Submission

By

THE NEW ZEALAND INITIATIVE

to the Transport and Industrial Relations Committee

on the

Employment Relations (Allowing Higher Earners to Contract Out of Personal Grievance Provisions) Amendment Bill

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1. INTRODUCTION AND SUMMARY

1.1 This submission on the Employment Relations (Allowing Higher Earners to Contract Out of Personal Grievance Provisions) Amendment Bill (**the Bill**) is made by The New Zealand Initiative, a think tank supported primarily by chief executives of major New Zealand businesses. In combination, our members' revenues account for a quarter of New Zealand's economy and provide employment to more than 140,000 people in New Zealand. The purpose of the organisation is to undertake research to contribute to the development of sound public policies in New Zealand to help create a competitive, open and dynamic economy and a free, prosperous, fair, and cohesive society.

1.2 We support the premise and purpose of the Bill. The personal grievance provisions - and particularly the fairness requirements constraining employers from dismissing employees for underperformance - are premised on a view that the common law of contract provides insufficient safeguards for low-paid, vulnerable workers. This premise does not apply to high-earning employees, typically with management responsibilities. Indeed, constraining businesses from terminating poorly-performing, high-earning management (and replacing them with higher performing managers) is likely to result in reduced productivity growth and increased risk of business failure, putting the jobs of low-paid, vulnerable workers at risk.

1.3 Consistently with these concerns, Australia's *Fair Work Act* 2009 excludes employees earning above a defined "high-income threshold" from the protection of Australia's unfair dismissal laws. The Initiative supports an amendment to New Zealand's Employment Relations Act 2000 (**the Act**) to bring New Zealand's labour laws into line with Australia's, and to increase the flexibility of employers to replace poorly performing, high-earning employees.

1.4 The provisions of the Bill have been criticised because the scope of the proposed exemption for high-earning employees extends beyond the unjustifiable dismissal provisions of the Act to the full suite of personal grievance provisions. Though we believe these criticisms are largely misplaced, we would support a narrowing of the exemption simply to exclude higher-earning employees from the protection of section 103(1)(a) of the Act; that is, from the right to bring a personal grievance claim for unjustifiable dismissal under the Act. For completeness, we note that this would not preclude a higher-earning employee from bringing a claim for breach by her or his employer of any aspect of her or his employment contract.

1.5 We consider two amendments to the drafting of the Bill are also required:

(a) First, the exemption in the Bill needs to be extended to employees who may become higher-earners as a result of a pay rise during the course of employment, but who may not be higher-earners when they commence employment, so would not come within 102A(1) of the Bill; and

(b) Secondly, we consider the requirements for employees to obtain independent legal advice are cumbersome, costly and unnecessary.

1.6 The most straight-forward way of resolving the concerns in paragraph 1.5(a) above would be simply to specify that new section 102A applies where:

(i) the employer and employee have included a term excluding the application of the relevant part of the Act (as currently provided in proposed new section 102A(2)); and

(ii) At the time of the employee's dismissal, the employee's annual gross salary is greater than the specified threshold.

This would bring the approach more closely into line with the position in Australia – though there, the only requirement is (ii) above. That is, Australia does not require the parties to contract out. If the employee's gross earnings exceed the threshold (currently A$140,000, the unjustifiable dismissal protections do not apply).

2. UNFAIR DISMISSAL PROCEDURES ARE COUNTERPRODUCTIVE AND UNNECESSARY FOR HIGH EARNERS

2.1 Economic theory suggests that regulations protecting workers from dismissal have an adverse effect on both the efficiency of hiring and firing workers. Dismissal protections raise transaction costs for firms. In these circumstances, all other things being equal, businesses will find it optimal not to hire workers whose short-term marginal product exceeds their market wages. Conversely, they will choose to retain unproductive workers whose wages exceed their productivity. The resulting distortions have the potential to reduce productivity and, in the case of senior management, significantly so.

2.2 Despite the potential adverse impacts on productivity, many countries, New Zealand included, have adopted dismissal protection laws to protect low-paid workers from being dismissed unfairly. In some jurisdictions, the protections apply ubiquitously to all employees, from unskilled employees to senior management. In others, they apply only to unionised workers or, as in Australia, just to lower-paid employees, with employees earning above a threshold not entitled to the benefits of the protections.

2.3 The rationale most commonly advanced for the protection of low-paid workers is the inequality of bargaining power between employers and low-skilled, low-paid workers, and the financial vulnerability of low-paid workers in the event of dismissal. This rationale is less strong for high earners who are more likely to have both the economic sophistication to negotiate the terms of their employment and the financial and human capital to protect them in the event of dismissal or unemployment.

2.4 Just as the rationale for protection of workers is asymmetric as between high and low earners, so too are the potential distortionary effects on productivity. Protecting an unskilled employee against dismissal without cause is less likely to adversely affect a firm's productivity than constraining the firm's ability to dismiss a senior manager whose performance may be poor, but not so poor as to justify dismissal.

2.5 Indeed, putting barriers in the way of a firm from dismissing underperforming senior management has the potential to put the jobs of unskilled or low paid workers at risk. The difference between the success or failure of a firm – or of a division within a firm – may, at the margin, depend on the quality of its senior management. Consequently, if a firm's owners are constrained by unfair dismissal laws from dismissing underperforming senior management, then this may be contrary to the interests of the very low-skilled, low-paid workers whose welfare the laws are designed to protect.

2.6 For these reasons, we consider unfair dismissal laws are neither necessary nor appropriate for higher-earning employees.

3. CRITICISMS OF THE SCOPE OF THE BILL ARE MISPLACED

3.1 During the first reading of the Bill, the criticism made was that the approach of disentitling higher-earners from the personal grievance procedures was too broad, and went far beyond merely precluding them from claiming that they had been unjustifiably dismissed. The concern

was that, while there might have been some merit in precluding higher-paid employees from benefiting from the unjustifiable dismissal protections, precluding them from relying on the other matters protected by the personal grievance would deprive them of their basic human rights not to be discriminated against on the grounds of age, sex, marital status, race, colour, national origin, etc.

3.2 We consider this concern is largely misplaced. Section 22 of the Human Rights Act 1993 makes it unlawful for any person to discriminate in offering employment, or in the course of employment, against any person on any of the prohibited grounds set out in the Human Rights Act. These include the grounds of age, sex, marital status, race, colour, national origin, and so on referred to in the Personal grievance procedures.

3.3 Accordingly, the Bill as drafted does not deprive higher-earning employees of these rights – though we acknowledge that some of the protections provided by the personal grievance procedures extend beyond the fundamental rights protected by the Human Rights Act 1993.

4. RECOMMENDED AMENDMENTS TO THE BILL

4.1 Despite the matters outlined in the previous section, we consider that it would be more practical and procedurally expedient to narrow the scope of the carve out in proposed section 102A simply to exclude higher-earning employees from the right to bring a personal grievance claim *for unjustifiable dismissal* under the Act under section 103(1)(a) of the Act. This would preserve the right of higher-earnings to bring a personal grievance for any of the other wrongs prescribed in section 103 of the Act.

4.2 And it would not preclude a higher-earning employee from bringing a claim for breach by her or his employer of any aspect of her or his employment contract.

4.3 We consider two amendments to the drafting of the Bill are also required:

(a) First, the exemption in the Bill needs to be extended to employees who may become higher-earners during the course of employment as a result of a pay rise, but who may not be higher-earners when they commence employment, so would not come within 102A(1) of the Bill; and

(b) Secondly, we consider the requirements for employees to obtain independent legal advice are cumbersome, costly and unnecessary.

4.4 The one way of resolving the concerns in paragraph 4.3(a) above would be simply to specify that new section 102A applies where:

(a) the employer and employee have included a term excluding the application of the relevant part of the Act (as currently provided in proposed new section 102A(2)); and

(b) At the time of the employee's dismissal, the employee's annual gross salary is greater than the specified threshold. to any individual earning over the specified higher-income threshold (as occurs in Australia).

4.5 Alternatively, the approach taken in proposed new section 102A could be replaced with the more straight-forward mechanism in Australia's Fair Work Act 2009 which provides that the unjustifiable dismissal provisions do not apply to employees earning above a specified high income threshold.

The New Zealand Initiative
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