NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the Employment Relations Amendment Bill (No 2)

September 2010

1. Introduction

1.1 This submission is made on behalf of the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand businesses. The purpose of the organisation is to contribute to the development of sound public policies that reflect overall New Zealand interests.

1.2 The Business Roundtable believes that New Zealand employment law has become unnecessarily complex and costly for both employers and employees. Contrary to common misconceptions, there is no inherent and systematic imbalance in bargaining power in the labour market. As a consequence we believe employment law should move in the direction of standard contract law.[1]

1.3 The government's top priority goal is to achieve income parity with Australia by 2025. In this context the 2025 Taskforce that reported in November 2009 emphasised the need for changes in labour market regulation. It recommended that:

a. Labour law should be amended to strengthen the freedom of negotiation between workers and their employers, including, for example, streamlining provisions governing dismissal of workers, and putting less emphasis on procedural matters.

b. Statutory provisions allowing enforceable mutually-agreed probationary periods for new employees should be extended, from the current maximum of 90 days for those working for small firms to a maximum of 12 months for employees of firms of any size.

c. For employees earning in excess of $100,000 per annum, employment relations should be governed by the standard provisions of contract law rather than by the Employment Relations Act.

d. The youth minimum wage should be reinstated as a matter of urgency, and minimum wage rates should be reduced to the same ratio to average wages that prevailed in 1999.

1.4 Given the 2025 goal, there is some logic in looking to features of Australian employment law that are superior to counterpart rules in New Zealand. Recent governments have advanced the concept of harmonisation with Australia and while we do not support

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[1] See Geoff Hogbin, *Power in Employment Relationships: Is There an Imbalance*?, New Zealand Business Roundtable, March 2006.

harmonisation for its own sake, we see merit in adopting sound Australian arrangements. In general, we do not see Australia's cumbersome Fair Work Act as a model for New Zealand. However, there are some desirable provisions in it which we comment on below.

1.5 Another important context for reviewing employment law is the government's Welfare Working Group. Unless barriers to employment are reduced, changes to benefit rules to encourage beneficiaries into work are likely to enjoy limited success. Employment decisions by firms need to be de-risked. As an interim step, there may be a case for special rules for long-term beneficiaries.

1.6 We support many of the amendments proposed in the bill. We comment selectively below on certain amendments and on other changes to the Employment Relations Act that we would like to see introduced at this stage.

2. Specific comments on the Employment Relations Amendment Bill (No 2)

2.1 *Union access*

2.1.1 We support the proposed amendments. In addition, we recommend:

- that in line with Australian law, unions should be required to give employers 24 hours notice of a desire to enter a workplace, and
- that access penalty provisions apply to all persons who fail to meet their obligations in Sections 19 to 24 inclusive, not just employers.

2.2 *Communication during bargaining*

2.2.1 We support this amendment but ask the Committee to consider issues raised in other submissions by business organisations in relation to the good faith provisions of the Act.

2.3 *Trial period*

2.3.1 We support the extension of the current 90-day trial period to firms of all sizes. This was part of National's election policy; it did not limit the provision to small employers. However, for the reasons set out in our submission on the Department of Labour's discussion paper on Part 9 (attached as an annex), we consider this move is too limited. The recent Global Competitiveness Index rated New Zealand poorly, at 83rd place, for restrictive hiring and firing practices. (Singapore is top for overall labour market efficiency and for the sub-category 'flexibility'. Switzerland is top for the other sub-category 'efficient use of labour'.) In relation to Australian law (see above) we note that:

- the ACTU (which is the counterpart to the CTU) supported a 3 month trial period in submissions on the Rudd government's legislation. Union opposition to a similar move here is difficult to comprehend, and

- the Fair Work Act (for which Julia Gillard, an ex-trade union lawyer, was the responsible minister) went further and included a 12-month trial period for small firms (under 15 employees) and 6 months for larger firms.

We submit that at a minimum the current Australian arrangements should be adopted.

2.3.2 We suggest, however, that there is a good case for going further. New Zealand needs to adopt better policies than other countries if it is to overcome any natural disadvantages, such as its size and geographical location, and be equally prosperous. The latest Global Competitive Index ranks Switzerland in first place overall, and Switzerland's employment law allows either party to an employment contract to terminate it at any time, provided notice is given. We favour a similar regime: employers have told us, for example, that they would only contemplate taking on certain beneficiaries with a no-fault dismissal regime. We suggest this should apply to long-term beneficiaries. In sections 5 and 6 of our Part 9 submission we

canvass this and other options for relaxing dismissal rules and ask the Committee to consider them.[2]

2.3.3 The practice of employers paying 'go away' money to avoid the cost and distraction of a personal grievance case is well known. However, little information is available on the extent of the practice. We recommend that the Department of Labour should report on a quarterly basis the total amounts that, to its knowledge, are paid. This would be useful to inform future reviews of personal grievance arrangements.

2.3.4 We note that the Human Rights Commission has argued that the 90-day proposal is a violation of a fundamental human right. There is no basis for this view. A flagstone at the graveyard site of the economist and moral philosopher Adam Smith carries the inscription: "The property that every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable." The fuller extract from Smith's *The Wealth of Nations* is:

> The property which every man has in his own labour, as it is the original foundation of all other property, so it is the most sacred and inviolable. The patrimony of a poor man lies in the strength and dexterity of his hands; and to hinder him from employing this strength and dexterity in what manner he thinks proper without injury to his neighbour is a plain violation of this most sacred property. It is a manifest encroachment upon the just liberty both of the workman and of those who might be disposed to employ him. As it hinders the one from working at what he thinks proper, so it hinders the others from employing whom they think proper.

2.4 *Reinstatement*

2.4.1 We do not support retaining reinstatement as a remedy. An analogy is with a marriage break-up. No serious person would suggest that, after a long and acrimonious separation, a court would be allowed to say, "I hereby direct you to take your awful partner back again".

2.4.2 Employment contracts are also relational contracts. Unless the decision is a voluntary one, reinstatement is the ultimate slap in the

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[2] It is important to note that the costs of dismissal laws fall on employees as a whole and the unemployed, not employers. See Charles Baird, *The Employment Contracts Act and Unjustifiable Dismissal: The economics of an unjust employment tax*, New Zealand Business Roundtable,1996.

face for the employer and the greatest victory for a recalcitrant employee. It neuters the business owner, demoralises the management team and engenders contempt for the enterprise in the rest of the workforce.

2.4.3 A reinstated employee will forever after (and with some justification) consider themselves 'above the law' in the workplace, free to openly defy the employer and mock their authority. This power imbalance renders the employment relationship completely dysfunctional and the impact spreads throughout the workplace, contaminating the function of the enterprise.

2.4.4 Appropriate remedies for a painful separation process can include financial help but, more practically, should include counselling to mend hurt feelings, career guidance and support to transition into new employment opportunities. Reinstatement, unless by voluntary decision on the part of the employer, is not an appropriate remedy. It was only claimed in 17 out of 579 personal grievances in 2009, and usually as a tactic to bring pressure on an employer to reach a settlement.

2.5 *Justification for dismissal*

2.5.1 We think the proposed amendment would be an improvement but is not adequate.

2.5.2 Section 103A of the Employment Relations Act, which provided for the first time a statutory formula for the justification for dismissal, was enacted in 2004. There is no doubt that the way in which the Employment Court has interpreted the new provision has made it more difficult for employers to satisfy the obligation in personal grievance proceedings to prove justification for a dismissal or other disciplinary action. The declared intention of the minister of labour and the select committee, during the amendment bill's passage through the House, was not to create any major new law but simply to restore the law to that which existed prior to the Court of Appeal's decision in *Oram* in 2001. That intention has been ignored by the

Employment Court, which has invented a whole new jurisprudence, effectively giving the Authority and the Court the power to override employers' decisions merely because they feel it is reasonable to do so.

2.5.3 This has resulted in significant extra costs for employers who are required either to retain staff guilty of misconduct merely because of the potential cost of litigation if dismissal followed, or who are required to settle personal grievance claims which lack merit simply because the cost of defending the proceedings outweighs the cost of settlement. Under the law which existed prior to the *Oram* decision, and which was well settled, the Authority and the Court had the power to determine on an objective basis whether an employer's conclusion that serious misconduct had occurred was justifiable. But the law also made it clear that whether dismissal should result from proven serious misconduct was a matter for the employer and not the courts. In other words, the test was whether dismissal was a reasonable option available to an employer in the circumstances. The new jurisprudence under s103A has effectively made the members of the Employment Relations Authority and the judges of the Employment Court the sole arbiters of what is reasonable in a given situation.

2.5.4 We recommend a repeal of s103A and, if necessary, the inclusion of a precautionary provision which expressly restores the law to that which applied before s103A came into force.

3 Other issues

We wish to raise four other matters that are not covered in the bill as it stands and submit that the Committee should consider them.

3.1 *Union bargaining monopoly*

3.1.1 National's 2008 election policy ('National's Plan for Employment Law') contained a commitment to "Remove union monopoly bargaining rights over collective agreements". The government has made a point of keeping its election promises. So far it has not kept this one.

3.1.2 Reviewing the monopoly would also seem to be required to give effect to the 17 August 2009 Government Statement on Regulation which stated that “a particularly strong case” would be needed to support regulatory proposals that impair market competition.

3.1.3 This is another area where New Zealand would benefit by studying Australian arrangements. The Fair Work Act enshrined the basic right of all employees to enter into Collective Agreements (CAs) with their employers. The previous Workplace Relations Act 1999 had featured two types of CAs: section 327 employee collective agreements and section 328 union collective agreements. We understand that:

- the vast bulk of agreements were made under s328, that is, the legal parties to agreements were (a) a corporation and (b) a union (on behalf of all workers, union or not)

- when an employer wanted an agreement directly with their staff (s327) the union would typically fight vigorously against a 'non union agreement' being struck

- if a s327 agreement was made, when approved by the Industrial Relations Commission any union could apply to be 'covered' by the agreement; a meaningless action that was simply noted in the Commission records

- it was widely recognised that having two types of agreements provided a source of workplace conflict; first the parties would fight over which type of agreement it would be, and at the conclusion of that dispute they would then fight about what was going to be in it, and

- many types of corruption or inappropriate transactions took place when unions and employers could sign agreements between them (note that this also happens in New Zealand, with the ‘flow on’ rule and the ‘bonuses’ that employers are made to pay union

members for the ‘right’ to pass on the benefits of any agreement to non union workers).

3.1.4 Now, though, under Julia Gillard’s legislation:

- there is no provision for employers to make CAs with unions, except in the case of ‘greenfields’ agreements (start up companies that have no employees when the agreement is made)

- all CAs are made between employers and employees, as the legal parties to the agreement

- employees individually nominate their bargaining agents in writing to the employer (these can be anyone at all, not just unions) and all agents have equal rights under the Act to ‘good faith’ bargaining

- if no agent is nominated the union is a default bargaining agent only of union members (the employer is able to ask for proof of membership, so as to be clear about who is represented by whom)

- employees vote on the proposed CA and if it is ‘approved’ then an employee (of the employer’s choice) signs the agreement on behalf of all employees, and

- once the agreement is passed by Fair Work Australia, any union can apply to be 'covered' by the agreement but this is a meaningless action that is simply noted in the FWA records.

3.1.5 We submit that it is generally desirable that employers make agreements directly with employees and that the union monopoly is removed. Workers should be treated like adults who can choose whether to represent themselves or choose someone else to represent them.

3.1.6 We understand that the recent change in Australia has removed the argument over whether the agreement will be a 'union' or 'non union' agreement; all agreements in Australia are now what used to be referred to as 'non union'. It is also fairer on the employees, as they have more control over, and responsibility for, a contract that applies to them and binds them.

3.2 *Fixed term contracts*

3.2.1 This is another area where New Zealand could benefit from Australian practice. In Australia, fixed term employment is commonly used. The term is not defined in legislation, nor is the practice or rules around it dealt with. The Modern Awards sometimes define it, as do enterprise agreements. It is not an issue that attracts any attention or causes any controversy.

3.2.2 In practice, fixed term employment is often used for special projects or work that is of a temporary nature. In the past it was used to ‘try out’ staff but the six months/twelve months probation period has eliminated the need for that. Fixed term employment is widely accepted in industries where the nature of the work is at the behest of the client of the employer, eg the IT industry, and is seen as the acceptable method of replacing staff on maternity leave (which has a maximum length of two years).

3.2.3 The fixed term contract always includes the mandatory notice period for termination of employment, holidays and other leave in the term of the contract. The exception to this is when employment on the fixed term contract is casual, this type of arrangement being commonly used by labour hire companies.

3.2.4 We submit that the Employment Relations Act should be amended to allow unrestricted use of fixed term contracts. There are many situations other than those allowed in the Act that would make sense in a flexible labour market.

3.3 *Work and Income New Zealand policy*

3.3.1 Under current WINZ policy, an employee who loses their job as a result of their own misconduct is stood down from a benefit for 13 weeks. WINZ has a policy to decide if the employee was the cause of their own fate based on whether or not a personal grievance is raised. If the employee raises a personal grievance, that is sufficient to convince WINZ the employee was not the author of their own fate and they receive the benefit immediately. This is a flawed policy that encourages employees to take personal grievances.

3.3.2 In Australia, Centrelink administers the benefit system. Centrelink accepts an employer's verdict as to the cause of a dismissal. No suspension of the stand-down period is triggered if a personal grievance is taken. We submit that the Committee should recommend that a similar policy be applied in New Zealand to remove this incentive to make personal grievance claims.

3.4 *Period for making a personal grievance claim*

3.4.1 There is currently a three year period within which a personal grievance can be pursued. An employee who raises a grievance in a letter to the employer can do nothing, but then resurrect it three years later through a filing in the Employment Relations Authority. This is an absurd period of time for a claim to be hanging over the head of an employer. In Australia a final claim must be lodged within 7 days (the FWA can allow an extension in 'exceptional' circumstances). We think this is a sensible rule and submit that it should be adopted.

4 Recommendations

4.1 We recommend as follows:

- ***Union access***
  - This should be subject to 24 hours notification by unions, and unions should be subject to access penalty provisions.

- ***Trial periods***

  – at a minimum, Australian provisions (12 months for small employers and 6 months for large employers) should be adopted

  – additional options as outlined in sections 5 and 6 of the attached submission should be considered

  – no-fault dismissal should apply to long-term beneficiaries, and

  – the Department of Labour should report 'go away' money payments.

- ***Reinstatement***

  – Reinstatement should not be available as a statutory remedy.

- ***Justification for dismissal***

  Section 103A should be repealed and, if necessary, a precautionary provision should be included that expressly restores the law to that which applied before s103A came into force.

- ***Union monopoly***

  National's election commitment to remove the union monopoly on collective bargaining should be honoured.

- ***Fixed term contracts***

  Fixed term contracts should be generally available, in line with Australian law.

- ***Work and Income New Zealand***

  The 13-week stand-down period should not be suspended if a personal grievance claim is lodged.

- ***Period for making a personal grievance claim***

  This should be 7 days barring exceptional circumstances.

Annex

NEW ZEALAND BUSINESS ROUNDTABLE

Submission on the Department of Labour Discussion Paper *Employment Relations Act 2000: Review of Part 9: Personal Grievances*

March 2010

1. Introduction

1.1 This submission on the Department of Labour's discussion paper is made on behalf of the New Zealand Business Roundtable, an organisation comprising primarily chief executives of major New Zealand firms. Our interest is in sound public policies reflecting overall national interests, not simply the interests of the business sector.

1.2 We are happy for the contents of this submission to be a matter of public record.

2. General

2.1 In our view, issues relating to Part 9 of the Employment Relations Act 2000 need to be seen in the context of the government's overriding goal of lifting average New Zealand incomes to Australian levels by 2025. To achieve that goal, major improvements in labour productivity growth are required, given the staggering decline in recent productivity growth rates with the ill-conceived policies of the previous government. The Employment Relations Act (the ERA) was one such policy. It undermined the freer and more flexible employment relations environment created by the Employment Contracts Act 1991, imposed higher costs on employers, and inhibited productivity improvements. These trends need to be reversed if the 2025 goal is to be achieved.

2.2 It also needs to be appreciated that the ECA was by no means an ideal labour statute. Indeed, in respect of personal grievances it was a major step backwards. It mandated a personal grievance procedure and extended coverage to all employees (previously only employees who were members of a union were covered). This more than doubled the number of employees subject to the personal grievance provisions, yet there was no evidence of widespread abuse of their freedom to contract at will. Part 9 of the ERA and Employment Court decisions have made the provisions even more onerous. The current government's introduction of a 90-day trial

period for small employers is a small step to unwind these developments and make the relevant law less restrictive and costly.

2.3 The terms of reference for the review indicate that the Department of Labour will research the different approaches to personal grievances in various jurisdictions including Australia, the United Kingdom, Canada, the United States, the European Union and Scandinavia. Many of these are poor models for New Zealand. So-called 'employment protection' legislation in Europe is widely regarded as a major factor in the high rates of unemployment and poor productivity and innovation performance of many European countries. The regimes in a number of US states, which allow at-will contracts, are better models. We think the Department should also examine the regimes of dynamic Asian countries such as Hong Kong, Singapore, Malaysia and Korea. Countries in the Asian region and other emerging countries are likely to be more relevant benchmarks for New Zealand in the decades ahead than most of the old OECD member countries. The government has also recognised that New Zealand must offer a better policy environment than other countries if it is to overcome its economic disadvantages of size and location. We therefore need to strive for the best possible regime in this important area of labour regulation.

2.4 The discussion paper invites submitters not to be limited to the issues presented. In what follows we do not generally present answers to the questions asked. Business New Zealand, EMA (Northern) and no doubt other business organisations and firms are reporting on the experience of employers in more detail. Rather, we address fundamental policy issues in this area, starting in section 3 with an evaluation of the argument for much labour market regulation, namely the alleged imbalance of bargaining power between employers and employees. We then consider in section 4 the implications of this evaluation for personal grievances. We proceed in section 5 to examine options for reform of the existing personal grievance system, and in section 6 to a fuller discussion of one option, namely contracting out. We discuss s103A of the ERA in section 7. Our

conclusions follow in section 8. Throughout we focus on unjustified dismissal rules and not on other personal grievance categories. We do not comment on the mediation service issues raised in the discussion paper.

3. Power in employment relationships: Is there an imbalance?[3]

3.1 There is a widespread belief, notably among lawyers and industrial relations specialists, that employment relationships are characterised by a systematic imbalance of power between employers and employees. This belief, which traces back at least to the early years of the industrial revolution, was reinforced and propagated by Karl Marx, who argued that employers could and would use their stronger bargaining power to drive wages to subsistence levels.

3.2 The alleged power imbalance is central to the view that labour markets require special regulation. The Employment Relations Act 2000 is based on the premise of an "inherent inequality of bargaining power in employment relationships".

3.3 Most contemporary labour economists have a different view. Elementary economic analysis suggests that, as for other goods and services traded through markets, wages and other terms of employment are determined largely by supply and demand. There is no reason to suppose that the employer side of the market has inherent power over the employee side in determining wages and other conditions of employment. Several empirical observations support this analysis:

- Far from falling to subsistence levels (the logical consequence of inherent power imbalance), real wages in modern economies have risen steadily over the last two centuries to levels that would have seemed incredible in the times of Karl Marx.

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[3] This section draws on *Power in Employment Relationships: Is There an Imbalance?* by Geoff Hogbin, a report published by the New Zealand Business Roundtable in 2006. The issue was also discussed by Richard Epstein in a paper *Is There Unequal Bargaining Power in the Labour Market?*, published by the New Zealand Business Roundtable in 2005. Copies of both papers are included with this submission and are available at www.nzbr.org.nz.

- Aggregate labour income in modern economies accounts for around 65-75 percent of gross domestic product and is not higher in the more heavily regulated labour markets of the world. Indeed, it seems to be relatively higher in some of the most lightly regulated labour markets, such as the United States.

- If employers had inherent power to set wages below the value of labour's contribution to production, rates of return on capital should be higher in labour-intensive industries than in capital-intensive industries, but this is not the case.

- If employees were disadvantaged by their allegedly weak bargaining power in labour markets, there are many other ways in which they could supply their labour to productive activities (for example, self-employment, independent contracting, labour hire companies, or workers' cooperatives). The fact that individual employment contracts have remained the dominant arrangement for over two centuries is compelling evidence that they deliver greater net benefits for most workers than any of these alternatives.

3.4 At times there may be a sellers' or buyers' market for labour, due to supply and demand conditions, but this is so for other markets and does not reflect a systematic imbalance of the bargaining power of parties in employment relationships. As for other markets, wage adjustments facilitate market 'clearance' and the attainment of full employment.

3.5 Employment contracts are relational contracts like marriage contracts: there are incentives that are conducive to their stability and they are largely self-enforcing. For good reasons, most societies have abandoned fault-based laws governing the termination of marriages.

3.6 More detailed analysis indicates that systematic bargaining imbalances do not arise at the beginning of an employment relationship, while a contract is in force, or when it is terminated. It is

a fallacy to think that employers have advantages because they may have greater financial resources, enjoy the right to direct employees in undertaking tasks, or extend 'take-it-or-leave-it employment offers, as Geoff Hogbin's study explains.

3.7 A freely functioning labour market conducive to full employment is the best form of protection for both employees and employers against opportunistic exploitation. The common law provides other protections. Parties should be free to include additional provisions in employment contracts, but they should not be mandatory. In particular, both employees and employers should be able to terminate contracts at will, unless they jointly agree to other arrangements.

4. Mandatory unjustified dismissal rules

4.1 Under the common law of contract, employment is assumed to be at will unless there are explicit contractual terms to the contrary. At-will employment means that either the employer or the employee can sever the employment relationship at any time, for any reason or for no reason. Under unjustified dismissal regulations only the employee can sever the employment relationship at will. The imposition, by law, of unjustified dismissal restrictions in employment contracts is, in effect, a reassignment of job property rights away from employers to employees.

4.2 If unequal bargaining power existed, employers might choose to bind workers to stay in their employment while retaining the power to fire them at will. Yet, significantly, it is employees who have the uncontested ability to quit a job if they wish to do so. As University of Chicago legal scholar Richard Epstein has stated:

> If such an inequality did govern the employment relationship, we should expect to see conditions that exist in no labour market. Wages would be driven to zero, for no matter what their previous level, the employer could use his (inexhaustible) bargaining power to reduce them further, until the zero level was reached. Similarly, inequality of bargaining power implies that the employee will be bound for a term while the employer … retains the power to

> terminate at will. Yet in practice we observe both positive wages and employees with the right to quit at will.[4]

4.3 If employees were free to choose their conditions of employment, it is likely that many, if not most, would not seek unjustified dismissal provisions in contracts. This is clear from empirical evidence. As US judge Richard Posner has noted in respect of the United States:

> One piece of evidence that job security is not really efficient is that outside of the unionized sector (which now employs less than 20 percent of the nation's labour force)… employment at will is the usual form of labour contract. The worker can quit when he wants; the employer can fire the employee when the employer wants.[5]

The situation was similar in the non-unionised sector of the New Zealand labour market prior to the ECA.

4.4 Contrary to the perception that mandatory unjustified dismissal restrictions are a benefit won by unions, they are in reality a tax on employees or employment. This is not difficult to see. Consider a world in which unjustifiable dismissal restrictions are introduced for a category of workers (such as non-union workers prior to the ECA) to which they didn't previously apply. This raises the costs to firms of employing them (because they must factor into their employment cost calculations some risk of a costly dismissal). They can't absorb this cost by reducing their profits (because investors won't keep putting money into firms that don't make competitive returns). In competitive markets they can't increase their prices either. So they have to offset the expected cost of likely dismissals primarily by reductions in wages or other benefits or lower levels of employment than would otherwise prevail.

4.5 A study undertaken in the 1990s in New Zealand attempted to estimate the cost of this 'employment tax'.[6] It extrapolated findings from the United States on the magnitude of the effects of mandatory

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4 Epstein, Richard (1984) 'In Defense of the Contract at Will', *University of Chicago Law Review*, 51, p 972.

5 Posner, Richard A (1986), *Economic Analysis of Law*, Boston, Little, Brown and Company, p 306.

6 Baird, Charles W (1996) *The Employment Contracts Act and Unjustifiable Dismissal: The economics of an unjust employment law*, New Zealand Business Roundtable and New Zealand Employers Federation, Wellington. A copy of this study is included with this submission and is available on www.nzbr.org.nz.

unjustified dismissal restrictions in that country. The illustrative results included a 10 percent increase in the New Zealand Gini coefficient (a measure of the degree of inequality in the distribution of income), an 18 percent decrease in the mean income received by households in the lowest income quintile, a decrease of over 7 percent in real compensation paid to workers who continue to work, and a decline of overall employment (depending on the assumptions made) of from 1.5 percent to 3 percent. Since employment in New Zealand was 1.653,000 in December 1995, that amounted to between 19,000 and 47,000 jobs.

4.6 The predictable effects of the imposition of unjustifiable dismissal restrictions also include less efficiency in the management and deployment of labour resources, higher information costs in labour markets, the founding of fewer start-up firms and the expansion of fewer existing firms, the hiring of fewer high risk employees, diminished opportunities for entry level work and on-the-job training, and decreased productivity of many already-hired workers. Moreover, mandatory restrictions hit marginal workers, such as some youth and Maori, particularly hard. If it is hard to fire, it is more risky to hire in the first place. Employment law should make it easy for employers to 'take a chance' on marginal workers in particular, so that they can get a foot on the bottom rung of the employment ladder.

4.7 Firms competing in today's competitive markets may need to be able to lay off staff quickly and easily to maintain their viability and protect other jobs. Making dismissal hard or costly makes it difficult for employers to obtain acceptable levels of performance from some employees. The comments of a former union official, Grace Collier, in an article last year in *The Australian* are relevant here. She wrote:

> When it comes to sacking people for poor performance or misconduct there are two facts; firstly, no one who is sacked ever believes they deserved it. No matter what they did, they always deem it to be unfair. It is part of the human condition that we construct lies to self and others in order to be the innocent victim of an injustice rather than an appropriately punished perpetrator.
>
> The actuality is in the vast majority of cases employees who are sacked are sacked well after they should have been; they have usually been

> making life for everyone in their workplace hell, co-workers are fed up with them and in a temporary moment of courage or desperation the manager eventually takes the action they should have taken much earlier by saying goodbye …
>
> Secondly, nobody likes or enjoys sacking an employee; employers avoid it like the plague. Like most people, they are terrified of conflict. Let us not forget that small business owners work closely among their employees, developing strong working relationships and where workforce relationships are tight, bosses, and how they treat team members, are in turn watched closely by staff.[7]

4.8 Of course nothing in all this denies that there are bad employers just as there are bad employees. But we allow workers to escape from a bad employment situation by not restricting their right to quit. Similarly, employers should have the same freedom to dismiss, unless contracts include by voluntary agreement procedural or substantive provisions governing termination. The ordinary law of contract contains many remedies for things like fraud, misrepresentation and duress.

4.9 This will not prevent all bad employment relationships, just as we cannot prevent all bad marriages or other bad personal relationships. In framing legal rules we should recognise that there are some bad employers and some – probably many more – bad employees. We are, after all, talking about human beings with all their flaws, and it is sheer folly to try to legislate for utopia on earth. When we consider the interests of workers as a whole rather than isolated hard cases, it is clear that the best form of worker protection is not so-called job protection laws but ample alternative job opportunities which a freer labour market delivers – a situation where if you lose your job or don't like your employer there are plenty of others available. A worker with alternatives in a fully employed economy is a very difficult worker to exploit.

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[7] Grace Collier, 'This employment law's so bad it should just be let go', *The Australian*, 9 March 2009.

5. Options for reform of Part 9

5.1 There are numerous options for making the provisions of Part 9 of the ERA less restrictive and, as a result, encouraging higher productivity. In evaluating them, we believe the test the government needs to apply, consistent with its recognition of the need for policies of the highest quality, is which would be most conducive to achieving its 2025 goal. Options need to be evaluated in terms of the framework for regulatory impact analysis laid down in the Cabinet Manual and affirmed in the September 2009 Government Statement on Regulation. It is a matter of concern to us that the Part 9 discussion paper contains no Regulatory Impact Analysis or equivalent framework, contrary to the Cabinet Manual requirements. This analysis is necessary to enable ministers to make informed choices and to support amending legislation.

5.2 We present below options for reform in what we see as descending order of merit.

Option A: Remove unjustified dismissal rules

5.3 The foregoing analysis suggests that the optimal policy would be to eliminate mandatory requirements and allow dismissal provisions to be a matter of voluntary contract. Firms and workers would be able to determine the trade-offs that they prefer between job security on the one hand and lower wages or other benefits on the other.

5.4 This is the regime that applies in the United States, which is the most productive large economy in the world and enjoys typically low rates of unemployment. It is recognised as a major factor in its record of innovation through start-up firms – Silicon Valley firms are a case in point. Ease of hiring and firing encourages entrepreneurship and risk taking. Employment law in the US has traditionally been governed by the common law rule of at-will employment, meaning that an employment relationship can be terminated by either party at any time for any reason or without a reason. This is still true today in most states. Absent an express contractual provision to the contrary, an

employer can still fire an employee for no or any reason, as long as it isn't in breach of contract or an illegal reason, which includes a violation of public policy (a contract may not include a provision that obliges the employee to undertake an unlawful act).

5.5 We suspect a similar regime applies in the most prosperous Asian countries mentioned earlier. We believe an evaluation of reform options would demonstrate that it would offer the largest net benefits.

Option B: Allow opting-in to a statutory framework

5.6 A 'template' for dismissal provisions could be provided in the ERA which parties could adopt or modify in employment contracts. There would be no compulsion to do so. Such a 'standard form' provision should not be onerous in its terms. The essence of it would consist of the elements of natural justice – the right to be advised of allegations, the right to see and rebut evidence, and the right to be heard in one's own defence. This might save parties the costs of negotiating individual provisions and provide a guide to useful practice for those concerned about job security.

Option C: Allow opting-out of a statutory framework

5.7 This option would see similar or wider provisions in statute as in Option B but would allow parties to contract out of them. It would involve higher transactions costs than Option B (because an explicit provision would have to be written into contracts whereas under Option B parties might choose to have no job security provision at all). We discuss this option at greater length in section 6.

Option D: Amend Part 9

5.8 Part 9 could be amended in several ways:

- The provision for a trial period could be extended to firms with more than 19 employees. We see no reason for any limit.

- The 90-day period could be made longer. It is not at all unusual for problems in an employment relationship to arise only after a considerable time. We note that probation periods of around a year apply in some OECD countries. Australia has a 12-month period for small firms and a 6-month period for large firms although there is no real logic behind the distinction, as many Australian commentators have noted. In other contexts the government has promoted harmonisation of business law with Australia, but in order to grow faster than Australia New Zealand has to adopt superior policies. A probation period of 12 months was recommended by the 2025 Taskforce.

- There could be a salary cap (eg a salary of $50,000 per annum) over which no mandatory provisions apply (as suggested in Question 15). It might be assumed that higher income employees are better able to negotiate on their own behalf and assess the value of job security provisions to them.

5.9 Obviously elements of Option 4, and no doubt other ways of making Part 9 less restrictive, could be combined. We think a model option on these lines should be specified and tested in an RIA analysis against Options A – C.

5.10 We note in this context that issues underlying Part 9 of the ERA also relate to the issue of fixed-term contracts. Currently the ERA only allows fixed-term contracts in restrictive circumstances, and unions oppose their wider use on the grounds that they may be used to circumvent unjustified dismissal provisions. Consistent with our view that voluntary contracting is the most efficient form of employment relationship, we believe there should be no limitations on the use of fixed-term contracts and we ask the Department of Labour to include this issue in the review.

6. Contracting out: An elaboration of Option C

6.1 By way of background to this option, we note that one of the principal flaws in existing legislation is that it assumes not only that employers

will behave badly unless parliament dictates to them but, even more irrationally, that the prescriptive legislative rules should apply universally to all employment arrangements. There is no reason why parties to an employment agreement should not be able to contract out of many of the statutory obligations under the Employment Relations Act and other applicable legislation. It would be a matter for debate whether they should be able to contract out of all legislative provisions affecting the relationship. It may be argued, for example, that at least some of the provisions which impose obligations of good faith, and which apply both to employer and employee, should be retained. In many respects, however, the statutory provisions reflect established common law principles in any event.

6.2 A useful model for allowing contracting out of statutory obligations in employment is that which applies in respect of relationship property. It has been possible for many years to contract out of the statutory arrangements for the division of matrimonial property and, now, property in relationships in the nature of marriage. The contracting-out provisions seem to be working satisfactorily under the supervision of the courts; there is no reason why the same should not apply to employment relationships.

6.3 Accordingly we have formulated proposed draft amendments to s238 of the ERA which are attached as an annex to this submission. Section 238 prevents contracting out of the Act. The proposals are confined to the parties to individual employment agreements but there is no reason, in principle, why employers contracting with unions, acting on behalf of their members, should not be able to reach agreement to contract out of certain provisions of the Act. The drafting is general in nature and would apply to personal grievances.

6.4 The scheme of the proposed draft is relatively straightforward:

- Section 238A provides the right to contract out. It is subject to the limitations which might be included in sub-section (2) where

reference could be made, for example, to some of the good faith provisions.

- The important qualification to the contracting out right is that an agreement containing a contracting out provision must be entered into on the basis of the employee having had prior independent advice. This provision provides a safeguard against any risk of exploitation.

- An arrangement which contracts out of the Act would also be subject, under s 238B, to the power of the Employment Court to set the agreement aside, even though the procedural requirements have been complied with, if giving effect to the agreement would cause serious injustice.

6.5 We think that a rigorous evaluation of Options A – D would rank them in the order we outline in section 5. If Options A or B are not favoured we strongly recommend careful consideration be given to Option C, preferably with general application (as drafted), or confined to the unjustified dismissal provisions of the personal grievance regime.

7. Justification for dismissal or other disciplinary action

7.1 came into Section 103A of the ERA, which provided for the first time a statutory formula for the justification for dismissal, was enacted in 2004. There is no doubt that the way in which the Employment Court has interpreted the new provision has made it more difficult for employers to satisfy the obligation in personal grievance proceedings to prove justification for a dismissal or other disciplinary action. The declared intention of the minister of labour and the select committee, during the amendment bill's passage through the House, was not to create any major new law but simply to restore the law to that which existed prior to the Court of Appeal's decision in *Oram* in 2001. That intention has been ignored by the Employment Court, which has invented a whole new jurisprudence, effectively giving the Authority and the Court the power to override employers' decisions merely because they feel it is reasonable to do so.

7.2 This has resulted in significant extra costs for employers who are required either to retain staff guilty of misconduct merely because of the potential cost of litigation if dismissal followed, or who are required to settle personal grievance claims which lack merit simply because the cost of defending the proceedings outweighs the cost of settlement. Under the law which existed prior to the *Oram* decision, and which was well settled, the Authority and the Court had the power to determine on an objective basis whether an employer's conclusion that serious misconduct had occurred was justifiable. But the law also made it clear that whether dismissal should result from proven serious misconduct was a matter for the employer and not the courts. In other words, the test was whether dismissal was a reasonable option available to an employer in the circumstances. The new jurisprudence under s103A has effectively made the members of the Employment Relations Authority and the judges of the Employment Court the sole arbiters of what is reasonable in a given situation.

7.3 We recommend a repeal of s103A and, if necessary, the inclusion of a precautionary provision which expressly restores the law to that which applied before s103A force.

8. Conclusion

8.1 The personal grievance regime in Part 9 of the ERA is one of the most troublesome features of New Zealand's employment la (see question 20). It is a major obstacle to productivity and employment growth. We are pleased that it is under review and believe the review should be undertaken on a fundamental basis.

8.2 The move by the government to introduce a 90-day trial period improves on the regime that has been in place since the Employment Contracts Act 1991. It has been a successful initiative. Claims by unions that it would give rise to arbitrary firings and widespread exploitation have proved to be unfounded. No doubt any proposals to ease the Part 9 restrictions further would give rise to similar claims, but we believe they would not be credible.

8.3 It would be possible to ease the restrictions further by provisions such as a longer probation period, its application to employers of all sizes, and an exclusion from the provisions above a salary cap, along the lines of Option D above. However, this option would be sub-optimal in terms of the reform options available and the government's ambitious goals for economic growth. We think the most desirable reform would be to make the inclusion of unjustified dismissal provisions in contracts a matter for voluntary negotiation between employers and employees (Option A in this submission). Such at-will contracting is the norm in the United States, and we see no reason why New Zealand should deny itself the benefits of an arrangement that has helped make the United States the world's most productive and innovative large economy. It is a regime that has been favoured by Republican and Democratic administrations alike, and supported by employer and employee organisations. Other options include contracting into and out of a statutory framework (Options B and C in this submission).

8.4 We see the key requirement in the next stage of the review as being a rigorous regulatory analysis of the range of available options and the development of legislative proposals based on the most desirable of them. We also recommend a review of provisions relating to fixed term contracts to make them generally available and the repeal of S103A.

Annex I

Proposed amendment to 'no contracting out' provisions of the Employment Relations Act 2000

238 No contracting out

Subject to sections 238A and 238B, the provisions of this Act have effect despite any provision to the contrary in any contract or agreement.

238A Parties to individual employment agreements may contract out of this Act

(1) Notwithstanding section 238, but subject to subsection (2) of this section, an employer and an employee who are, or who are intending to become, parties to an individual employment agreement, may agree that any provision of this Act shall not apply to their employment relationship.

(2) The following are the provisions of this Act to which a contracting out agreement under subsection (1) may not apply –

(a) …

(b) …

(3) An agreement entered into under this section must comply with the following the requirements –

(a) The agreement must be in writing and signed by both parties:

(b) The employee must have independent advice before signing the agreement:

(c) The signature of the employee to the agreement must be witnessed by a lawyer or other authorised person:

(d) The person who witnesses the signature of the employee must certify that, before the employee signed the agreement, the effect and implications of the agreement were explained to the employee.

(4) Advice given pursuant to section 238A(3)(b) may be held to be independent notwithstanding that it has been paid for by the employee's employer.

(5) An agreement which purports to be made under this section shall be void unless the requirements set out in subsection (3) are complied with, provided that nothing in this subsection shall affect the validity of any other provisions in an employment agreement between the parties.

238B Court may set agreement aside if would cause serious injustice

(1) Where an agreement under s238A has been entered into in compliance with the requirements set out in subsection 238A(3), the Court may set the agreement aside if, having regard to all the circumstances, it is satisfied that giving effect to the agreement would cause serious injustice.

(2) The Court may exercise the power in subsection (1) in the course of any proceedings under this Act, or on application made for the purpose.

(3) This section does not limit or affect any enactment or rule of law or of equity that makes a contract void, voidable, or unenforceable on any other ground.

(4) In deciding, under this section, whether giving effect to an agreement made under section 238A would cause serious injustice, the Court must have regard to –

(a) the provisions of the agreement:

(b) the length of time since the agreement was made:

(c) whether the agreement was unjust in the light of all the circumstances at the time it was made:

(d) whether the agreement has become unjust in the light of any changes in circumstances since it was made (whether or not those changes were foreseen by the parties):

(e) the fact that, by entering into the agreement, the parties wished to achieve certainty as to the nature and the terms and conditions of their relationship, and the circumstances in which it could be terminated by either party:

(f) any other matters that the Court considers relevant.

(5) In deciding, under this section, whether giving effect to an agreement made under section 238A would cause serious injustice, the Court must also have regard to whether any party to the agreement has altered their position in reliance upon the terms of the agreement.