Contracts versus relationships: An examination of employer resistance to the Employment Relations Act 2000

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ABSTRACT

Employer opposition to the Employment Relations Act 2000 highlights the sometimes extreme differences in ideology underpinning different approaches to the regulation of the employment relationship. This paper seeks to examine if the contractual and relational approaches to governing employment relationships are mutually exclusive. While the contractual approach is clearly based in the extension of property rights through managerial prerogatives, the relational approach is based on a balancing of property rights and labour rights. It is observed that in practice, the actions to build trust and good faith are consistent with employer strategies to develop competitive advantage through people. However at an ideological level, a gulf still exists between the two approaches.

Introduction

During the past two decades employment legislation in New Zealand has undergone "frequent, radical changes" (Rasmussen 2004). The conciliation and arbitration system, first established in 1894, was replaced in 1991 by the contractual approach to employment relations embodied in the Employment Contracts Act. More recently, in 2000, the contractual approach was replaced with a relational approach through the adoption of the Employment Relations Act. At the time of its introduction, there was significant employer opposition to the ERA. This opposition was renewed in 2004 with the introduction of the Employment Relations Law Reform Bill, the provisions of which became effective on 1 December 2004.

Employer opposition to the ERA goes to the heart of assumptions regarding the rights of capital and labour within the capitalist system. This paper seeks to examine if the contractual and relational approaches to governing employment relations are mutually exclusive. In doing so, this paper will:

1. describe the changes in employment legislation in New Zealand during the past two decades;
2. review employer support for the ECA and their opposition to the ERA;
3. identify the tensions between the various outcomes of the employment relationship;
4. examine employer claims to a framework that allows relatively unfettered use of managerial prerogatives to ensure business success; and
5. examine if academic literature can bridge the gap between the contractual and relational approaches to governing employment relations.

Two decades of change in employment legislation

In 1991, a National-led government introduced the Employment Contracts Act ('the ECA'). The circumstances surrounding the replacement of New Zealand's industrial relations system of conciliation and arbitration with the ECA in 1991 have been well documented (see for example, Latornell 2004; Deeks & Rasmussen 2002; Deeks et al 1994). However, it is worth noting that one of the long-term impacts of the conciliation and arbitration system was the creation of uniform wages and working conditions within particular industries and occupational groupings regardless of an employer's size, location and financial performance or the individuals work performance (Coddington 1993) and (Dannin 1997). Also developed were entrenched relativities between industries and occupational groups (Harbridge & Crawford 1997). Enterprise-level issues were rarely, if ever, discussed during the negotiation of national awards (Coddington 1993). Ultimately, when coupled extreme tariffs and government regulations designed to protect domestic industries, the conciliation and arbitration system helped contribute to highly inefficient businesses which were inflexible and slow to adapt to the changing global business environment.

By contrast, the ECA provided a framework which facilitated a massive restructuring of businesses designed to increase flexibility and efficiency. The ECA was intended "to promote an efficient labour market" (preamble). It was built on the assumption that employment relationships are the result of an essentially private economic and transactional contract between an employer and an employee (Latornell 2004). Burton (2004: 136) has noted that "under the ECA employers had, for the first time, gained the right to negotiate terms and conditions suited to their own enterprises and, not surprisingly,… were not slow to make use of their newfound freedom". Kiely and Caisley (1993: 224) reported that, after the passage of the ECA contrary to all known contract law, employers "persist[ed] in asserting that they do have the 'right' to unilaterally vary employment contracts". Other employers adopted a 'take-it-or-leave-it' approach to negotiations, an approach which was upheld by the Court (Kiely & Caisley 1993). Many employers also discovered that they could effectively cut unions out of the employment relations process. Court of Appeal decisions allowed employers to 'recognise' the authority of unions to act as an employee's representative and then completely ignore them. The Courts held that recognition did not require an employer to negotiate with an employee's representative (Latornell 2004).

In 2000, a Labour-led government passed the Employment Relations Act ('the ERA'). The ERA was introduced because, in the government's view, the structural adjustments facilitated by the ECA had contributed to: casualisation of the workforce; increasing replacement of employer-employee relationships with employer-independent contract relationships; increasing replacement of collective contracts with individual contracts; and increased reliance on legalistic solutions to employment relationship problems (Wilson 2001: 7).

Through its introduction of the ERA, the government argued that "the contractual adversarial stance to employment relations was replaced by a negotiated cooperative approach that was founded on the equitable notion of good faith" (Wilson 2004: 9). As stated in the so-called Key Objects section, the intent of the ERA was:

> to build productive employment relationships through the promotion of mutual trust and confidence in all aspects of the employment environment and of the employment relationship, by recognising that employment relationships must be built on good faith behaviour and by acknowledging and addressing the inherent inequality of bargaining power in employment relationships (s. 3(a)).

In December 2004, the ERA was further amended by the Labour-led government. The object of the Act was changed by altering the order of its reference to the concepts of 'mutual trust and confidence' and 'good faith'. It also broadened the context within which unequal power relationships are assumed. The object of the act now reads

> to build productive employment relationships through the promotion of good faith in all aspects of the employment environment and of the employment relationship by recognising that employment relationships must be built not only on the implied mutual obligations of trust and confidence, but also on a legislative requirement for good faith behaviour and by acknowledging and addressing the inherent inequality of power in employment relationships (s. 3(a), as amended).

Amendments were also made to attempt to provide additional definition to the concept of 'good faith'. Section 4(1A) of the amended ERA states that

> The duty of good faith…
>
> (a) is wider in scope that the implied mutual obligations of trust and confidence; and
> (b) requires the parties to an employment relationship to be active and constructive in establishing and maintaining a productive employment relationship in which the parties are, among other things, responsive and communicative; and
> (c) without limiting paragraph (b), requires an employer who is proposing to make a decision that will, or is likely to, have an adverse effect on the continuation of employment of 1 or more of his or her employees to provide the employees affected—
>
> (i) access to information, relevant to the continuation of the employees' employment, about the decision; and
> (ii) an opportunity to comment on the information to their employer before the decision is made (Employment Relations Service 2004: 16)

Employer opposition to the ERA

When then the Employment Relations Bill (the 'Bill') was first debated, "there was substantial employer opposition to many parts of the Bill in large part, no doubt, due to its departure from the relative freedom of contract under the Employment Contracts Act" (Cleary 2004: 4). Some have characterised the opposition of the New Zealand Employers Federation (now Business New Zealand) and the New Zealand Business Roundtable (NZBR) to the Bill as an attempt to "destabilise the Government's relationship with the business community" (Wilson 2004: 13).

Employer opposition to the ERA at the time of its introduction in 2000 focused on a number of aspects. Among these were the creation of "profound uncertainty" (New Zealand Manufacturers Federation, 2000, p. 2) the ERA would generate for the economy, the complication of the direct relationship between employers and employees by overriding "the right of individual employers and employees to form a relationship that suits their circumstances" (New Zealand Business Roundtable 2000: 15), increasing compliance costs (New Zealand Manufacturers Federation 2000) and the potential for decreased "labour force flexibility" (New Zealand Manufacturers Federation 2000: 8). One of the most significant concerns of the opponents was the lack of information within the ERA regarding the nature, intent and definition of 'good faith behaviours'. This concern was clearly summarised by Harrison (2001: 87-89), who noted that the ERA gives rise to three fundamental interpretation issues regarding the content of the duty of good faith.

> First, does the duty of fair dealing apply to every aspect of the legal and social relationships which may arise in practice between any three of the named parties to an 'employment relationship'? Or does the duty only apply to the parties' dealings with each other in their respective capacities as employer, employee, union member, and so on?... Secondly, an important question arises as to the operational content of the obligation to deal in good faith. Is it effectively limited to matters of process, setting a standard for procedural (fair dealing) between the parties to an 'employment relationship'? Or does it transcend procedural dealings between the parties, and impose certain minimum standards of substantive conduct?...Thirdly, what standards of conduct, procedural or substantive as the case may be, does the duty to deal in good faith require?... [D]oes good faith mean or include: fair treatment, reasonable conduct; acting without negligence; acting without breach of applicable legislative provisions (for example, without discrimination contrary to the Human Rights Act 1993)? Or does 'good faith' mean no more than the absence of arbitrariness, or indeed the absence of an attitude of bad faith?

Employer representatives, particularly the NZBR, argued for a continuance of the ECA. "Employees and employers face disparate, complex and uncertain pressures. Mutually beneficial arrangements will only be achieved if they are able to determine contract types, terms and conditions that best suit their specific circumstances" (New Zealand Business Roundtable 2000: 6). The NZBR furthermore argued that "formal contractual mechanisms" is one way for employers and employees to reduce the risks of conflict and encourage long-term cooperation (New Zealand Business Roundtable 2000: 21). The NZEF stressed that the uncertainty in the business environment was underpinned by a "feeling that employers may lose *effective control* of their business" (New Zealand Manufacturers Federation 2000: 5, emphasis added).

In 2004, when amendments to the ERA were being discussed and debated, employer opposition to the ERA continued unabated. Business New Zealand argued that aim of the Bill—now passed into law—"is to take New Zealand back to the era of collectivism by placing difficulties in the way of individual bargaining and rewarding those who join the collective and therefore the union – something like compulsory unionism by another means" (Business NZ 2004: 21). Business New Zealand noted that amendments to the good faith provisions, which the government stated were an attempt to clarify the concept, have been characterised as "undermining the right of employers to manage their enterprises in the most effective way" (Business NZ 2004: 11).

Outcomes of employment relationships

Employer opposition to the ERA clearly underlines the challenges inherent in developing a legislative framework that balances the competing outcomes of employment relationships. At the workplace level, the framework for employment relationships serves to: resolve conflict and ensure due process; ensure the supervision, motivation and participation of individual employees; and determine the operation of work rules and work organisation (Katz & Kochan 1992).

At a societal level, Barbash (1972) has stressed that all industrial relations systems generate identifiable interests among the parties to the employment relations system: management interest in cost efficiency; employee interest in security and protection against cost efficiency; and government interest social welfare, economic planning and the balancing of the interests of the three parties. Similarly, Meltz (1989) argued that efficiency and equity are classical standards by which employment relationship and industrial relations systems are measured. More recently, Budd (2004: 13) has built on Meltz's view by adding voice to these standards.

> Efficiency is the well-known standard of economic performance, equity encompasses fair treatment, and voice is the ability to have meaningful input into decisions. Efficiency is an instrumental standard of economic performance—the effective use of scarce resources that provides the means for consumption and investment—and is the primary objective of employers. Equity and voice are the objectives of labor. Equity is an instrumental standard of treatment—a fair wage, basic social or private insurance coverage, vacation time, and non-discriminatory treatment are instrumental in providing the means toward greater ends such as food, shelter, health care, and leisure. Voice is an *intrinsic* standard of participation—participation in decision making is an end in itself for rational human beings in a democratic society. Intrinsic voice is important whether or not it improves economic performance, and whether or not it alters the distribution of economic rewards (original emphasis).

Control and managerial prerogatives

From the earlier discussion of employer opposition to the ERA, it is clear, that New Zealand business is expressing its perceived need for control and relatively unfettered managerial prerogatives. Traditionally, within the field of employment, the management of employees has been based on "the perceived need for close control of the work and behaviour of the lower echelons if organisational goals were to be achieved, and these views still have resonance today" (Skinner & Spira 2003: 28). This need for close control is embodied in Frederick Taylor's principles of scientific management. Even though changes in the business environment and changes in organisational structures have resulted in greater empowerment of employees, "there still remains a need for accountability, both internal and external, which necessitates the implementation of control systems and procedures" (Skinner & Spira 2003: 28). And while it is likely that many managers would insist that they have moved beyond Taylorist work practices, Shapiro (2000: 321) has noted that the influence of Taylor's ideas "with their orientation to making human work fit the mechanical requirements of efficiency and accuracy is still felt. Taylor's legacy could be observed within some organisations in their tendency to separate employees' hands from their brains".

Management prerogative centres on the problem of who is in control of the operations of the business (Turnbull 1948). Mayer (2001: 221) notes that "while democracy is the norm in the state, at least in the advanced industrial nations, authoritarianism prevails in the economy". While managerial prerogatives are thought to arise, at least in part, out of the "old master-servant doctrine of common law" (Turnbull 1948: 47), they are more often viewed as being derived from the rights of property ownership which lie at the heart of the capitalist system. Barbash (1972: 43-44) has noted that capitalism functions on three levels.

> First, it represents the private ownership of property and property rights, and second the exercise of managerial authority in the enterprise associated with these property rights. On both these planes the objective eventually is profit maximising or, perhaps more precisely, optimising or 'satisficing.' Third, capitalism is an ideology whose proponents seek to create a climate of opinion and policy generally favourable to the advancement of private profit opportunities. As applied to the labor process the management plane of capitalism represents a system of power or management prerogatives. Management justifies its prerogatives as essential to the maintenance of enterprise efficiency and, hence, of profit.

The concept of management prerogatives is based on the argument that due to inherent property rights, management has a legal authority to direct and control a business organisation. Traditionally, this has been viewed as the right and authority to organise and direct employees, machinery, materials and money in order to achieve the objectives of the enterprise (Young 1963).

Management prerogatives "afford management the ability to control the enterprise by directing its workforce, determining the means and methods of operation, and, in short, exercising all the rights necessary to effectively and efficiently run the business" (Darrow-Kleinhaus 2001: 10).

This view of managerial prerogatives is not, however, without its opponents. Young (1963: 242) argues that management prerogatives do not include controlling employees.

> As far as the employee is concerned, the specific authorities which have been given to management are restricted to the right to enter into an agreement with the employee and the authority to use the assets of the firm to compensate the employee for his services.

In reaching this conclusion, Young relies on the work of John R. Commons who noted that "the labor contract is not a contract, it is a continuing renewal of a contract at every successive moment, implied simply from the fact that the labourer keeps at his work and the employer accepts his product" (Commons 1939 cited in Young 1963: 243). Young concludes his argument by noting that "management has confused its legal rights and economic power" (Young 1963: 244). The employer's economic power is such that it more often than not enables them to propose an employee's terms of employment on a 'take-it-or-leave-it' basis. Traditionally, due to a fear of unemployment, employees are often willing to accept employment conditions that have been unilaterally imposed by an employer. "The employer used economic coercion in the threat of discharge rather than legal control to achieve employee compliance" (Young 1963: 244).

In a similar vein, Budd (2004: 45) argues that while there is not an accepted consensus as to a hierarchy of rights within society, property rights of the owners of capital have somehow been elevated above the equity rights of labour.

> The tradition that asserts the superiority of property rights over labor rights focuses on *exclusive* property rights—the extent to which ownership allows the exclusion of others, which has historically served as the foundation of autonomy and liberty. But the function of property rights has evolved from protection of liberty to promotion of economic efficiency. (original emphasis).

Economic theory has largely ignored the equity rights of labour, instead arguing that well-defined property rights and the freedom to use property are critical to the efficient function of a market-based economy. Any government regulations which constrain property rights are typically seen as restrictions on property rights and the efficient function of the market (Budd 2004).

Interrelations of trust, contracts and control

This paper now turns to examine if academic writing in the areas of trust, contracts and control are able to bridge the gap between contractual and relational approaches to governing the employment relationship. Unfortunately, academic literature regarding the interrelationships of trust, contracts and control is extremely limited. There is some consensus regarding the conditions required for trust to exist. Trust exists when there is a "willingness to be vulnerable under conditions of risk and interdependence" (Rousseau et al. 1998: 395). Malhotra and Murnighan (2002: 534) note that academic literature "suggests that contracts and trust can or do substitute for one another". They note that "contracts are external controls that help to reduce uncertainty by constraining individual and organisational behaviours" (2002: 536). Sitkin and Roth (1993: 367), classify contracts, bureaucratic procedures and legal requirements as different kinds of control mechanisms. Organisations tend to adopt these control mechanisms "as substitutes for trust when interpersonal relations are lacking". In a similar manner, trust and control can be viewed as two different mechanisms for managing risk and uncertainty (Skinner & Spira 2003). Reed (2001: 201) characterises trust and control as coordinating mechanisms.

> Conventionally, the concept of 'trust' is taken to signify and represent a co-ordinating mechanism based on shared moral values and norms supporting collective co-operation and collaboration within uncertain environments. In sharp contrast, 'control' is taken to refer to a co-ordinating mechanism based on asymmetric relations of power and domination in which conflicting instrumental interests and demands are the overriding contextual considerations.

Trust tends to be associated with control in some shape or other, however, the relationship between trust and control is not clearly understood (Das & Teng 1998). "The relationship between trust and control is considered to be substitutional. While trust is thought to render control superfluous, *control is believed to undermine trust*" (Sydow & Windeler 2003: 75). It has been argued that contracts and other legalistic mechanisms serve to increase confidence within relationships and even build trust. However, evidence appears to counter this argument. Investigating the impact of contracts on trust, Malhotra and Murnighan (2002: 556) conclude that "whereas binding contracts may help to reduce risk and enhance the likelihood of cooperative interaction, they can work against the development of informal understanding and mutual trust". Furthermore, legalistic control mechanisms can lead to "an inflationary spiral of increasingly formalised relations" (Sitkin & Roth 1993: 367).

Clearly, the academic literature provides little assistance in bridging the gap between contractual and relational approaches. Trust and control appear to be separate, but related concepts. They both seek to reduce uncertainty, but they largely function as substitutes for one another. Furthermore, control appears to be tightly aligned with contractual approaches to employment relations, which trust appears to be equally as tightly aligned with relational approaches to employment relations.

Building 'trust' and 'good faith' in practice

The recent amendments to the ERA make clear the government's view that 'good faith' is "wider in scope than the legal doctrine of implied mutual obligations of trust and confidence" (Employment Relations Act 2000, s. 4(1A)(a)). The amended ERA requires the parties to an employment relationship to be "active and constructive in establishing and maintaining a productive employment relationship in which the parties are, among other things, responsive and communicative" (Employment Relations Act 2000, s. 4(1A)(b)). The legislation does not however, give concrete examples of what employer actions would be appropriate in building 'trust' and 'good faith'. This is not unexpected, as legislation often does little more than enunciate general principles. It is this lack of certainty surrounding the definition and interpretation of key concepts that underpin the entire piece of legislation which fuels at least some of the employer opposition to the ERA.

A review of the academic and practitioner literature on trust and good faith does provide insights into the types of employer actions and practices needed to build trust and good faith. The following are some examples of employer practices that could be used to build trust and good faith.

1. Building a management team that does more than pay lip-service to organisational values, but instead lives those values as well, by providing training and educational opportunities to enhance "manager's competencies, skills, and capabilities, especially in the areas of leadership, participation in decision-making, delegation, communication and fairness" (Whitener et al. 1998: 526).
2. Implementing human resource processes and procedures which are built on principles of procedural justice. "Employees who feel treated fairly by, and have high quality relationships with their supervisors will exhibit higher trust in them" (Whitener 1997: 397).
3. Ensuring managers and supervisors use verbal rewards, expressions of appreciation, support and encouragement for employees (Lewicki et al 1998).
4. Ensuring the work environment is free of discrimination, bullying and harassment (Rogers 1995a).
5. Ensuring open communication through five critical behaviours: being positive, seeking other's ideas, listening, disclosing information and 'not shooting the messenger' (Rogers 1995b).

The practices noted in academic and practitioner literature are consistent with contemporary, strategic human resource management practices "designed to enhance employee commitment to an organisation's vision, mission and goals" (Latornell 2004: 81). So at a practical level, building trust and good faith is consistent with business claims of needing to base an organisation's competitive advantage on its people. Ultimately, it is the potential constraint on operations

created by a legislated requirement of good faith behaviours and implied mutual obligations of trust and confidence which is at odds with employer ideology.

In the contracting model of the employment relationship, "the contract between the parties, although enforceable in court…, is intended to be largely or entirely self-enforcing" (Wachter 2004: 176). As a consequence the parties tend to rely on organisational norms "to guide their behaviour, with the firm's hierarchical governing structure serving as the ultimate authority for resolving disputes" (Wachter 2004: 179). Can we therefore trust employers to ensure the outcomes of efficiency, equity and voice desired for the employment relationship are met? Wachter (2004: 189) argues, that the hierarchical, norm-based system embodied in the contracting model of the employment relationship does not always work. "Although the firm has the appropriate incentives to treat workers fairly, the managers may not act this way because of either individual managers' idiosyncratic behaviour or firm policy". For example, when faced with a decision where the solution brings the organisation's need for efficiency into conflict with the employee's need for equity or voice, it can be expected that the need for efficiency will, more often than not, win.

Conclusion

Employer opposition to the Employment Relations Act 2000 is focused on the potential loss of effective control over operations due to the imposition of a standard of good faith behaviours and implied mutual obligations of trust and confidence. This opposition is clearly based on an ideology which elevates the rights of property owners and the related issue of managerial prerogatives above the rights of labour. While the actions and practices which organisations could adopt in order to build trust and good faith are generally consistent with contemporary, strategic human resource management practices. However, it is the potential constraint on operations created by a legislated requirement of good faith behaviours and implied mutual obligations of trust and confidence which is at odds with employer ideology. Academic research to date provides little insights into how to bridge this gulf; contracts and control are generally seen to be substitutes for trust in managing uncertainty. Clearly, if employers are unwilling to be vulnerable to the risk that the actions of their employees will be in the interests of the organisation, employer acceptance of trust and good faith will be limited. It also appears that unless a middle ground between contractual and relational approaches to governing the employment relationship can be found, New Zealand will be subject to periodic and wild swings in employment legislation associated with changes in the political ideology of the Government.

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