MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Fair Pay Agreements: application of the Commerce Act and further advice on vetting

Date:	19 February 2021	**Priority:**	Medium
Security classification:	In Confidence	**Tracking number:**	2021-2190

Action sought		
	Action sought	**Deadline**
Hon Michael Wood **Minister for Workplace Relations and Safety**	Note the application of the Commerce Act to FPAs Forward this briefing to the Minister of Commerce and Consumer Affairs Agree to further details regarding the vetting process for FPAs Note the interaction between the mechanism for giving legal effect to FPAs, the vetting process and legal risks, and agree to restrict FPAs to employment-related matters only	26 February 2021

Contact for telephone discussion (if required)				
Name	**Position**	**Telephone**		**1st contact**
Tracy Mears	Manager, Employment Relations Policy	04 901 8438		✓
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The following departments/agencies have been consulted

Minister's office to complete:

- ☐ Approved
- ☐ Noted
- ☐ Seen
- ☐ See Minister's Notes
- ☐ Declined
- ☐ Needs change
- ☐ Overtaken by Events
- ☐ Withdrawn

Comments

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Fair Pay Agreements: application of the Commerce Act and further advice on vetting

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Purpose

To provide advice on the application of the Commerce Act to the Fair Pay Agreement (FPA) system, vetting of FPAs, and the interaction between the vetting process and legal risks.

Executive summary

The application of the Commerce Act

The Commerce Act prohibits entering into, or giving effect to, provisions of contracts, arrangements or understandings that substantially lessen competition in a market (for goods or services), and agreements that contain cartel provisions.

The Commerce Act excludes employment relationships from the definition of a service and has an exclusion for collective bargaining for employment conditions and remuneration. Therefore, at least to the extent FPAs cover only employment-related terms, we understand the Commerce Act would not apply.

The prohibitions in the Commerce Act could still apply in situations where the bargaining parties attempt to set terms relating to other markets (e.g. the price of contractor labour, or product prices).

We consider the status quo application of the Commerce Act to collective bargaining would be appropriate for FPAs as they would apply to employees. Further work in relation to the Commerce Act will be required when contractors are brought into the FPA system.

Note that even though employment-related terms in an FPA would not be subject to the Commerce Act, there is still a risk that these terms could have a negative impact on competition in affected markets (e.g. higher pay levels could create difficulties for small employers).

Further advice on vetting

We have previously advised that before FPAs are ratified and finalised they should be vetted by a government body. Although we did not recommend which body should perform the function, you indicated that the vetting process should be undertaken by the Employment Relations Authority (the Authority). You also indicated the function should occur prior to ratification and must be timely. You indicated you wanted further advice on the degree to which FPAs were vetted.

The main advantage of the Authority undertaking vetting would be the potential legal certainty of the Authority's giving its position on its legality, ahead of the Chief Executive of MBIE making the FPA into law through a legislative instrument.

However, we do consider if the Authority performs the vetting function it introduces higher costs (given the skillset required for vetting and high salary costs of the Authority members) as well as delivery risks, relating both to known resource constraints and accountability of the institution. We note that if the FPA Budget bid is scaled down there would be implications for the operational

feasibility of the vetting function being given to the Authority, including a potential impact on the Authority's existing dispute resolution functions.

The current approach under the Employment Relations Act to accountability and independence of the Authority means there would therefore be limited accountability mechanisms to hold the Authority to account for delivery in meeting quality and timeframes for vetting certification. An alternative could be for MBIE to perform this function in addition to legislating the FPAs. This would provide more accountability, increased flexibility in meeting demand, and better value for money.

Noting these risks, we are seeking your confirmation of your decision for the Authority to perform the function and the dependency on adequate resourcing coming through the Budget process. Alternatively you may wish to discuss this matter with officials.

We recommend that the vetting body should have a positive obligation to approve FPAs unless it is satisfied that the FPA does not comply with the FPA legislation, minimum employment standards, or is otherwise contrary to law.

The interaction between the mechanism for giving legal effect to FPAs, the vetting process and legal risks

We consider there are legal risks (e.g. in relation to the Commerce Act) if bargaining parties can agree terms in FPAs which are inconsistent with some legal requirements.

The body giving legal effect to FPAs through secondary legislation (MBIE) will be subject to some legal risk and will be wholly reliant on the vetting process undertaken by the Authority to identify any unlawful terms.

We originally envisaged that the vetting process would be used to identify and mitigate those risks. However, the Authority may not be able to identify risks such as a term of an FPA being unlawful under the Commerce Act in advance of a court ruling on the matter.

The possible consequences of this risk are judicial review of the body making the secondary legislation bringing the FPA into force (MBIE), a challenge under the Commerce Act that a provision of the secondary legislation was prohibited, or a complaint to Parliament's Regulations Review Committee.

We do not have a good way of identifying the size of this legal risk. If this risk is small, no further steps may be necessary to mitigate those risks. We recommend mitigating this risk by reducing the scope of the type of terms the bargaining parties could agree to employment-related terms only. This would also address the Legislation Design and Advisory Committee's recommendation to narrow the scope to manage rights-related issue.

Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

The application of the Commerce Act

a **Note** that the Commerce Act prohibits entering into, or giving effect to, provisions of contracts, arrangements or understandings that substantially lessen competition in a market (for goods or services), and agreements that contain cartel provisions.

Noted

b **Note** that since the Commerce Act both excludes employment relationships from the definition of a service and has an exclusion for collective bargaining for employment conditions and remuneration, to the extent FPAs cover only employment-related terms we understand the Commerce Act would not apply.

Noted

c **Note** that we consider the prohibitions in the Commerce Act would still apply in situations where an FPA was setting non-employment terms or was regulating a non-employment market, such as the following:

- The contractor market: If the bargaining parties agreed in the FPA that contractors needed to be paid the same rate as employees.
- The product market: If the bargaining parties agreed either in the FPA or subsequently that in response to the FPA companies would raise prices of a related product (e.g. businesses agree to raise all their prices by 10% to reflect the higher labour costs resulting from the FPA).

Noted

d **Note** we consider the status quo application of the Commerce Act to be appropriate.

Noted

e **Note** that including contractors in the FPA system in future will require a careful examination of the competition impacts and would likely require a Commerce Act authorisation in the FPA legislation.

Noted

f **Note** that although we understand the prohibitions in the Commerce Act would not apply when setting employment-related terms in an FPA, there is still a risk that these terms could have a negative impact on competition (e.g. higher pay levels could mean that some firms could exit the market or it could create barriers to entry).

Noted

g **Forward** this briefing to the Minister of Commerce and Consumer Affairs, Hon Dr David Clark, for his information.

Agree / Disagree

Further advice on vetting

h **Note** you have previously indicated that the Employment Relations Authority (Authority) should perform the function.

Noted

i Note there are delivery risks delivery risks if the Authority performs the vetting function, relating both to resourcing and accountability of the institution.

Noted

j **Note** that if the FPA Budget bid is scaled down there would be implications for the operational feasibility of the vetting function being given to the Authority, and it could have implications for delivery of the existing dispute resolution functions depending on how the Chief of the Authority chose to prioritise work by the members.

Noted

k **Confirm** your decision for the Authority to perform the vetting function (or discuss alternative options with officials).

Agree / Disagree / Discuss

l **Agree** that in vetting FPAs, the Authority should have a positive obligation to approve FPAs unless they do not comply with the FPA legislation, minimum employment standards, or is otherwise contrary to law.

Agree / Disagree

m **Note** we will provide further advice on timeframes for the vetting process in an upcoming briefing covering timeframes for the whole FPA system

Noted

The interaction between the mechanism for giving legal effect to FPAs, the vetting process and legal risks

n **Note** that we consider there are legal risks (e.g. in relation to the Commerce Act) if the bargaining parties can agree terms in FPAs which are inconsistent with some legal requirements.

Noted

o **Note** that the body giving legal effect to FPAs through secondary legislation (MBIE) will be subject to legal risk as a result of approving the FPA, and will be wholly reliant on the vetting process undertaken by the Authority to identify any unlawful terms.

Noted

p **Note** we originally envisaged that the vetting process would be used to identify and mitigate those risks, but now consider there is a risk that the Authority (or any vetting body) will not be able to identify risks such as term of an FPA being unlawful under the Commerce Act in advance of a court ruling on the matter.

Noted

q **Note** the possible consequences of this risk are judicial review of the vetting body, a challenge in the courts of the validity of the secondary legislation bringing the FPA into force by the government body (MBIE), or a complaint to Parliament's Regulations Review Committee.

Noted

r **Note** you could either accept this risk or take action to mitigate this risk by reducing the scope of the type of terms the bargaining parties could agree to by restricting them to employment-related terms only.

Noted

s **Agree** to restrict the scope of FPAs to employment-related terms only (i.e. FPAs should focus on terms which impact on employment such as pay, terms and conditions, and working conditions, and should not be able to include terms which regulate prices of related products).

Agree / Disagree

Tracy Mears
Manager, Employment Relations Policy
Labour, Science and Enterprise, MBIE

19 / 02 / 2021

Hon Michael Wood
Minister for Workplace Relations and Safety

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Background

1. We are providing you with a series of briefings on outstanding issues in the FPA system.

2. This briefing provides advice on three topics:

    - The application of the Commerce Act to FPAs
    - Subsequent advice on the vetting of FPAs and how they are brought into force (following your decisions on briefing 2021-1615).
    - The interaction between the mechanism for giving legal effect to FPAs, the vetting process and legal risks.

3. We have also included information about how awards were finalised in Annex One.

4. The issues relating to the Commerce Act are one example of the legal issues which FPAs may encounter. We originally envisaged that the vetting process would identify legal issues such as in relation to the Commerce Act, but as we set out below this may no longer be feasible. Therefore the design of the system creates legal risks that the legislative instrument bringing FPAs could be challenged in court (e.g. on the basis it contained unlawful terms).

The application of the Commerce Act to FPAs

5. This section examines two inter-connected issues:

    - To what extent could FPA bargaining be covered by the prohibitions on anti-competitive behaviour ('restrictive trade practices') in the Commerce Act?
    - To what extent is it desirable for FPAs to be covered by the Commerce Act?

6. The initial design of the FPA system will only cover employees (not contractors), but you intend to include contractors in the system at a future date. We have not yet examined what implications including contractors would have for the Commerce Act, and we will do this work in future when considering the inclusion of contractors. However, it is likely that a statutory authorisation enabling bargaining for contractors would be required, as with the bargaining framework for contractors in the Screen Industry Workers Bill.

The Commerce Act prohibits restrictive trade practices, but carves out services relating to employment and collective bargaining

Contracts of service are carved out of the prohibitions

7. Part 2 of the Commerce Act regulates restrictive trade practices. Most notably it prohibits entering into, or giving effect to, provisions of contracts, arrangements or understandings (agreements) that substantially lessen competition in a market, and agreements that contain cartel provisions.[1]

8. The scope of both the substantially lessening competition prohibition and the cartel prohibitions are linked to the supply or acquisition of "goods" or "services". If the supply or acquisition in question relates to something that is neither a good nor service then the prohibitions do not apply. Importantly section 2 of the Commerce Act expressly excludes from the definition of services "rights or benefits in the form of … the performance of work under a contract of service." This means that work performed by employees (under a contract of service) is outside the scope of the prohibitions in the Commerce Act.[2]

[1] Cartels are agreements between competing buyers or sellers of goods or services to lessen competition between them, such as by fixing prices or restricting output.
[2] This part of the definition of services in the Commerce Act has generated very little case law. We are aware of only one case on this point – the *New Zealand Steel* case we discuss below.

Collective bargaining is also covered by an exception

9. The Commerce Act also contains a number of exceptions to the prohibitions.[3] One of these is an exception for employment-related agreements (s44(1)(f)), which essentially carves out collective bargaining for remuneration and working conditions from the Commerce Act:

> *"Nothing in this Part applies ... (f) to the entering into of a contract, or arrangement, or arriving at an understanding in so far as it contains a provision that relates to the remuneration, conditions of employment, hours of work, or working conditions of employees" …*
>
> *"to any act done to give effect to a provision of a contract, arrangement, or understanding, or to a covenant referred to in paragraphs (a) to (g)."*

10. This exception does not extend to colluding to raise prices or lower the quality of services in related or downstream markets as a result of the collective agreement (e.g. agreeing to raise the price a product that the relevant workers make in a factory). Therefore there is a distinction between *agreeing and giving effect* to a collective agreement, and how affected parties *respond to it*.

These exceptions will translate across to the FPA system

Legal professional privilege

13. The intent of the FPA system is to allow employer organisations and unions to bargain to set employment terms and conditions. In effect, reducing competition for labour below a certain price is one of the core purposes of the FPA system, and it would be counterproductive if the bargaining parties were hamstrung in bargaining by possible prosecution under the Commerce Act. Therefore the current application of the Commerce Act appears to be appropriate in this regard, consistent with collective bargaining under the ER Act.

14. However, notwithstanding these exceptions above, it is still possible that some terms of an FPA could still be subject to the prohibitions in the Commerce Act. We explore these possible situations below.

FPAs could also include terms which were not employment related and which could be subject to the Commerce Act

15. You have previously decided that there should be no restriction on the topics which the bargaining parties can discuss (i.e. outside the mandatory to agree and mandatory to discuss topics, all other topics would be permissible to discuss). Therefore it is possible that FPAs will include terms which cover wider topics which would still be subject to the Commerce Act, including where they 'spilled over' into other (non-labour) markets. We set out two examples below which would still be subject to the prohibitions in the Commerce Act.

Example 1: regulating the rate of contractors through an FPA

16. In this example the FPA bargaining parties may seek to set standards for the contractor market (contracts for services) which is not covered by the carve-out in the definition of services in the Commerce Act.

[3] It is also possible to create 'statutory exceptions' (s43) which mean that where another Act specifically overrides the Commerce Act, nothing in the relevant Part of the Commerce Act applies. This is the approach taken in the Screen Industry Workers Bill.

Legal professional privilege

17. This situation was the subject of the only case we are aware of which tests the current collective bargaining exception in the Commerce Act: *New Zealand Steel Ltd v National Distribution Union Inc* in the High Court.[5] The Court expressed a view in this case that the collective bargaining exception would likely not apply to a situation where a collective agreement limited the use of contractors and equalised the pay rate for contractors (i.e. the terms would be subject to the Commerce Act).[6]

Example 2: If the bargaining parties agreed how to respond to the terms of an FPA

18. In this situation the agreement could take the form of either a term of the FPA itself or a subsequent agreement that companies would pass on the costs of the FPA through raising prices or lowering the quality of a downstream product. For example businesses could agree to raise all their prices by 10% to reflect the higher labour costs resulting from an FPA. These situations would not fall within the exemption for employment-related terms because the agreement relates to a product market, and it is likely that they would be found to be a prohibited agreement.[7]

19. There have been two recent cases in which the Commerce Commission has successfully taken proceedings against competitors who agreed to raise prices in response to an industry shock. The most relevant example involved livestock companies agreeing to raise prices in response to the Ministry of Primary Industry's introduction of the National Animal Identification and Tracing system (NAIT), which created costs for livestock companies. In one of the related cases the High Court imposed a pecuniary penalty of $2.6 million due to three price fixing agreements which PGG Wrightson entered into.[8]

Overall the status quo application of the Commerce Act to collective bargaining situations should be sound for the purposes of the FPA system

20. We consider that this distinction between making and giving effect to an agreement (exception if employment-related) and how to respond to it (no exception) should be maintained in relation to the FPA system. Although we want the bargaining parties to be free to agree FPAs, we do not want them to also agree to raise prices or lower the quality of services in related markets in response to the FPA. Rather we want businesses to independently set the prices/quality of services provided which reflect the FPA minimum standard for employment terms.

Note that even if terms in an FPA are employment focussed they could have an impact on other markets

21. Terms which are solely employment-related could have impacts in other markets. For example, if the wages agreed in an FPA were higher than some small employers could afford then those small employers may exit the market as a result. This would not be a competition issue from a legal perspective as such a situation would still be within the bounds of the Commerce Act exceptions, but it would have an impact on competition in that market.

22. Another risk is that FPAs could include terms which create a conflict between current employers and employees and those who are not yet in the sector (i.e. insiders vs outsiders). For example, the bargaining parties could agree to occupational regulation being created through FPAs, where the FPA set minimum requirements to perform an occupation (e.g. all

[5] *New Zealand Steel Ltd v National Distribution Union Inc*, HC Auckland CIV-2009-404-6090, 11 May 2010
[6] At [69] and [70] of the judgement
[7] However, if the companies all independently chose to raise prices in response to an FPA we understand that would not breach the prohibition.
[8] *Commerce Commission v PGG Wrightson Ltd*, HC Auckland, 11 December 2015. In December 2016 the High Court also imposed penalties on a number of employees of relevant companies for their roles in the price fixing agreements.

policy analysts must have a Master's degree). This could make it difficult for workers to enter an occupation and reduce the supply of labour.[9]

23. These risks are partially mitigated by some of the design features of the FPA system:

    - The obligations that the bargaining representatives have to represent non-members. In theory this should make it more difficult for the bargaining representatives to take positions which conflict with non-members who are not directly represented.
    - The agreed FPA will need to be ratified by both employees and employers.

Supplementary advice on the vetting process

Background

24. We have previously advised (briefing 2021-1615 refers) that FPAs should be vetted before they are finalised to ensure they are compliant with minimum requirements under FPA legislation as well as wider key legal requirements.

25. In terms of the wider key legal requirements, we specifically noted two examples of where a proposed FPA could be problematic:

    - It contravened the Commerce Act, e.g. there was a provision in the agreed FPA which had the effect of substantially limiting competition (and was outside the existing exception for collective bargaining).
    - It was inconsistent with NZ's international obligations: e.g. the FPA explicitly discriminated against foreign companies in favour of NZ-based/owned companies.

26. In response to the briefing you indicated that you would like:

    - Only limited additional checks above the minimum to occur – with the detail to be discussed.
    - For the Employment Relations Authority to do the check, and for it to be timely.
    - For the vetting to occur pre-ratification

27. You also asked how awards were finalised. We have included information on this point in Annex One.

Which body should perform the vetting function?

28. In our last briefing on vetting (2021-1615) we did not provide recommendations on which body should perform the vetting function. You indicated that the Authority should perform the function.

29. The main advantage of the Authority undertaking vetting would be the potential legal certainty of the Authority giving its position on its legality, ahead of the Chief Executive of MBIE making the FPA into law through a legislative instrument.

30. However, we do consider it introduces higher costs (given the skillset required for vetting and high salary costs of the Authority members) as well as delivery risks if the Authority performs the vetting function, relating both to resourcing and accountability of the institution. In the short term, there are known resource constraints compared to demand for the Authority's services. We note that if the FPA Budget bid is scaled down there would be implications for the operational feasibility of the vetting function being given to the Authority. If you confirm your decision for the Authority to perform the function there could be implications for delivery

[9] We note in practice it may be difficult to distinguish between a condition of entry to an occupation and preferential rates for workers with more advanced qualifications.

of the Authority's existing dispute resolution functions depending on how the Chief of the Authority chose to prioritise work by the members.

31. The current approach under the Employment Relations Act to accountability and independence of the Authority means there are therefore limited mechanisms for Parliament, MBIE or Ministers to hold the ERA to account for delivery in meeting quality and timeframes for vetting certification. There are alternatives, which would maintain separation of decision making from Ministers and meet the skillset required, including for MBIE to perform this function in addition to legislating the FPAs. MBIE is more directly accountable for its performance, could draw on a wider pool of resources if demand required and provide better value for money for the skill sets required.

32. Noting these risks, and the dependency on adequate resourcing coming through the Budget process, we are seeking your confirmation of your decision for the Authority to perform the function. Alternatively you may wish to discuss this matter with officials.

What standard should FPAs be vetted against?

33. We recommend that the ER Act requirement is carried across so that FPAs must comply with both the FPA legislation, minimum employment standards, and is not otherwise contrary to law. As we set out in Annex One, this would also be consistent with the system in the Labour Relations Act 1987 where the Arbitration Commission could decline to bring an award into effect if it contained anything contrary to any enactment.

34. Giving the Authority a role in vetting prior to finalisation of agreements would be a new role, given collective agreements are not currently vetted before they are finalised. However, Authority members do have a knowledge of wider law and take the requirements of s54 of the ER Act into account when making decisions on collective agreements. Therefore we are confident that Authority members will be able to perform the vetting function. We note there are likely to be situations where the Authority will not be in a position to make a definitive statement that the term of an FPA is unlawful prior to a ruling by a court on the point of law (we discuss this in relation to the Commerce Act below).

35. We consider the system should create a positive obligation to approve the FPA unless the Authority has identified an inconsistency with either the FPA legislation, minimum employment standards, or is otherwise contrary to law.

36. One other option we discarded was to specify the laws which the vetting body would need to check against. We consider it would be difficult to identify the relevant laws ahead of time and such an approach could risk excluding pertinent legislation, so we do not recommend this option.

37. Finally, we note both the vetting function and responsibility for bringing FPAs into force could be transferred to the new institution which you intend to create. The new institution could be equipped with the expertise to take a wider view of relevant law when vetting FPAs.

Should the legislation specify how quickly the vetting process must occur?

38. You have indicated you want the vetting process to be performed by the Authority and that it must be timely. You have choices about whether and how the FPA legislation ensures the vetting process is timely.

39. The ER Act includes timeframes in some instances in relation to Authority functions. The closest parallel is in relation to making determinations. For example in certain situations the Authority must provide a determination within a three-month timeframe.[10] This timeframe can

[10] The Authority may reserve determinations rather than providing an oral determination or an oral determination of its preliminary findings. It must then provide a written determination of its finding as soon as possible and not later than three months after the date on which the investigation meeting concludes or the last evidence or information was received from the parties or any other person.

be extended by the Chief of the Authority if they decide exceptional circumstances exist. Over the past five years, approximately 7% of determinations were issued outside the three-month time timeframe.[11]

40. The time required for the vetting process will depend in part on the complexity of the FPA in question. For example, a complex industry based FPA could include a large number of different schedules setting pay and terms and conditions for each occupation within the sector, possibly also broken down further with regional variations. The bargaining parties may also seek to include a large number of terms which do not strictly relate to employment terms in the agreement which could lengthen the time required to undertake the vetting process. In contrast, some FPAs could be very simple and contain uniform pay and terms and conditions.

41. There is a balance to be struck between the workability of the system, and the ability of the bargaining representatives to put in place an FPA in a reasonable period of time, and putting in place an unworkably short period for the Authority to complete the vetting process which could reduce the efficacy of the vet.

42. Our provisional view is that the Authority should be required to assess FPAs within a month, with the Chief of the ERA having the power to extend this by one month (to two months total) in exceptional circumstances. We have tested this recommended timeframe with the Chief of the Authority and he does not have objections to this timeframe. We will provide you with further advice and a recommendation in a forthcoming briefing on timeframes, as we think it important to consider all timeframes together.

The interaction between the mechanism for giving legal effect to FPAs, the vetting process and legal risks

There are legal risks if bargaining parties include terms which are unlawful

43. The broad scope that bargaining parties have to agree the terms of an FPA mean there is a risk that they could agree a provision which is inconsistent with some legal requirements. For example, the parties could agree terms which fall outside the Commerce Act exemption for employment-related terms and conditions. This occurred in the *New Zealand Steel* case discussed above, where the issues in relation to the Commerce Act were not identified or raised at the time the collective agreement was entered into, but were subsequently identified and litigated.[12]

44. The ER Act requires that the content of collective agreements cannot be “contrary to law” or “inconsistent with [the ER Act]” (s54). The requirement in the ER Act relies on the bargaining parties avoiding any unlawful terms. In collective bargaining, if the bargaining parties agreed a provision that fell outside the exemption for the Commerce Act, they would be liable for the breach of the Commerce Act. However, because the FPA would be given legal effect through secondary legislation, the legal risks would be different. The body giving legal effect to FPAs through secondary legislation (MBIE) will be wholly reliant on the vetting process undertaken by the Authority to identify and mitigate any unlawful terms. MBIE will be subject to a legal risk of judicial review, but because MBIE will not have any discretion as to whether to approve the FPA (beyond procedural checks) this is not likely to be significant. There is also a potential risk that the validity of the secondary legislation could be challenged, in which case MBIE or the Attorney General could be the respondent.

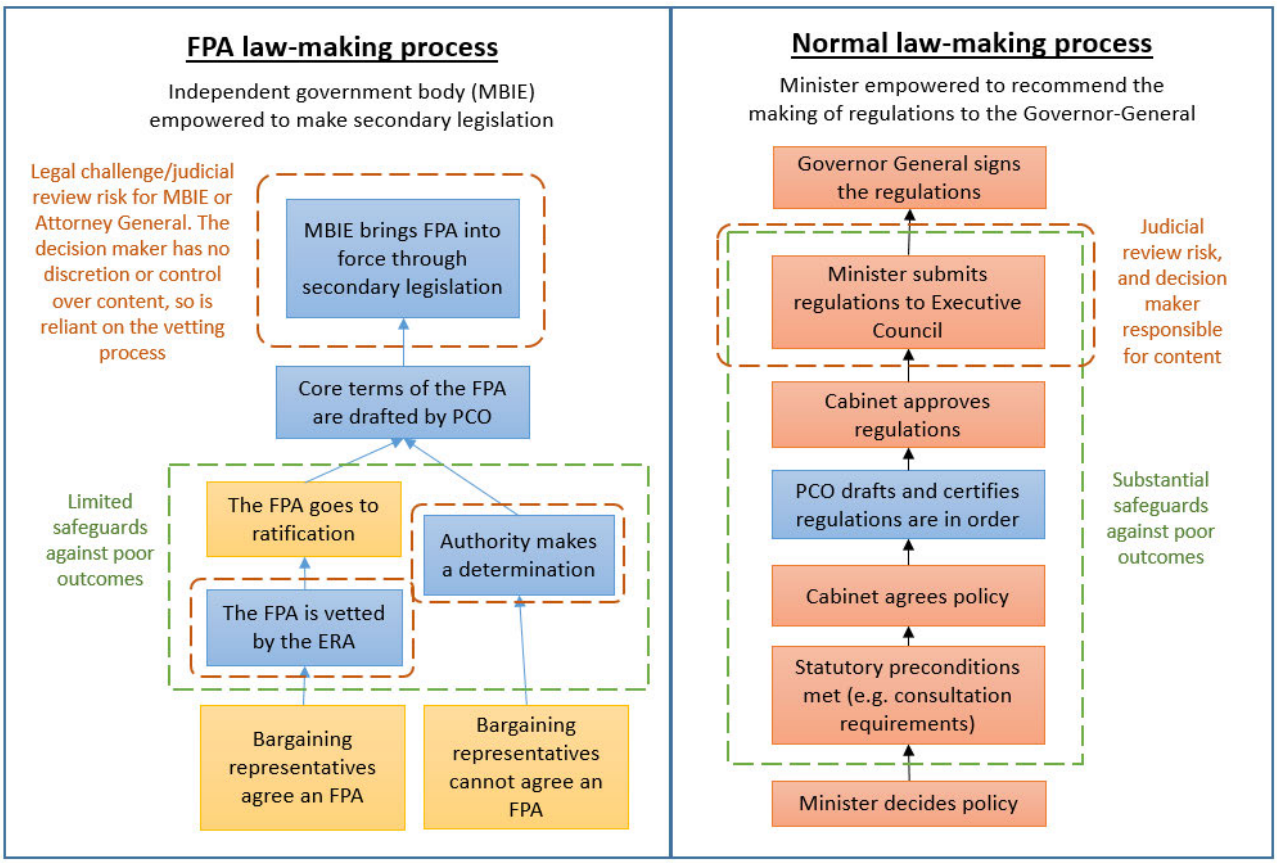
[11] MBIE legal research prepared in October 2020
[12] *New Zealand Steel Ltd v National Distribution Union Inc*, HC Auckland CIV-2009-404-6090, 11 May 2010 at [6]

The vetting process is an important safeguard in the FPA system

45. Normally legislation and regulations contain a number of safeguards to ensure the law-making is appropriate and is subject to democratic processes. Primary legislation is subject to Parliamentary scrutiny, and regulations must be submitted to Cabinet, Executive Council and the Governor-General. In contrast the FPA system will not have the same level of safeguards when bringing FPAs into force. After the vetting process is concluded and ratification has passed, the government body which makes the secondary legislation will not have any discretion about whether to bring the FPA into force.

46. The intent of the vetting process is to prevent unlawful terms in bargained FPAs from being given legal effect (in secondary legislation). The vetting process will therefore act as a safeguard to ensure there is at least a degree of oversight of what the bargaining parties agree. Vetting agreements prior to the point they are finalised and resolving legal issues should also reduce the number of legal challenges to FPAs after they are given legal effect.

47. This risk is summarised in the following diagram. However we note that there is a spectrum of law-making processes and sometimes ministers have limited discretion (e.g. when approving recommendations from technical bodies).



48. An important consideration in terms of these risks is whether, in practice, the Authority could definitively identify where a provision is “contrary to law”. Earlier in this briefing we discussed the potential application of the Commerce Act. It is unlikely that the Authority (or any vetting body) could determine that a provision was inconsistent with the Commerce Act without a decision by a Court on a claim. Without such a finding, there would not be a basis to say a provision of an FPA was unlawful on competition grounds so the Authority would be required to approve the FPA.

49. Given it will be difficult to assessing compliance with the Commerce Act ahead of time, there is the possibility of an after-the-fact challenge to an FPA which is already in force.

In what situations could FPAs be legally challenged?

50. We anticipate there could be a number of mechanisms for legally challenging an FPA on the basis it contained unlawful terms. For the purposes of the examples below we examine where an applicant alleged that a term of the FPA was outside the Commerce Act exceptions and in breach of the Commerce Act. We anticipate the most likely avenues for challenge would be:

    - A legal challenge of the validity of the FPA legislative instrument. This challenge could assert that the legislative instrument was outside the law because some of its provisions were unlawful. MBIE or the Attorney General would likely be the respondents, and they would be reliant on the vetting process undertaken by the Authority to mitigate this risk. However, as noted above, in relation to the Commerce Act the Authority is unlikely to be able to identify breaches ahead of a court judgment.
    - A challenge under the Commerce Act in the Courts that the FPA is in contravention of its prohibitions. If the challenge was successful, then one possible outcome would be that the provision in question would be unenforceable. Depending on who the parties to the agreement were, there could also be penalties and/or damages awarded. Alternatively if the courts could not separate the provision in question from the rest of the FPA then the whole FPA could be impacted. Another impact of a successful case could be that the FPA secondary legislation would also consequently be outside the empowering provision in the FPA legislation.
    - A complaint to Parliament's Regulations Review Committee that it should draw the matter to the attention of the House of Representatives. The Committee could refer the regulation to the House on the basis that the regulation "is not in accordance with the general objects and intentions of the enactment under which it was made" or one of its other grounds.

51. The extent to which a legal challenge will be possible will depend on the empowering provision which delegates the ability to make secondary legislation. For example, the independent body's act of making secondary legislation bringing the FPA into force should not constitute a specific authorisation of those provisions for the purposes of the Commerce Act.

52. We do not have a good way of identifying the size of this legal risk. If this risk is small, no further steps are necessary to mitigate those risks. Our view is that it is worth considering options to mitigate that risk.

53. While the vast majority of FPAs will likely focus predominantly on employment terms and will not have negative or unintended outcomes, we consider it is necessary to design the system to account for outlier cases. In theory there is no limit to the type of topics which the bargaining parties could agree in FPAs, even if these non-employment terms would be subject to the Commerce Act and could subsequently be found to be prohibited.

To mitigate legal risks we recommend FPAs should be focussed on employment terms only

54. Our view is that it is worth considering mitigating that risk by reducing the scope of the type of terms the bargaining parties could agree. We note that the courts had a high degree of discretion about whether to register awards under the previous system as a way of managing this risk.

55. Our view is that it would be beneficial to restrict what the bargaining parties can include in FPAs to just employment-related terms. We note you have already decided that all other terms which are not mandatory to agree or mandatory to discuss should be allowed, but it is unclear whether you were envisaging other *employment-related* terms or any other terms with no restrictions.

56. Restricting FPAs to focus on employment-related terms would minimise the risk of the parties agreeing terms which had an impact on other markets (which may in any case be prohibited by the Commerce Act). Such a restriction would also simplify the vetting process by setting a boundary around the possible terms for FPAs.

57. The Legislation Design and Advisory Committee (LDAC) in its advice to MBIE also recently noted that legislation should not create a power that is wider than necessary to achieve the policy objective, and that prescribed limits to the extent of a power are key safeguards. There are currently no restrictions on the content of FPAs, which means that the scope of agreed FPAs could be wider than necessary to achieve the objective of the system.[13] LDAC therefore recommended that "narrowing the scope of what terms may be included will make it easier to manage rights-related issues." These rights issues include freedom of association and the freedom to contract.

58. However, putting in place a restriction on the terms which could be agreed would also have the effect of preventing the bargaining parties from agreeing terms in the FPA that they consider would be beneficial for the occupation or industry but were not employment-related. We note if FPAs could only include employment-related terms the bargaining parties could potentially create a non-binding side agreement to the FPA (i.e. an industry accord) which covered non-employment related matters.

59. There is a trade-off between flexibility for the bargaining parties and the risks of non-employment terms being agreed which could be contrary to the law. We recommend that restricting FPAs to employment-related matters would be prudent.

60. Finally, we note there is a connection between allowable terms and the design of the purpose statement in the FPA legislation. Given the significance of FPAs in effectively setting new minimum employment standards which bind a whole sector or occupation, and the possible interference with some rights, we anticipate the courts will read FPAs as narrowly as possible, taking into account the purpose of the legislation. For example, if the purpose statement narrowly referred to creating a bargaining system to set employment standards, then terms which were agreed in FPAs which did not relate to employment matters could be declared outside the purpose statement and the empowering provision.

Next steps

61. We are providing advice on the remaining aspects of the design of the FPA system required to seek Cabinet approval to draft the Bill and to inform the drafting instructions.

Annexes

Annex One: Information on how awards were finalised

[13] We recently advised (2021-2100) that the objective of the FPA system should be "to improve labour market outcomes by enabling employers and workers to collectively bargain industry- or occupation-wide minimum employment terms and conditions."

Annex One: Information on how awards were finalised

1. The system we describe below is the one in force in the mid-twentieth century under the heavily amended Industrial Conciliation and Arbitration Act 1894.

2. There were two forms of instruments: industrial agreements (only binding on signatory parties such as unions and employer associations) and awards (binding on everyone).

3. The process for enacting awards was essentially judicial, with a legislative foundation. There were two mechanisms for awards coming into effect:

    - If there was agreement it could be referred to the Court of Arbitration and the existing award could be varied without a hearing.
    - If there was not agreement, the dispute was referred to a Council of Conciliation (with representation of employers and unions). If the Council could not agree then it was referred to the Court of Arbitration to make an award.

4. This system was reformed at various times, including through the Industrial Relations Act 1973, which created an Industrial Commission and Industrial Court to replace these institutions, and the Labour Relations Act 1987.

5. Importantly, the body bringing the award into force typically had some discretion in making an award:

    - Industrial Conciliation and Arbitration Amendment Act 1911: parties could apply to the Court to have an industrial agreement made into an award. Where the industrial agreement was proved to the Court that it binds a majority of employees in an industry, the Court shall declare the agreement to be an award "unless, in the opinion of the Court, such agreement is … against the public good or is in excess of the jurisdiction of the Court."
    - Industrial Conciliation and Arbitration Act 1954: where an industrial dispute was referred to the Court, the Court may, "if it considers that for any reason an award ought not to be made in the matter of that dispute, refuse to make an aware therein".
    - Industrial Relations Act 1973: the Commission may refuse to make an award "if it considers for any reason an award ought not to be made in the matter of that dispute".
    - Labour Relations Act 1987: where a dispute of interest has been referred to the Arbitration Commission, the Commission shall refuse to register an award if it is satisfied that:
        - The parties do not have the right to represent employers or workers whom the award would purport to cover
        - Any matter contained in the proposed award is contrary to any enactment
        - The proposed award's coverage overlaps with another award or agreement or is likely to overlap with a proposed agreement with an employer who has been specified for separate negotiations.