantaged or casual workers and may reduce flexibility for some part-time and flexible work arrangements.
24. Overall, I do not consider that Option B would sufficiently simplify the Act to justify the implementation changes employers and employees would be required to make, or the potential reduction in payments for a significant proportion of employees. While I wish to address areas of concern in the legislation, this option is contrary to the intent of the review, which was to not reduce the current core holidays and leave entitlements.

Option C (my preferred option)

25. Option C is a mix of recommendations from the Group (as a whole, or from the different representatives) and other policy options I considered. This option represents my preferred combination of changes to the Act. Option C provides a reasonable balance in meeting employer and employee interests and represents a "middle ground" that also addresses the main areas of concern with the legislation.
26. This option will address the review's objectives in the most effective way. While some changes will provide greater choice, others will make it easier for both employers and employees to understand and comply with the legislation. Where appropriate, changes to the legislation are accompanied by some limitations on employees (to address concerns about increased compliance costs to employers) and some limitations on employers (to protect statutory minimums).
27. The ability to cash up annual holidays and transfer public holidays will provide increased choice and flexibility for employees around how they access their entitlements to annual holidays and public holidays. Compliance costs associated with considering an employee's request to cash up, or transfer public holidays, are very minor, as an employer can refuse to cash up for any reason, without giving reasons, and can also have a policy to not cash up annual holidays. The changes to relevant daily pay (RDP) will reduce direct and compliance costs for sectors that work variable hours, days or shifts and sectors that have variable rates of pay. These sectors have experienced the most difficulties with RDP. Sectors that have experienced no difficulties with the current calculation are able to maintain their current arrangements.
28. Other changes under this option are designed to improve the balance of fairness in the legislation (such as the changes to alternative holiday entitlements) and improve the overall operation and efficiency of the legislation (increasing penalties for non-compliance and changing the rules concerning the provision of medical certificates). Overall, I consider that this option comes closest to meeting all of the review's objectives and that the benefits of this option outweigh any negative effects that may arise as a result of the changes.

29. The specific changes I am seeking in respect of the Holidays Act are detailed below.

Allowing employees and employers to agree to cash up one week of an employee's minimum entitlement to annual holidays, at the employee's request

30. I recommend an employer and employee be allowed to agree to cash up a maximum of one week of the minimum annual holiday entitlement in any one entitlement year,^[4] at the employee's request. This change gives effect to our pre-election commitment to give employees the choice to trade in one week of annual holidays for cash; the emphasis being that it is the employee's choice. If employees choose to cash up a week's annual holidays they will still have the opportunity for three weeks away from work for rest and recreation. This does not alter employees' minimum entitlements to four weeks' annual holidays. It does alter the ways that the entitlement to four weeks' annual holidays can be exercised.

31. Introducing the ability for employees and employers to agree to cash up to a week's annual holidays is expected to have the following benefits:

- greater choice for employees
- financial assistance to employees if they face financial pressure
- assist employers when there are labour or skill shortages. It may reduce the need for replacement staff when employees are on holidays
- it may help to reduce holiday balances and the associated financial liability
- it may increase productivity if experienced workers do not need to be replaced temporarily with workers with less experience, and
- it should not increase direct costs (for example, while employers will pay an additional week's pay this will be offset by the employee working for an additional week).

32. There are some risks that allowing cashing up of annual holidays may:

- reduce opportunities for rest and recreation away from work and decrease motivation and productivity if employees do not have adequate breaks away from work
- increase working hours and decrease time for community and family activities, and
- negatively impact on health and safety, including increasing the risk of fatigue and stress-related illnesses, which could increase sick leave (both employers and employees have responsibilities to ensure staff are fit for work and not at risk from long-term fatigue).

33. I consider that these risks are mitigated by the following design features.

A maximum of one week of annual holidays a year can be cashed up

34. I recommend that employees and employers can agree to cash up a maximum of one week of annual holidays in any one entitlement year. If they do not cash up a week's holiday during the entitlement year, employees could not cash up more than a week in the following year(s).

35. Allowing a maximum of one week of holidays to be cashed up each year provides greater choice for employees because it allows an employee to cash up less than a week, or cash up a week spread across over more than one request. It also encourages employees to take more holidays off work and protects against large amounts of holiday entitlements being cashed up, which may occur if more than a week is allowed to be cashed up or if non-cashed up holidays are allowed to be carried over to other years.

36. Employees could make more than one request to cash up during an entitlement year, until one week's holidays have been cashed up. This may be seen as increasing compliance for some employers. However, I consider that, from a compliance view, it is no different to employees being able to make multiple requests to take annual holidays as they are currently able to.

37. Because there are a variety of work patterns, I consider that employers and employees should reach agreement on what cashing up a maximum of one week means in their individual circumstances. The agreement must be a genuine reflection of the employee's working week. For example where an employee is employed on a work pattern that changes during the year, such as going from part-time to full-time work, the employer and the employee should agree on what cashing up a maximum of one week means in these circumstances. This is not a new requirement as the Act already requires employers and employees to agree on what four weeks of annual holidays means in their circumstances.

38. The ability to cash up a maximum of one week of annual holidays does not include any annual holidays that have been accumulated before this provision comes into force.

Limitations on employees' ability to request to cash up annual holidays

39. I recognise that not all employers may wish to, or will be able to, agree to employees' requests to cash up annual holidays. For instance, the employer may have an annual closedown period and wish to ensure that their employees have enough holidays to cover this period, or they may operate in an industry where four weeks' holidays away from work is desirable for health and safety reasons. If employees have a general ability to request to cash up, employers would have to consider all requests even though they may have no intention to ever agree to the request.

40. Better outcomes may be achieved if employers can inform employees that the employer has a "no cash up" policy. An employer may have a "no cash up" policy covering the whole business, or some parts of their business but not others.

41. If employees have a limited ability to request to cash up, employers can advise employees before they accept an offer of employment that the employer has a "no cash up" policy, which may be set out in the employment agreement. The employee would be unable to then make a request to cash up at a later date, unless the employer changes their policy. I expect that employers will consult with their existing employees in the development of any policy on cashing up annual holidays in good faith.

42. Allowing employers to not have to consider any requests to cash up may be seen as not being in line with the good faith requirements on employers and employees. However, this is balanced by ensuring that employers are up front with their employees about their position on cashing up annual holidays.

43. This option should also limit compliance costs for businesses that are never able to or do not ever wish to agree to cashing up annual holidays, as they will not have to consider requests they would never agree to.

44. I do not intend that this limitation be extended to the taking of annual holidays as leave. Employers would still be required to consider, in good faith, individual requests to take annual holidays.

Protections for employers and employees

45. There is some concern that employees may be pressured into cashing up annual holidays and employers may be forced to agree to requests. I recommend including the following protections in the legislation:

- any request to cash up must be initiated by the employee
- employees are able to request to cash up holidays for any reason and they do not have to provide their employer with a reason for their request
- the request must be in writing and a new request made each time holidays are cashed up
- employers must consider the request within a reasonable timeframe
- employers must advise the employee in writing whether they accept or refuse the request
- employers can refuse a request for any reason and do not have to provide the employee with a reason, and
- a requirement to cash up annual holidays cannot be raised in salary negotiations or be a condition of employment.

46. To ensure that employers and employees have a shared understanding of how requests to cash up will be handled, I recommend that the process for cashing up can be included in employment agreements, but a requirement to make requests cannot be.

Payment for cashed up annual holidays

47. Payment for cashed up annual holidays must be for the agreed portion of one week's annual holiday (up to the maximum of one week of the annual holiday entitlement) and must be paid as soon as practicable after the employer has agreed. I expect this to be the next available pay period.

48. The rate of pay must be based on the greater of:

- the employee's ordinary weekly pay (at the time of payment for the cashed up annual holidays), or
- the employee's average weekly earnings for the 12 months immediately before the end of the last pay period before payment for the cashed up annual holidays is made.

49. An exception to this rate of pay would apply to employees who are on or return to work from parental leave. Currently, employees are entitled to holiday pay based on average weekly earnings (not the greater of ordinary weekly pay or average weekly earnings) for annual holidays that they become entitled to during a period of parental leave, or a period of preference for re-employment or for the 12 months starting from the day that they return to work from a period of parental leave or preference for re-employment^[5]. I consider that if an employee cashes up annual holidays earned during these three periods, the value of the cashed up holidays should be paid at the rate of their average weekly earnings for the 12 months immediately before payment for the cashed up annual holidays is made. This ensures that cashed up holidays and holidays taken away from work have the same value and does not create an incentive for choosing one way of using annual holidays over another.

Enforcement of the cashing up of annual holidays

50. As with the other provisions on annual holidays, I consider that Labour Inspectors and the Employment Relations Authority should have the powers to enforce this new provision to ensure that employees receive their minimum entitlement to annual holidays. To assist in this role, I consider that Labour Inspectors should continue to be able to determine the value of an employee's ordinary weekly pay and also the proportion of annual holidays cashed up where employers and employees cannot agree on one or both of these amounts. This is in line with Labour Inspector's current powers to make determinations on ordinary weekly pay and how an employee's entitlement to annual holidays can be met.
51. If a Labour Inspector or the Employment Relations Authority finds that an employee has been forced to cash up annual holidays by their employer then I consider that an appropriate remedy be that the cashed up portion of their annual holidays is restored to the employee's annual holidays' balance, despite the payment being made. A similar principle is used where an employer incorrectly pays holiday pay with an employee's regular pay (the employer may then be required to make holiday payments subsequently to that employee in spite of the earlier regular payments).

Gross earnings

52. The Group did not reach agreement on whether the payment for cashed up annual holidays should be included in gross earnings as currently defined in section 14 of the Act. I recommend that the payment for cashed up annual holidays should not be included in gross earnings. If it is included in gross earnings, employees who cash up annual holidays will receive higher payments for holidays and leave than employees who do not cash up.

The calculation of pay for public holidays, alternative holidays, sick leave and bereavement leave

53. Relevant daily pay (RDP) has proven to be the most vexatious and frustrating element of the Holidays Act 2003. The issues stem from the fact that RDP creates different values for different days of work, making it more attractive for an employee to be "sick" on a high income day and creating multiple and complex cost and staffing issues for many businesses and industries.
54. Calculation of RDP requires a detailed knowledge of the provisions of an employee's employment agreement and of the (ever changing) arrangements for such things as shift rosters, overtime requirements and rates of pay. As RDP is predictive of the pay an employee would have received, it sets the scene for disagreements between employers and employees based on contractual interpretation of the actual amount an employee would receive for any given public holiday, sick or bereavement leave day or alternative holiday.
55. Anecdotal evidence including during the submissions process identified "gaming issues" as a source of concern. It is my view that these issues would be resolved by ensuring that the value of pay, in respect of any employee, is averaged for every day of the week. In other words, an average daily pay (ADP) value is applied to the day of absence instead of one that tries to predict what an employee would have earned had they worked the day concerned.
56. I recommend that Cabinet agree to amend the Act so that all employees are paid their ADP for public holidays taken, alternative holidays, sick leave and bereavement leave. ADP will replace the relevant daily pay (RDP) calculation. The key feature of ADP is that all employees receive a payment for the above leave types based on averaging their gross earnings over the previous 52 weeks, (or the number of weeks worked if the employee has worked for less than 52 weeks). ADP is a policy shift away from the RDP concept of paying an employee what they would have earned.

57. I consider that the concept of averaging an employee's pay over 52 weeks was at the core of the Group's Standard daily pay (SDP) proposal. While there was disagreement on some aspects of the proposal, there appeared to be agreement in principle around the concept that calculating payment over a longer period than four weeks would reduce some of the anomalies in payments that can occur with the current RDP calculation.
58. The benefits of averaging over a 52 week period are as follows:
- it will make the Act easier to understand because payment for leave is based on past identifiable earnings rather than on what would have been earned (or an approximation thereof)
 - it overcomes the problem of employers having a choice of calculations, because there will be only one calculation to apply
 - it effectively smoothes out increases in pay. This avoids the higher and lower payments that can be caused by averaging over four weeks as currently
 - it will remove incentives for employees to "game" the system by taking leave on high income days (for example after periods of overtime or on days they may work longer than others), because regardless of whether an employee takes a long or short day's leave they will only receive an averaged payment
 - it will provide more certainty for employers and employees around the value of leave for any particular day, and
 - it will be an easier calculation than RDP in sectors where productivity or incentive payments form part of an employee's pay, because there will no longer be a need to undertake separate averaging calculations.
59. Because ADP does not rely on having 'contractual hours' defined in employment agreements it is likely to require less implementation changes than SDP. It is also likely to be easier to understand than SDP.
60. The impact of ADP on employees varies. Over the course of a year some employees may receive a lower payment than they would under RDP, for instance employees who have had a pay rise in the last 12 months.⁶¹ Employees paid by commission or productivity, or with variable hours of work, may receive an increase or a decrease in payments compared with RDP, depending on a number of factors, such as the additional payments received in the previous four weeks. It is difficult to accurately estimate how many employees will be advantaged or disadvantaged by ADP. As the Act sets out minimum payments for leave, it is possible that employers may pay their employees a higher amount that is in line with current practice.
61. ADP is likely to reduce compliance costs in sectors with complex work arrangements (payment by commission or productivity or variable hours of work). It is likely to increase compliance costs for some employers such as those with traditional working hours or where pay rates and hours are easily identifiable as they would have to undertake calculations which they currently do not have to do, as RDP is identifiable. As the Act specifies the minimums for calculating holiday and leave payments, these employers may continue with their current method of calculating payments providing it is equal to or greater than that provided in the Act. Therefore, employers who want to maintain their current system are able to do so.
62. Overall I consider that the benefits of ADP outweigh any negative effects that may arise as it resolves the main issues with the current calculation of RDP.

Allowing employers and employees to agree to transfer the observance of public holidays to another day

63. I recommend that Cabinet agrees to restore the ability of employers and employees to agree to transfer public holidays. While the Act provides 11 public holidays for the observance of days of national, religious or cultural significance it may better suit individual workplaces and employees to agree to observe public holidays on other days. My recommendation is that employers and employees should have the choice to do so. This is in addition to the current provision that allows employers and employees to agree to transfer shifts that cross into or out of a public holiday.
64. Prior to a Supreme Court decision in 2007 employers and employees could agree to transfer public holidays. However, the majority of the Supreme Court found that the legislation was unclear and the intended flexibility was operating (in some cases) at the expense of minimum standards. The Group has identified a list of criteria that employers and employees will need to meet if they wish to transfer. These criteria will overcome previous concerns around determining whether there is genuine agreement between an employer and employee to transfer the public holiday.

65. The criteria are:

- the public holiday to be worked must be identified
- the other day on which the public holiday is to be observed must be identified or identifiable
- the public holiday must otherwise have been a working day for the employee
- the public holiday must be transferred to day that is otherwise a working day for the employee and not another public holiday
- there must be a true agreement which is informed and voluntary
- the parties must reach their agreement in good faith consistent with section 73 of the Act, and
- while an agreement to observe a public holiday on another day may result in no time and a half or alternative holiday for working on a public holiday, the avoidance by the employer of the obligation to make such a payment must not be the objective of the transfer.

66. Restoring the ability for employers and employees to agree to transfer public holidays is expected to have the following benefits:

- greater choice for employers and employees to observe public holidays on another day in line with the operational needs of the employer or the individual needs of the employee, and
- recognises cultural and religious diversity in the workplace.

67. There are some risks of:

- increased compliance costs
- potential abuse of employees' entitlements to public holidays
- potential employment relationship problems, and
- less clarity than the status quo for employers, employees and those who enforce the Act.

68. I consider that these risks are mitigated by the criteria identified by the Group and the following limitations and protections.

Limitations on employees' ability to request to transfer public holidays

69. As with agreements to allow cashing up annual holidays, I recommend providing employees with a limited ability to request a transfer. Employers can inform employees that the employer has a "no transfer" policy. An employer may have a "no transfer" policy covering the whole business, or some parts of its business but not others. While this places restrictions on employees, I believe that this is outweighed by increased certainty for both parties and reduced compliance costs.

70. If employees have a limited ability to request transfer, employers can advise employees before they accept an offer of employment that the employer has a "no transfer" policy^[7], which may be set out in the employment agreement. The employee would be unable to then make a transfer request at a later date unless the employer changes their policy. For existing employees, I expect that employers would consult with their employees in the development of any policies on transferring public holidays in good faith.

Protections for employers and employees

71. I recommend that employees and employers agree to the transfer of public holidays in writing, whether in an employment agreement or otherwise. This would assist with the parties' understanding and enforcement of any agreements and is consistent with other existing requirements in the legislation.

72. I consider that Labour Inspectors should have the powers to ensure that employees receive entitlements to transferred public holidays where these fall on otherwise working days to the same extent that Labour Inspectors can determine entitlements for employees in the current public holiday provisions.

The treatment and entitlements of casual employees

73. I am aware that on the basis of their status as "casual" employees, some employees are denied access to holiday and leave entitlements. One of the main issues in this area is ensuring accurate employment treatment so that employees who work a minimum regular shift are treated as permanent part-time employees, not as casuals^[8]. However, it appears that the underlying issues around casual employment (such as a general lack of awareness and the inaccurate treatment of some permanent part-time employees) are wider than holiday and leave entitlements.
74. Beyond providing more educational material on casuals' employment entitlements the Group recommended making no changes in this area. They considered that the existing law already provides adequate protection for casual employees and that the key issue is ensuring correct calculation and delivery of entitlements.
75. Therefore, I recommend the status quo with respect to the treatment of casual employment.

The accumulation of alternative holidays

76. The issue of accumulation of alternative holidays was included because officials were advised that the transitional provisions around "days in lieu" earned under the Holidays Act 1981 was causing a large accumulation of old "days in lieu", creating a financial liability for employers. However, this issue did not come through in submissions and the Group did not make recommendations for changes to the accumulation of alternative holidays.
77. From submissions, it appears that the main issues for employers about alternative holidays are that employees receive a whole day's holiday for working part of a public holiday and employees are able to choose when they take their alternative holiday within the first twelve months. On the latter issue it appears from submissions that some employees do not always take the employer's view into consideration when deciding when to take their alternative holiday and this can lead to operational problems for employers.
78. If Cabinet agrees to require employers and employees to agree on when the alternative holiday is taken and, failing agreement, the employer may reasonably decide, this would be a change from the status quo under which employees have the right to choose when they take their alternative holidays within the first twelve months. This change still provides employees with a full day's alternative holiday for working on a public holiday but it is offset by removing the ability of employees to choose when the alternative holiday is taken.
79. Removing the ability for employees to decide when the alternative holiday is taken will make alternative holiday requirements consistent with the requirements for annual holidays. It will also reduce potential negative impacts on business operations and productivity.
80. The employee's entitlement to a full day's alternative holiday is maintained. Therefore, I do not consider this change to be a reduction to current entitlements. The problem that is being addressed is of an employee choosing an alternative holiday(s) that is inconvenient to the employer. So, both parties will need to agree on when the alternative holiday is taken.

Other changes to the Holidays Act 2003

Determining an "otherwise working day"

81. To assist employers and employees determine what is an "otherwise working day", I recommend an addition to the list of factors set out in section 12(3) of the Act.
82. An employee's entitlements to a public holiday, an alternative holiday, sick leave and bereavement leave are all determined with reference to whether the particular day would have been an otherwise working day under the Act. The Act currently sets out a number of factors to assist employers and employees to determine what would otherwise be a working day (section 12). From cases such as *New Zealand Fire Service Commission v New Zealand Professional Firefighters Union*^[9], Labour Inspectors have developed a tool commonly known as the "but for" test. This tool helps an employer or employee to work out whether an employee would have worked on a particular day "but for" a public holiday or sickness. This tool is recognised in case law^[10] but is not actually listed in the Act. Setting out the test in legislation will make it easier for employers and employees to determine whether a day is an otherwise working day.

Proof of sickness or injury (medical certificates)

83. The current rules around the provision of medical certificates places an unreasonable burden on employers. Currently, an employer may request proof of sickness or injury within the first three calendar days of leave, if the employer suspects an illness is not genuine. The employer is required to meet the employee's reasonable expenses if they request proof of sickness in this timeframe. Anecdotal evidence suggests that the compliance cost and time associated with establishing suspicion can be high and onerous on the employer. I consider addressing this issue will ensure that these compliance costs do not eventuate.
84. I recommend that Cabinet agree to amend the Act so that employers can request proof of sickness or injury within three consecutive calendar days without first having reasonable grounds to suspect that the sick leave is not genuine. The employer will still be required to meet the employee's reasonable expenses in obtaining the proof.

Increasing the effectiveness of the enforcement of the employment relations framework

85. To support the objectives outlined in paragraph 6 it is important to ensure that we have effective mechanisms in place to enforce the minimum code set out in the employment relations framework and provide a level playing field to all employers. Some employers may deliberately not comply with their employment obligations. This anti-competitive behaviour disadvantages those employers who meet or exceed their employment obligations.
86. In addition to this review of the Holidays Act, I am also reviewing other areas of the employment relations framework [EGI Min (10) 26 refers]. To ensure that the framework is fair to all employers, I have directed the Department of Labour to provide me with options to increase the efficiency and effectiveness of the enforcement of the minimum code by Labour Inspectors. I am reporting on these options in the paper seeking Cabinet approval of my recommendations for the Employment Relations Act 2000.
87. As part of the overall package on enforcement, I recommend that the maximum penalties for non-compliance with the Holidays Act be increased from \$5,000 to \$10,000 for individuals and from \$10,000 to \$20,000 for companies and other body corporates. I consider that the current penalties are insufficient to provide a real deterrence to some employers. Increasing the maximum penalties will send a strong signal to employers and employees, the Employment Relations Authority and the Courts that non-compliance will not be tolerated.

Defining discretionary payments and allowances

88. I consider that the review provides the opportunity to make minor alterations to other areas of the Act. These include further defining the following terms used in the Act.

Discretionary payments

89. The policy intent is that discretionary payments should be excluded from gross earnings because they are payments that the employer is not bound by the terms of the employee's employment agreement to pay the employee (section 14(b) of the Act). Because the term is not further defined in the Act, it is being interpreted in some cases as excluding payments where the amount to be paid is discretionary even if the payment itself is provided for in the employment agreement (for example, if the employment agreement provides for a bonus payment, even if the amount is discretionary, it should be included in gross earnings). To ensure that the term is better understood and applied correctly, I recommend that a definition of discretionary payments is included in the Act.

Allowances

90. There is currently no definition of allowances in the Act. The policy intent is that allowances are included in gross earnings unless they are payments to reimburse the employee for any actual costs incurred by the employee related to his or her employment. Allowances are included in gross earnings if they are non-reimbursing taxable allowances. I recommend that a definition of allowances is included in the Act.

No changes to the treatment of public holidays or the status of Easter Sunday

91. Because there was no clear consensus from submissions about what, if any, changes should be made to the current treatment of public holidays the Group recommended the status quo. I support their recommendation for this reason. I recommend that Cabinet agree to maintain the status quo with regard to the treatment of public holidays.

92. With regards to the status of Easter Sunday, the Group considered the issue of shop trading restrictions on Easter Sunday to be outside their terms of reference. They noted that if moves to change the public holiday status of Easter Sunday were to proceed, the issue of shop trading on Easter Sunday would need to be considered as well, because of the links between the trading status of Easter Sunday and whether it should be a public holiday.
93. I recommend that Cabinet agree that the status quo be maintained with regard to Easter Sunday whereby Easter Sunday is not a listed public holiday. I consider that the increased costs of making Easter Sunday a public holiday will outweigh any potential benefits.

Consultation

94. The Department of Prime Minister and Cabinet, Treasury, Ministry of Economic Development, State Services Commission, Ministry of Social Development, Inland Revenue, Ministry of Education, Ministry of Justice, Ministry of Health, Ministry of Pacific Island Affairs, Ministry of Women's Affairs and Te Puni Kōkiri have been consulted about the content of this Cabinet paper.
95. Treasury and the Ministry of Economic Development (MED) have concerns that the proposed package of changes may not improve the functioning of the legislation. Agencies have had limited time to consider the current proposals and a number of proposals that may impose additional costs on businesses were made late in the review process. The balance of costs and benefits of the package of proposed changes is not clear. At a minimum, amendments are likely to impose transitional costs on both employers and employees and the extent of other potential costs is unclear.
96. Treasury and MED are particularly concerned that the costs to business associated with the proposal to replace relevant daily with average daily pay for public holidays, alternative holidays, sick leave and bereavement leave may exceed the benefits and therefore not provide an effective solution to the current problems with calculating relevant daily pay for the portion of businesses where employees have complex work arrangements. There is also a risk that this proposal will impose unnecessary costs on the majority of employers for which the current method of calculation is relatively straightforward. Providing an additional option for employers to calculate pay could add to the confusion that some employers already have about which calculation to use. This would increase compliance costs, particularly for small businesses.
97. It is not clear how viable the proposal that employees be able to cash-up a maximum of one week's annual leave is as the cost of implementing it (particularly if employees apply to cash-up leave incrementally) may be so high that employers choose to have a no cash-up policy. There is also a risk that this proposal could create new employment tensions between employers and employees.

Implementation risks

98. There is a risk that the proposed changes will have short-term negative impacts, such as one-off compliance costs for employers as part of implementing the changes, such as making changes to payroll systems and renegotiating employment agreements.

Commencement of legislation

99. I recommend that the proposed changes to the Holidays Act be effective from 1 July 2011.
100. I propose that the ability of employees to request to cash up annual holidays is effective from the date the employee becomes entitled to annual holidays on, or after, 1 July 2011. For instance, an employee who becomes entitled to annual holidays on 1 September will be able to make a request to cash up from 1 September 2011. An employee who becomes entitled to annual holidays on 1 June will be able to make a request to cash up from 1 June 2012. This will reduce the risk that employers will be faced with a large number of requests at once. It is similar to the way the increase in the minimum entitlement from three to four weeks was implemented.
101. The first public holiday to be affected by the proposed changes will be Labour Day 2011 (the fourth Monday in October).

Fiscal implications

102. There are no significant fiscal implications from the proposals in this paper. The changes are likely to create initial compliance costs for all public sector agencies as they make changes to payroll systems and employment agreements. This is no different to the increased compliance costs faced by employers in the private sector.
103. The changes may increase or decrease the direct costs of holidays and leave for public sector employers depending on employee's individual circumstances.

Human rights

104. The proposals in this Cabinet paper appear to be consistent with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993, and New Zealand's obligations under the International Covenant on Economic, Social and Cultural Rights. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.

Legislative implications

105. The proposals in this paper will require amendments to the Holidays Act 2003 to make the Act easier for businesses and employees to understand and apply, reduce direct and compliance costs and make the Act more readily applicable to a range of employment patterns.

106. The 2010 Legislative Programme includes a Holidays Amendment Bill in Category 2: must be passed in 2010 [CAB Min (10) 6/7 refers].

107. Any amendments are expected to be binding on the Crown.

Gender implications

108. The Ministry of Women's Affairs considers that there is a risk that the proposal to introduce the ability for employees to cash up annual holidays may disadvantage women workers because women are more likely to want to take holidays for family reasons. For example, parents may decide that one of them should cash up one week of annual holidays in order to relieve financial pressures. There may be a financial incentive for the highest earner to cash up their fourth week, and in most circumstances this is likely to be the male earner. This process may reinforce or instigate unequal distribution of childcare responsibilities as women would have to take more annual holidays during school holidays to care for children. It will also have potential implications for men by reducing their opportunities to participate in child caring and reducing their opportunities for breaks away from work.

109. If more men than women cash up a fourth week, this is likely to increase gaps in incomes between the different genders. The size of the possible increase is unknown.

110. There could also be some concern that solo mothers on low incomes may cash up their fourth week to relieve financial pressures, which could have flow-on effects such as, reduced work-life balance, increased stress, poorer health outcomes and lower productivity from not having a fourth week's holiday.

111. I consider that factors such as differential income may well influence families in the decisions they choose to make concerning cashing up annual holidays. While the risks identified by the Ministry of Women's Affairs may be legitimate there are positive aspects to the ability to cash up annual holidays.

Regulatory impact analysis

112. A Regulatory Impact Statement has been prepared by the Department of Labour and is attached to this paper.

113. I have carefully considered the analysis and advice of officials as summarised in the attached Regulatory Impact Statement. This advice suggests that the full impacts of the options considered are uncertain. While this uncertainty makes it difficult to determine which options might provide the highest net benefits of the policy options available, I consider that my preferred package of options provides increased choice and flexibility for employers and employees; ensures the balance of fairness in the legislation is appropriate for both groups; reduces compliance costs and unnecessary red tape, including when these might be unduly affecting workplace productivity; or improves the operation and efficiency of the legislation.

Publicity

114. I intend to release the Cabinet paper publicly once decisions have been made by Cabinet in respect to the proposals outlined in this paper.

Recommendations

I recommend that the Committee:

1. **note** that the Ministerial Advisory Group reviewing the Holidays Act 2003 reported back to the Minister of Labour in December 2009 on possible future policy options for amending the Holidays Act 2003 (the Act), without reducing current entitlements, in order to:
 - make the Act easier for businesses and employees to understand and apply
 - reduce direct and compliance costs, and
 - make the Act more readily applicable to a range of employment arrangements
2. **note** that I have considered the status quo and three different combinations of policy options based on the degree of change to the Act that would be achieved by each combination
3. **note** that the following recommendations comprise the Government's final response to the recommendations made by the Ministerial Advisory Group on the Holidays Act 2003

Allowing employees and employers to agree to cash up one week of an employee's minimum entitlement to annual holidays, at the employee's request

4. **agree** that an employee may request to cash up a maximum of one week of their minimum annual holiday entitlement in any one entitlement year
5. **agree** that a request to cash up annual holidays must be initiated by the employee (for any reason)
6. **agree** that the ability to cash up a maximum of one week of annual holidays does not include any annual holidays that have been accumulated before this provision comes into force
7. **agree** that an employee's ability to request to cash up annual holidays is subject to their employer allowing such requests to be made. An employer can advise an employee before they accept an offer of employment that the employer does not allow the cashing up of annual holidays, the employee will then be unable to request to cash up annual holidays (unless their employer later changes their policy)
8. **agree** that an employer may have a "no cash up" policy covering the whole business, or some parts of its business but not others
9. **agree** that when an employee is able to make a request, the request must be made in writing and a new request to cash up holidays must be made each time
10. **agree** that when an employee is able to make a request, and does so in writing, that an employer must consider any requests within a reasonable timeframe and advise the employee in writing whether the employer accepts or refuses the request
11. **agree** that an employer can refuse a request for any reason and does not have to provide the employee with a reason
12. **agree** that a requirement to cash up annual holidays cannot be raised in salary negotiations or be a condition of employment
13. **agree** that the process for cashing up of annual holidays may be included in employment agreements, but a requirement to make requests cannot be included in employment agreements
14. **agree** that the payment of any cashed up annual holidays should be made as soon as practicable after the employer has agreed
15. **agree** that, except for cashed up holidays covered by section 42(2) of the Parental Leave and Employment Protection Act 1987, the rate of payment for any cashed up annual holidays must be based on the greater of:
 - the employee's ordinary weekly pay (at the time of payment for the cashed up annual holidays), or
 - the employee's average weekly earnings for the 12 months immediately before the end of the last pay period before payment for the cashed up annual holidays is made
16. **agree** that the rate of payment for any cashed up annual holiday entitlements under section 42(2) of the Parental Leave and Employment Protection Act 1987 are at the employee's average weekly earnings for the 12 months immediately before the end of the last pay period before payment for the cashed up annual holidays is made
17. **agree** that Labour Inspectors be able to determine the value of an employee's cashed up annual holidays and the proportion of annual holidays cashed up where employers and employees cannot agree on one, or both, of these amounts

18. **agree** that where a Labour Inspector or the Employment Relations Authority finds that an employee has been forced to cash up annual holidays by their employer then an appropriate remedy be that the cashed up portion of the employee's annual holidays is restored to the employee's annual holidays' balance, despite the payment being made by the employer
19. **agree** that the value of cashed up annual holidays is excluded from gross earnings as defined in section 14 of the Act

The calculation of pay for public holidays, alternative holidays, sick leave and bereavement leave

20. **agree** that payment for sick and bereavement leave, public holidays taken and alternative holidays will be calculated using average daily pay described in 21
21. **agree** that the policy intent of average daily pay is to ensure that employees receive a payment for sick and bereavement leave, public holidays and alternative holidays based on averaging their gross earnings over the previous 52 weeks before the leave is taken, (or the number of weeks worked if the employee has worked for less than 52 weeks)

Allowing employers and employees to agree to transfer the observance of public holidays to another day

22. **agree** to allow employers and employees to reach a written agreement (whether in an employment agreement or otherwise) to transfer public holidays in line with the criteria proposed by the Ministerial Advisory Group. These criteria are:
 - the public holiday to be worked must be identified
 - the other day on which the public holiday is to be observed must be identified or identifiable
 - the public holiday must otherwise have been a working day for the employee
 - the public holiday must be transferred to a day that is otherwise a working day for the employee and not another public holiday
 - there must be a true agreement which is informed and voluntary
 - the parties must reach their agreement in good faith consistent with section 73 of the Holidays Act 2003, and
 - while an agreement to observe a public holiday on another day may result in no time and a half or alternative holiday for working on a public holiday, the avoidance by the employer of the obligation to make such a payment must not be the objective of the transfer
23. **agree** that an employee's ability to request to transfer public holidays is subject to their employer allowing such requests to be made. An employer can advise the employee before they accept an offer of employment that the employer does not allow the transfer of public holidays, the employee will then be unable to request to transfer public holidays (unless their employer later changes their policy)
24. **agree** that an employer may have a "no transfer" policy covering the whole business, or some parts of its business but not others
25. **agree** that Labour Inspectors powers in regards to current public holiday entitlements will extend to entitlements for transferred public holidays that are otherwise working days for an employee

The accumulation of alternative holidays

26. **agree** to change the legislation so that an employer and an employee decide on when the alternative holiday is taken, and, failing agreement, the employer may reasonably decide
27. **agree** that an employer's ability to reasonably decide replaces an employee's ability to decide when the alternative holiday is taken

Other changes to the Holidays Act 2003

28. **agree** to include the "but for" test in the Holidays Act 2003 to provide employers and employees with another factor for determining an "otherwise working day"
29. **agree** that an employer can request proof of sickness or injury within three consecutive days, without first having reasonable grounds to suspect that the sick leave is not genuine, at the cost of the employer

30. **note** that any changes to provide more effective enforcement of the employment relations framework through changes to the powers of Labour Inspectors will be included as part of proposed amendments to the Employment Relations Act 2000 in 2010
31. **agree** to increase the maximum penalty for non-compliance with the Holidays Act to:
 - \$10,000 if the employer is an individual, and
 - \$20,000 if the employer is a company or other body corporate
32. **agree** to further define discretionary payments as not including payments where the amount to be paid is discretionary, but the payment itself is provided for in the employment agreement
33. **agree** to define allowances as non-reimbursing taxable payments

No changes to the treatment and entitlements of casual employees, the treatment of public holidays or the status of Easter Sunday.

34. **agree** that any further amendments are not required in relation to:
 - the treatment and entitlements of casual employees
 - the treatment of public holidays, and
 - the status of Easter Sunday. It should continue to not be a listed public holiday under the Holidays Act 2003.

Commencement of legislation

35. **agree** that the amendments to the Holidays Act 2003 as outlined in the above recommendations, if enacted, would take effect from 1 July 2011
36. **agree** that the cashing up of annual holidays is effective from the date the employee becomes entitled to annual holidays on or after 1 July 2011

Drafting instructions

37. **invite** the Minister of Labour to issue drafting instructions to the Parliamentary Counsel Office to give effect to the decisions in paragraphs 4 to 36 above

Publicity

38. **note** that I intend to release the Cabinet paper publicly once decisions have been made by Cabinet in respect to the proposals outlined in this paper

Minor or technical matters

39. **authorise** the Minister of Labour to make any decisions on additional minor and technical matters that are necessary for drafting these proposals and that are consistent with the Cabinet's decisions.

Hon Kate Wilkinson
Minister of Labour

Footnotes

[1] The Group consisted of: Peter Kiely (Chair, Barrister and Solicitor), Paul Mackay (Business New Zealand), Helen Kelly (New Zealand Council of Trade Unions), Philip Doak (Air New Zealand) and James Ritchie (New Zealand Dairy Workers Union).

[2] The Group made some progress towards agreeing on an alternative formula (called standard daily pay). The Group did not agree on some of the components of the formula.

[3] Using the “but for” test, an employer or employee can ask themselves “would an employee have worked on this day but for the public holiday/sick day etc”. The test is recognised in case law but is not actually listed in the Act as one of the factors that employers and employees can use to work out an otherwise working day.

[4] Employees are entitled to four weeks' annual holidays at the end of each completed 12 months of continuous employment. In this context, the entitlement year is referring to the 12 months from when an employee receives their entitlement to annual holidays. For instance, if an employee starts work on 1 February 2010, they are entitled to four weeks' annual holidays on 1 February 2011. The employee could make a request to cash up a maximum of one week of annual holidays on, or after, 1 February 2011 and before 1 February 2012.

[5] Section 42(2) of the Parental Leave and Employment Protection Act 1987

[6] Because the calculation of ADP is over a 52 week period it effectively smoothes out increases in pay. This avoids the spiking that can be caused by RDP's four week averaging formula which delivers a payment that is linked to the employee's recent earnings.

[7] Some employers may never wish to agree to transfer for operational reasons.

[8] Casual employment is usually employment on an "as and when" required basis, with no guarantee of set hours or continuation of employment. Casual employees have many of the same employment rights, entitlements and obligations as other employees.

[9] [2007] 2 NZLR 356

[10] Most recently in *Potter v Elderstock Ltd* (AA 290/09)