MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Brooke van Velden	**Portfolio**	Workplace Relations and Safety
Title of Cabinet papers	Introducing an Income Threshold for Unjustified Dismissal Strengthening consideration and accountability for the employee's behaviour in the personal grievance process	**Date to be published**	By 31 January 2025

List of documents that have been proactively released		
Date	**Title**	**Author**
November 2024	Introducing an Income Threshold for Unjustified Dismissal	Office of the Minister for Workplace Relations and Safety
20 November 2024	Introducing an Income Threshold for Unjustified Dismissal ECO-24-MIN-0265 Minute	Cabinet Office
12 November 2024	Regulatory Impact Statement: Introducing an income threshold for unjustified dismissal	MBIE
November 2024	Strengthening consideration and accountability for the employee's behaviour in the personal grievance process	Office of the Minister for Workplace Relations and Safety
20 November 2024	Strengthening consideration and accountability for the employee's behaviour in the personal grievance process ECO-24-MIN-0268 Minute	Cabinet Office
7 November 2024	Regulatory Impact Statement: Strengthening consideration and accountability for the employee's behaviour in personal grievance process	MBIE

Information redacted **YES / NO** *(please select)*

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Regulatory Impact Statement: Personal grievances: Introducing an income threshold for unjustified dismissal

Coversheet

Purpose of Document	
Decision sought:	This Regulatory Impact Statement (RIS) supports the Cabinet paper that seeks the key policy settings for a threshold for unjustified dismissal personal grievances.
Advising agencies:	The Ministry of Business, Innovation and Employment (MBIE)
Proposing Ministers:	The Minister for Workplace Relations and Safety
Date finalised:	12 November 2024

Problem Definition

The costs of unjustified dismissal protection for high-income employees, particularly for senior executives, are higher than for the wider workforce

Employers may only dismiss an employee if they have a good reason (eg, poor performance or misconduct) and followed a fair and reasonable process. If an employee was dismissed and does not think their employer had either a good reason or followed a fair process, they may raise an unjustified dismissal personal grievance against their former employer.

The costs of following a proper dismissal process and risk of an unjustified dismissal claim may make employers reluctant to performance manage an employee through to dismissal. Allowing underperforming employees to remain in place can reduce the organisation's overall performance.

The impact of allowing underperforming employees to remain in place is greater for employees on higher incomes. We differentiate between three groups of high-income employees:

- Senior executives: Managers who report directly to the board (eg chief executives, managing directors) and those with a significant influence over the management of the organisation (eg general managers).
- Highly-paid middle managers: Managers who are in charge of sub-parts of a function of the organisation and who manage staff.
- Highly-paid non-managers: Technical experts who are not people leaders (eg lawyers, doctors, and engineers).

We heard through stakeholder engagement that senior executives have a major impact on organisational performance, and that there are particular performance management challenges relating to senior executives, for example:

- taking time to performance manage an executive is relatively more costly than other employees, as they have a significant impact on organisational performance, and

- the importance of 'fit' of a senior executive, either from a skills or personality perspective, which is less suited to performance management processes.

We heard that highly-paid middle managers and non-managers also have a significant impact, though this is generally lower than senior executives, and there are not the same performance management challenges.

Overall, the first problem is that the costs of unjustified dismissal protection for high-income employees, particularly for senior executives, are higher than for the wider workforce.

Some employers and senior executives appear to address these costs through 'contracting out' of unjustified dismissals, but this is not enforceable

To address these costs, employer representatives, employment lawyers, and technical experts advised that some senior executives and employers contract out of unjustified dismissal protection through 'no-fault termination' or 'face-doesn't-fit' clauses. These clauses provide that employers may dismiss senior executives without fault and quickly (ie without a performance management process or ability to raise an unjustified dismissal), in exchange for a severance agreement. However, these clauses are unenforceable, as the *Employment Relations Act 2000* (the Act) prevents contracting out. The lack of enforceability of this type of arrangement is the second problem.

Executive Summary

The New Zealand National – ACT New Zealand Coalition Agreement committed to considering simplifying personal grievances and in particular setting an income threshold above which a personal grievance could not be pursued.

In May 2024, the Minister for Workplace Relations and Safety agreed that the threshold would apply only to unjustified dismissal, and not the wider suite of personal grievance grounds (ie discrimination, harassment, etc).

The problem definition (as set out above) covers two issues:

- the costs of unjustified dismissal protection for high-income employees, particularly for senior executives, are higher than for the wider workforce, and
- some employers and senior executives appear to address these costs through 'contracting out' of unjustified dismissals, but this is not enforceable.

Through targeted engagement, with employer and employee groups, employment lawyers, dispute resolution experts and technical experts, we developed our understanding of the problem definition (described above).

We propose that the objective for this work is to provide employers with access to simplified dismissal processes for employees with a significant impact on organisational performance, and who have high bargaining power.

This RIS provides analysis on design options for an income threshold for unjustified dismissals, including:

- Who does the threshold apply to and how does it do so?
- What is the income level of the threshold?
- Are employees automatically excluded or do they contract in, or out, of raising an unjustified dismissal claim?

- Would there be mandatory minimum severance payments for dismissed employees?

MBIE's recommended package, and the Minister's proposal (agreed to in August 2024), is outlined below:

	MBIE's recommended proposal	**Minister's proposal**
Who does the threshold apply to?	Senior executives	High-income employees
How does it do so?	Occupation (senior executives) and income-based threshold ($200,000)	Income-based threshold ($200,000)
Automatic or contracting?	May contract out of unjustified dismissal protection	Automatic, but may contract into unjustified dismissal protection
Minimum severance payments?	No minimum severance payments	No minimum severance payments

Overall, we consider that MBIE's recommended proposal best meets the objective. The key benefit of MBIE's proposal is that it provides greater certainty for contracting out arrangements, compared to the status quo. The improved certainty may encourage greater use of contracting out. We consider that MBIE's recommended proposal is preferable to the status quo, due to the increase in certainty.

The key benefit of the Minister's proposal is to provide access to simpler dismissal processes to more employers than the status quo, by using a simple income-based threshold and a contracting in approach. An income-only approach is consistent with the wording of the Coalition Agreement commitment.

However, the Minister's proposal is not well targeted to employees with significant impact on organisational performance and who have high bargaining power. Covering all high-income employees risks creating non-mutually beneficial arrangements, such as dismissing employees who otherwise would have been successfully performance managed at a reasonable cost, and those who are less able to mitigate the negative impacts of job loss. We do not consider that this proposal is preferable to the status quo, on balance.

Limitations and Constraints on Analysis

The evidence that contributed to the problem definition and analysis is primarily based on targeted stakeholder consultation with a limited number of stakeholders. These included academics, employer and employee representatives, employment lawyers, and technical experts. Stakeholders included those who had experience with contracting out arrangements.

Targeted engagement was valuable, and we heard a range of views. However, this remains anecdotal evidence, as individual employment agreements are private, as are the details of any dispute. Because of this privacy, quantitative information does not exist, and feedback from engagement is the best available evidence.

Targeted engagement was focused on a limited number of stakeholders. A full public consultation process would have allowed for great sector or regional analysis of the potential impacts of the policy.

This evidence is supplemented by domestic and international evidence, including on: the impact of employment protection legislation, the impact of managers on organisational

performance, bargaining power, and the impact of job loss. We also drew on the Australian policy settings for their high-income threshold for unfair dismissals. However, the focus of this Regulatory Impact Statement is on a small part of the labour market (ie high-income employees). Whilst New Zealand and international evidence is drawn upon, most of the evidence focuses on the labour force as a whole, or on low-income employees, rather than high-income employees. This limits the applicability of the evidence to the problem definition.

Responsible Manager(s) (completed by relevant manager)
Beth Goodwin Manager, Employment Relations Policy Labour, Science and Enterprise Ministry of Business, Innovation and Employment  12 November 2024

Quality Assurance (completed by QA panel)	
Reviewing Agency:	Ministry of Business, Innovation and Employment
Panel Assessment & Comment:	A Quality Assurance Panel with representatives from the Ministry of Business, Innovation and Employment has reviewed the Regulatory Impact Statement for *Introducing an income threshold for unjustified dismissal*. The Panel considers that the information and analysis summarised in the Regulatory Impact Statement meets the criteria necessary for Ministers to make informed decisions on the proposals in this paper. The Panel notes anecdotal evidence is based on targeted consultation and considers that these limitations have been made clear and are supplemented with additional evidence where possible.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. The New Zealand National – ACT New Zealand Coalition Agreement committed to considering setting an income threshold above which a personal grievance could not be pursued.

The Employment Relations Act 2000 outlines the eligibility and the reasons for raising a personal grievance

2. Any employee may raise a personal grievance against their employer. The only exception is employees who are employed on a valid 90-day trial period. Those employees may not raise a personal grievance claim on the grounds of unjustified dismissal, though other personal grievances may be sought.

3. The Act establishes a number of reasons an employee may raise a personal grievance: unjustified dismissal, unjustified disadvantage,[1] discrimination,[2] sexual and racial harassment, duress over membership of a union or other employee organisation, and an employer's failure to comply with specified employment obligations.[3]

4. The Act establishes a system of procedures and employment institutions designed to support employers and employees to resolve employment relationship problems (including personal grievances) and, if possible, preserve the employment relationship.

5. Section 238 of the *Employment Relations Act 2000* (the Act) prevents contracting out of the Act, so any agreement between employers and employees that the personal grievance regime does not apply to them is not enforceable in law. Annex One includes more detailed information on personal grievances.

Unjustified dismissal personal grievances are the most common type of personal grievance claim

6. The most common type of personal grievance claim is unjustified dismissal, with nearly 80 percent of the Employment Relations Authority (the Authority) determinations addressing unjustified dismissal claims.[4] Unjustified dismissal settings restrict the ability for employers to dismiss employees and therefore has a direct impact on labour market flexibility, whereas other grounds (eg discrimination and harassment) do not have such an impact.[5] This Regulatory Impact Statement (RIS) focuses on unjustified dismissal settings.

7. Employers may only dismiss an employee for a good reason, which includes misconduct, performance issues, redundancy, incompatibility, and incapacity.

8. As well as having a good reason for dismissal, employers must follow a fair and reasonable process, underpinned by the requirement in the Act to act in good faith. This generally includes investigating the matter, communicating concerns to the employee, providing an opportunity for the employee and employer to respond genuinely to the complaint, considering mitigating factors, and alternatives. This process can require a significant investment in time and effort for employers.

9. An employee may bring a personal grievance for unjustified dismissal if they believe that the employer did not have a good reason to dismiss them, or that the process was unfair.

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[1] This can include: being given a warning, suspension, or demotion without good reason, had hours of work or pay changed without consultation, been underpaid, been misled by their employer, not had the opportunity to respond to allegations against them, not had a safe workplace, or not been informed about proposals which may affect their employment.

[2] The Act restates the prohibited grounds in the *Human Rights Act 1993* and adds two further grounds for discrimination: health and safety and union membership.

[3] This includes failures related to continuity of employment for employees affected by restructuring, breaches regarding hours and shifts, retaliation in relation to health and safety or protected disclosure, protection of employee's employment whilst in Reserve Forces service or training, or Easter Sunday rules.

[4] Of the 1,037 personal grievance determinations from 2019-2023, 813 were for unjustified dismissal, and 511 for unjustified disadvantage (determinations can cover more than one issue). By comparison, only 25 claims were for discrimination and 27 for sexual harassment.

[5] See: Recent trends in employment protection legislation | OECD Employment Outlook 2020 : Worker Security and the COVID-19 Crisis | OECD iLibrary (oecd-ilibrary.org).

Unjustified dismissal settings are a key employment protection for many employees…

10. The benefits of unjustified dismissal settings are to ensure that an employer has a genuine reason to dismiss an employee, or a genuine reason for restructuring positions, and to follow a proper process. For dismissal due to poor performance, this includes providing feedback to the employee and enabling the employee to improve. For a restructuring, this involves considering, among other things, redeployment.

11. These settings are intended to ensure employers follow a proper process in situations that could lead to job loss, and that their decisions are fair and reasonable. For workers with low bargaining power, these settings are likely to provide greater protection than they could negotiate for themselves.

… but increase costs and uncertainty for employers, potentially making employers reluctant to dismiss employees

12. Unjustified dismissal personal grievances increase costs for employers, with some examples outlined below:

    - Employers must invest time and financial resources in following a fair and reasonable process before dismissing an employee. What is fair and reasonable is often dependent on the specifics of the case, and can vary widely. For example, serious misconduct may justify a summary dismissal (but still require a fair and reasonable process), whereas a performance management process may entail a lengthy process.

    - If a dismissal is challenged, there are costs involved in progressing through the dispute resolution process (mediation, Authority, and the Employment Court (the Court)). For employers, costs include time spent away from the business, financial costs (eg hiring lawyers or replacement staff), and impact on workplace morale and productivity.

    - Costs involved in settling a claim or the cost of remedies (reinstatement, reimbursement of lost wages, and compensation for humiliation, loss of dignity, or injury to the employee's feelings). In the 12 months to November 2023, the average award for remedies in unjustified dismissal cases was $24,599.

    - Employers and employees may negotiate severance payments to reduce the likelihood of legal action.

13. These costs are uncertain for employers, as it is unclear at the start of a process how long each step will take, whether the dismissal will be challenged, and the costs that arise through the challenge process (including the outcome of the Authority and/or Court's determination, and any remedies).

14. The costs of following a proper dismissal process and risk of an unjustified dismissal claim may make employers reluctant to performance manage an employee through to dismissal, or to restructure positions within the organisation in case employees have to be made redundant. Allowing underperforming employees to remain in place or to continue with an inappropriate business structure may create other costs, such as lower productivity. The OECD notes that overly strict dismissal regulation can negatively impact efficient job allocation, innovation, and productivity growth.[6]

[6] See: Recent trends in employment protection legislation | OECD Employment Outlook 2020 : Worker Security and the COVID-19 Crisis | OECD iLibrary (oecd-ilibrary.org)

What is the policy problem or opportunity?

We undertook targeted stakeholder consultation to inform our understanding of the problem

15. Officials undertook targeted stakeholder consultation in July and August to inform our understanding of the problem. We met with the following stakeholders for one-hour meetings to discuss the problem definition and key design options for an income threshold[7]:

Stakeholder Group	Stakeholders
Academics	University of Canterbury
	Victoria University of Wellington
Employee representatives	NZCTU and Affiliates
	CTU Rūnanga
	Associated of Salaried Medical Specialists
	Tertiary Education Union
Employer representatives	BusinessNZ
	Employers and Manufacturers Association
Employment lawyers	The Employment Law Committee of New Zealand Law Society
	The Employment Law Committee of the Law Association
	MinterEllisonRuddWatts
	The Employment Law Institute of New Zealand Inc.
	Employment Law and Privacy Committee of the New Zealand Bar Association
Professional body	Chartered Accountants Australia and New Zealand
Technical experts	SAP New Zealand Ltd
	Fair Way Resolution
	MYOB
	Human Resources Institute of New Zealand

16. The stakeholders were chosen to provide a range of perspectives and to help fill gaps in our knowledge base, including employer and employee groups who would be affected by the threshold, employment lawyers and technical experts who have experience in negotiating agreements and disputes between employers and high-income employees. The feedback from stakeholders is highlighted in our analysis below.

The costs of unjustified dismissal protection for high income-employees are higher, particularly for senior executives

17. Domestic and international literature on the role of managers in firm performance affirms that management practices are a key factor in determining firm productivity and export performance. New Zealand performs poorly on international measures of

[7] Note this consultation also included discussion on the coalition commitment to consider removing eligibility for personal grievance remedies for 'at-fault' employees. This is a separate policy and is not discussed further in this Regulatory Impact Statement.

management quality, with consistently low scores from 2005-2017, including on the measures which are correlated with productivity.[8]

18. Targeted engagement provided nuance to the impact of managers on organisational performance. Here, we differentiate between three groups:

    - Senior executives: defined as managers who report directly to the board (eg chief executives, managing directors) and those with a significant influence over the management of the organisation (eg general managers).
    - Highly-paid middle managers: Managers who are in-charge of sub-parts of a function of the organisation and who manage staff.
    - Highly-paid non-managers: Technical experts who are not people leaders (eg lawyers, doctors, and engineers).

19. Targeted engagement affirmed that senior executives have a major impact on organisational performance, and having a poor performer has a significant negative impact. We heard that there are particular performance management challenges for senior executives, for example relative costs (as underperformance is more costly due to the impact on organisational performance), and the importance of 'fit' of a senior executive, either from a skills or personality perspective, which is less suited to performance management processes.

20. Stakeholders indicated that the impact of highly-paid middle managers was significant, but generally lower than senior executives. This is because middle managers generally influence a narrower part of the organisation, whereas senior executives usually influence major functions of the organisation and therefore productivity. We also heard that the performance management challenges discussed for senior executives did not apply to middle managers, and performance management could be successful and cost effective.

21. Generally, the international literature suggests that flexible labour markets are associated with greater productivity. However, New Zealand's existing flexible labour market[9] and enduring low management quality scores suggests that there are more important factors in shaping management practices and their impact on firm performance than unjustified dismissal settings alone. This limits the impact any changes to unjustified dismissal settings could have on management practices, and therefore to wider economic factors, such as productivity.

22. There is less research on the impact of highly-paid non-managers, though generally employees who are paid more have greater productivity and can be expected to have a larger impact on firm performance than lower paid employees. Stakeholders indicated that the impact of this group was more varied and generally lower than senior executives. We also heard that the performance management challenges that applied to senior executives do not typically apply to highly-paid non-managers, and that such groups often have additional accountability mechanisms, for example through the Medical Council or Law Society.

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[8] For a comprehensive discussion, see: Lynda Sanderson (2019), *The Evolution of Management Practices in New Zealand*. See also: New Zealand Management Practices Research Team (2010), *Management Matters in New Zealand – How does manufacturing measure up?*, and Alain de Serres et al. (2014), *An International Perspective on the New Zealand Productivity Paradox*.

[9] OECD (2017), *Back to Work: New Zealand Improving the Re-employment Prospects of Displaced Workers.*

Research indicates that high-income employees have greater bargaining power, with stakeholders indicating this is consistently true for senior executives

23. Given the potential costs of unjustified dismissal protection, it is worthwhile to consider the potential benefits. First, we consider bargaining power. Greater bargaining power indicates a more equal negotiation between employee and employer, mitigating concerns that the outcome of negotiations is inequitable and reducing the need for employee protections.

24. MBIE has undertaken a range of work considering bargaining power. Whilst not specifically focussed on high-income employees, MBIE's research generally points to low bargaining power being more prevalent amongst low-income employees, a finding consistent with international studies.[10] This suggests that high-income employees have greater bargaining power.

25. We heard from employment lawyers, dispute resolution experts, and employee groups that senior executives are sophisticated negotiators, and have sufficient bargaining power to negotiate protections from job loss (discussed further in the section describing existing 'contacting out' practices).

26. We heard from the same groups that other highly-paid employees have a greater diversity of negotiating skills and bargaining power. This includes some employees with comparable levels of skill and bargaining power to senior executives, particularly where they have specialist skills that are in high demand. In these scenarios, employees feel confident that they can negotiate beneficial agreements, or walk away from negotiations and find other employment.

27. However, we also heard that highly-paid non-executives includes those with less ability to negotiate mutually beneficial contracting out arrangements. Examples we heard during engagement were:

    - highly-paid non-managers on collective agreements, who do not have sufficient bargaining power to negotiate better individual conditions, and

    - employees in thin labour markets, including where there are few employers, for example employees in the education or science sectors or in small New Zealand markets.

28. We cannot estimate the size of each group or the balance between them.

High-income employees may be better able to mitigate the negative impacts of job loss, though negative impacts remain

29. One of the rationales for unjustified dismissal protection is to mitigate the negative impacts of job loss. The negative impacts include financial stress, hardship, worse health outcomes, and re-employment challenges (including wage scarring[11] and a shift to lower quality work).

30. Broadly, New Zealand evidence finds that financial resilience increases with income. The evidence suggests there are a small number of households with high incomes who would struggle to cover a fall of income, indicating job loss could have a significant negative impact.[12] High-income employees are also more likely to have redundancy or

[10] For example, see Corey Allen and David Maré (2022), *Who benefits from firm success? Heterogeneous rent-sharing in New Zealand*. MBIE's Chief Economist Unit is also considering the role of monopsony power in the New Zealand labour market, which refers to the extent that employers can set the wages of employees.

[11] Reduced wages upon re-employment.

[12] Te Aru Ahunga Ora Retirement Commission (2021), *New Zealand Financial Capability Survey 2021.*

severance payments in their employment agreements, which help to mitigate the immediate loss of income.

31. We heard widespread concern about the impact of job loss on high-income employees from stakeholders, particularly where high-income employees have high fixed costs (eg housing costs) and where employees are in 'thin' labour markets where there are fewer job opportunities, meaning there may be longer period of job search.

32. The negative health impacts of job loss are well-studied and significant.[13] There is less specific research on the experiences of high-income employees, though it confirms that job loss can have significant negative impacts.

33. Potential worse outcomes upon re-employment are another concern. In its 2017 assessment, the OECD noted that New Zealand had relatively fast re-employment rates but had high levels of wage scarring.[14] New Zealand research on wage scarring did not analyse the impact on high-income employees, but the impacts are larger for better educated and older workers, characteristics associated with higher incomes.[15] Stakeholders raised particular re-employment concerns for high-income employees in thin labour markets, where they may need to relocate (domestically or internationally), and the reputational damage of job loss may be significant.

The market appears to address the high costs of unjustified dismissal for senior executives through 'contracting out'

34. We heard that some senior executives and employers contract out of unjustified dismissal protection through 'no-fault termination' or 'face-doesn't-fit' clauses, despite such clauses not being enforceable in law. These clauses provide that employers may dismiss senior executives without fault (ie without a performance management process or ability to raise an unjustified dismissal), in exchange for a severance agreement, which generally include:

- a severance payment (we heard these are generally six to twelve months of salary), and
- 'leaving with dignity' provisions, which can cover a range of matters, for example how an exit will be communicated and providing a reference for future employment.

35. Stakeholders with experience with these clauses said that they are working well. For employers, they provide a route to quickly dismiss senior executives (in a matter of days or weeks), whilst the severance agreements mitigate the impacts of job loss.

36. Although we cannot estimate the exact coverage of these clauses, all employer groups, employment lawyers, and dispute resolution experts were aware of the practice, and that such clauses were unenforceable.

37. Stakeholders indicated that contracting out occurs with senior executives, but not highly-paid middle managers or non-managers. Stakeholders were only aware of contracting out arrangements in the private sector, though severance payments do occur in the public sector.[16]

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[13] For example, see Dean Hyslop et al. (2021), *Involuntary job loss: welfare effects, earnings impacts and policy options*.

[14] OECD (2017), *Back to Work: New Zealand Improving the Re-employment Prospects of Displaced Workers.*

[15] Dean Hyslop (2019), *The Impacts of Job displacement on workers by education level*.

[16] See the Auditor General's 2019 guidance on severance payments in the public sector: Severance payments: A guide for the public sector.

The legislation does not allow contracting out, raising potential risks for employers

38. Whilst we heard that contracting out is working well, such clauses are unenforceable, as section 238 of the *Employment Relations Act 2000* (the Act) prevents contracting out. If the status quo continues, this inconsistency with legislation could:

    - disincentivise senior executives and employers from contracting out, even if it is mutually beneficial to do so, and
    - lead to a personal grievance being established after the employer has paid out in accordance with a contracting out clause. This risk has never crystallised, as far as we are aware. Stakeholders highlighted the significant reputational costs of raising a personal grievance, and that employers and senior executives are strongly incentivised to agree to a settlement. We expect the risk of a personal grievance being raised in this scenario to be low.

Some stakeholders see value in unjustified dismissal protection

39. Some employment lawyers, academics, and employee groups noted that unjustified dismissal settings provided benefits for senior executives, despite the existence of contracting out. Employment lawyers who had represented senior executives noted that they could be subject to poor workplace practices, such as bullying, or an unfair dismissal that causes significant reputational damage. In this context, unjustified dismissal protection provided access to justice to address unfairness, even though personal grievances were rarely raised.

40. Some employment lawyers and academics considered that unjustified dismissal protection provided senior executives with leverage to negotiate severance agreements. They raised concerns that removing access to unjustified dismissal would shift this power balance and undermine this practice. Other stakeholders disagreed, with the employer representatives noting that the ability to negotiate for favourable terms is a pre-condition for being a senior executive, and some employment lawyers and dispute resolution experts noting that both sides understand that an unjustified dismissal would not be raised for reputational reasons, so did not provide real leverage.

What objectives are sought in relation to the policy problem?

Objective: To provide employers with access to simplified dismissal processes for employees with a significant impact on organisational performance and who have high bargaining power

41. The objective for this work is to provide employers with access to simplified dismissal processes for employees with a significant impact on organisational performance and who have high bargaining power.

42. This is intended to find an appropriate balance between costs and benefits for high-income employees. There are two key elements to this objective: **simplifying dismissal process** and **targeting** the policy to where the costs currently outweigh the benefits, where ensures the intervention is mutually beneficial for employers and high-income employees.

43. Employer representatives, some employment lawyers, and some technical experts considered that there was an opportunity to provide additional certainty to the existing contracting out arrangements between senior executives and employers. Employee representatives and the majority of employment lawyers and technical experts did not see a case for change, and largely considered that the status quo is functioning well.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

44. The following criteria will be used to compare the options:

- **Simple:** This means providing a **simpler dismissal process** than what the current unjustified dismissal personal grievances allow.
- **Targeted:** This ensures that this policy focuses on employees with significant impact on organisational performance, tailoring the solution to the identified problem.
- **Cost effective:** For employers, employees and the Government.
- **Minimise unintended consequences or risks:** This seeks to minimise any negative impacts.

What scope will options be considered within?

45. The New Zealand National – ACT New Zealand Coalition Agreement committed to setting an income threshold above which a personal grievance could not be pursued. In May 2024, the Minister for Workplace Relations and Safety agreed that the threshold would apply only to unjustified dismissal protection, and not the wider suite of personal grievance grounds or other employment legislation. This RIS provides analysis on design options for an income threshold for unjustified dismissals, including:

- Who does the threshold apply to and how does it do so?
- What is the income level of the threshold?
- Are employees automatically excluded or do they contract out of raising an unjustified dismissal claim?
- Would there be mandatory minimum severance payments for dismissed employees?

What options are being considered?

46. Options for the above-mentioned key policy questions are discussed below.

Who does the threshold apply to and how does it do so?

Income-based threshold

47. The simplest approach is to adopt a solely income-based threshold, which is also consistent with the wording of the Coalition Agreement commitment. For employers, this approach is the simplest to comply with and will provide the most certainty over which employees are covered by the threshold.

48. Census 2018 data indicates that approximately 50 percent of those earning over $170,000 are classed as managers[17], with the remaining 50 percent being classed in other categories (eg professionals, technicians, and trade workers).[18]

49. Capturing all highly-paid employees risks creating non-mutually beneficial arrangements, such as dismissing employees who otherwise would have been successfully performance managed at a reasonable cost, and dismissing employees who are less able to mitigate the negative impacts of job loss. These concerns were mainly raised by legal experts and employee groups.

50. Including highly-paid middle managers and non-managers may also increase employment costs for roles that are not already contracting out of unjustified dismissals, as employees may bargain for higher salaries or other benefits to compensate them for the reduced employment security.

Income and occupation-based threshold

51. An alternative option is to pair the income approach with an occupation-based approach, where the threshold applies to 'senior executives', which would be defined in legislation as a manager in the top three tiers, ie:

- those reporting directly to a board or a governing body (tier one, chief executives),
- those reporting to a chief executive (tier two, eg, chief financial officers, chief operating officers, chief people officer), or
- a manager who reports to a person who reports to a chief executive (tier three, eg general managers).

52. An employee would need to meet both the income and occupation requirements for the threshold to apply to them. This option effectively targets senior executives, ensuring the threshold is tailored to the problem definition, as well as avoiding the risks of covering highly-paid middle managers and non-managers (discussed above).

53. This approach would allow employees to challenge their status as a senior executive. The judiciary would be required to consider each case on its merits, and it will take time for case law to develop. However, senior executives generally do not challenge their existing unenforceable contracting out clauses, given the reputational impacts of doing so and the size of severance package arrangements. We consider the risk of legal challenge from senior executives is therefore low.

54. This approach would add an additional requirement to the Coalition Agreement, which is proposing introducing an 'income threshold'.

What is the income level of the threshold?

55. There are three options for the income level threshold. In 2023, of all wage and salary employees:

- 5.1 percent received over $150,000,
- 2.2 percent received over $200,000, and

[17] This uses the Statistics NZ classification of managers. Managers earning over $170,000 in the census are likely to align with our definition of senior executives and highly-paid managers.

[18] $170,000 is the highest income band available in the census data.

- 1.2 percent received more than $250,000.

56. There is no 'bright line' of income which separates highly-paid middle managers and non-managers (eg, medical specialists) from senior executives. For example, we heard from employer groups that managers who exert a significant influence over organisational performance would earn at least $180,000 (particularly in small businesses), whilst some employment lawyers noted many middle managers earn close to $200,000.

57. Neither is there a bright line where an employee is resilient to the impacts of job loss. New Zealand survey data indicates that financial resilience increases with income, but this survey indicates that there are a small number of high-income households which would struggle to cover a fall of income (particularly where there are high housing costs).[19]

58. The employer groups we engaged with considered that an income threshold of $180,000 - $200,000 was appropriate, while a few legal experts and academics were concerned that a threshold of this level would be too low.

Are highly-paid employees covered by the threshold automatically excluded or is the ability to raise an unjustified dismissal claim subject to negotiation?

59. There are three options on whether employees earning over the threshold:

- are excluded from raising an unjustified dismissal claim (automatic exclusion),
- are excluded from raising an unjustified dismissal claim, with the ability to contract back into unjustified dismissal protection (contracting in), or
- may negotiate whether an unjustified dismissal claim could be raised (contracting out).

<u>Automatic exclusion</u>

60. An automatic exclusion would mean any employee meeting the threshold requirements would not be able to bring an unjustified dismissal claim, and employers and employees would not be able to negotiate to be covered by unjustified dismissal protection.

61. As currently happens, employers and employees over the threshold would be free to negotiate bespoke dispute resolution clauses in their employment agreements. For example, employers and employees could agree that, before a dismissal occurs, they must attend compulsory private arbitration. If the employer does not follow this process before dismissal, an employee could raise a breach of contract claim through the Employment Relations Authority and Employment Court (but not an unjustified dismissal claim).[20]

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[19] Te Aru Ahunga Ora Retirement Commission (2021), *New Zealand Financial Capability Survey 2021.*

[20] Breach of contract claims can only be raised in the Employment Relations Authority (the Authority) or Employment Court (the Court). Case law confirms that an employee can claim common law damages for breach of contract. Breach of contract claims differ from personal grievances in a number of ways; notably that the limitation for raising a claim is significantly longer (6 years, compared to 90 days for most personal grievances) and the remedies that can be claimed are different. Common law remedies include compensatory, aggravated and exemplary damages, injunctions and declarations. Generally speaking, contractual damages are intended to put the wronged party in the position they would otherwise have been in had the relevant breach not occurred.

62. An automatic exclusion is slightly more certain and would be the simplest to use for employers, and ensures the policy applies to all employees above the threshold. This would allow employers to dismiss employees earning more than the threshold without being required to meet the standard fair and reasonable employer requirements in the Act.

63. Employees could still raise a personal grievance under other grounds (eg discrimination or harassment). As noted above, employers would also be required to adhere to any contractual requirements included in the employment agreement and, if those requirements are not met, a legal challenge could be raised.

64. However, it would constrain freedom of contract for both employers and employees. We heard from employee groups, academics, and employment lawyers that this could disadvantage some employers and employees, for example:

- employers who may wish to offer unjustified dismissal protection as a point of difference over competitors (eg, employers competing in international markets), and
- employees who may wish to maintain unjustified dismissal protection, particularly where there is significant cost in accepting the role (eg moving to New Zealand or moving cities), or where the impact of job loss is particularly high (eg those with high mortgages).

65. In short, if employers see value in unjustified dismissal protection as a way to attract employees, and employees see value in the security provided by unjustified dismissal protection, removing it could have negative labour market impacts. Employee groups representing health sector workers were particularly concerned about this impact if highly-paid non-managers (eg medical specialists) were covered by the threshold.

<u>Automatic exclusion, with a provision to contract in</u>

66. An alternative option is to have an automatic exclusion, with a provision to contract into the unjustified dismissal protection. This would provide greater flexibility than an automatic exclusion alone, by allowing employers and employees to agree to be covered by unjustified dismissal protection. This option would increase the freedom to contract for both employers and employees.

67. Whether employers and employees agree to contract in will depend on the preferences of each party and the relative bargaining power between them. Broadly, we expect high-income earners covered by collective agreements to be more likely to contract-in, particularly in regulated professions where there are additional accountability mechanisms regarding competence (eg the *Health Practitioners Competence Assurance Act 2003*). In these regulated professions, employers and employees may wish (or be required) to use those accountability mechanisms, rather than following a simplified dismissal process. Having the 'default' approach as an automatic exclusion likely shifts the bargaining power towards employers, generating costs for employees who wish to be covered by unjustified dismissal protection.

68. Contracting in is marginally less certain than an automatic approach, as employers and employees could potentially challenge whether contracting in occurred. As with an automatic approach, a personal grievance could be raised under other grounds, as could a failure to adhere to the terms of the employment agreement.

<u>Contracting out</u>

69. An alternative option is to allow contracting out: if the threshold is met, employers and employees could negotiate whether an unjustified dismissal claim could be raised. Unlike existing contracting out arrangements, this option would be enforceable under

the Act. This could be done at any time, including when the employment agreement is first negotiated, or when a dispute has arisen, and a dismissal is imminent.

70. This process aligns with the status quo, where senior executives and employers negotiate away unjustified dismissal protection in exchange for severance agreements. These severance agreements help to mitigate the impacts of job loss, allowing for a mutually beneficial agreement to removal of unjustified dismissal protection.

71. As with contracting in, whether employers and employees agree to contract out will depend on the preferences of each party and the relative bargaining power between them. By contrast with contracting in, contracting out likely tilts the bargaining power towards employees, generating costs for employers if they want the employee to contract out of unjustified dismissal protection. This is more likely to ensure contracting out arrangements are mutually beneficial, as employees are more able to negotiate appropriate benefits in exchange for not being covered by unjustified dismissal protection.

72. There is a risk that some employees do not agree to a contracting out arrangement, and the employer would find it beneficial to dismiss that employee. Employers would be required to meet existing fair and reasonable employer requirements in this scenario (eg performance management).

73. Contracting out is a little less certain than an automatic and contracting in approaches, as employees could potentially challenge the contracting out (for example, if any procedural requirements are not met, if these are included either in legislation or in the employment agreement). If the contracting out process is found to be unlawful, then an unjustified dismissal claim could be successfully raised. As with an automatic approach, a personal grievance could be raised under other grounds, as could a failure to adhere to the terms of the employment agreement.

Would there be mandatory minimum severance payments for dismissed employees?

74. There are two options for mandatory minimum severance payments for dismissed employees. One potential option of mitigating the impact of job loss on employees is to introduce a mandatory minimum severance payment. There are currently no legislated minimum severance pay requirements (eg redundancy payments), and any minimum payment would be what is included in the employee's employment agreement.

75. We heard during engagement that senior executives receive severance payments when dismissed under a no-fault dismissal clause. There was variation in the amount received, though most stakeholders suggested they fell within six and twelve months of salary.

76. This could be formalised through minimum severance pay requirements where employees are dismissed above the threshold.

77. The key benefit of a minimum severance payment is to ensure that all employees would receive compensation to mitigate the immediate financial impact of job loss.

78. The impact analysis for this option will depend on the other settings chosen. If a targeting mechanism is chosen which effectively targets senior executives (income and occupation approach or contracting out) we do not consider that minimum severance requirements would be required, as senior executives have sufficient bargaining power to negotiate their own severance agreements. This was supported by employer groups, a technical expert, and a few legal experts.

79. There may be unintended consequences with introducing a severance payment, for example it becomes the expected payment rather than the minimum payment, or

employers may have to pay the severance payment even where there is an 'at-fault' dismissal (eg they are dismissed for serious misconduct).

What package of options is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

MBIE's recommended package

Who does the threshold apply to and how does it do so?

80. We consider the choice between an income-only and the income and occupation-based approaches to be finely balanced, given an income-only approach provides certainty but poorly targets senior executives, whilst an income and occupation-based approach effectively targets senior executives, but creates some level of uncertainty as an employee could challenge their classification as a senior executive.

81. We recommend an income and occupation-based approach, as it provides more certainty on whether an employee is covered by the threshold to both employees and employers than the status quo, while targeting senior executives effectively.

What is the initial income level of the threshold?

82. We recommend $200,000, as this is most likely to target senior executives from both small and larger businesses. We consider that a higher threshold of $250,000 would exclude some senior executives from small and medium businesses, whilst a lower threshold would include middle managers.

Are employees automatically excluded or do they contract out of raising an unjustified dismissal claim?

83. We recommend contracting out. Contracting out provides the option for employers and employees to decide whether to contract out of unjustified dismissal protection and mitigates potential negative labour market impacts of an automatic approach. Contracting out most closely aligns with our understanding of the status quo, where employers and senior executives negotiate mutually beneficial clauses.

Would there be mandatory minimum severance payments for dismissed employees?

84. We do not recommend introducing mandatory minimum severance pay requirements, unless a threshold of $150,000 is chosen. This is because employees who earn between $150,000 to $200,000 are likely to have relatively lower ability to mitigate the impact of a job loss.

MBIE's recommended package would meet the objective

85. We recommend a threshold with the following design features:

- income and occupation-based threshold of $200,000,
- which allows employers and senior executives to contract out of unjustified dismissal protection, and
- no mandatory minimum severance payments.

86. The key benefits of this option are that it simplifies dismissal processes where employers and senior executives agree to contract out of unjustified dismissal. This option also targets employees with significant impact on firm performance and high bargaining power.

87. Furthermore, this option provides greater certainty of agreements to contract out of unjustified dismissals and ensure employment relations legislation is not preventing

otherwise mutually beneficial agreements. The additional certainty may encourage more employers and senior executives to negotiate these agreements. Given this approach largely codifies the status quo, we expect it to have a relatively small overall impact. Given the objective is to provide certainty, we consider the proposed settings are, on balance, preferable to the status quo.

88. A core challenge in this work is that it covers a relatively small part of the labour market and there is limited evidence on its functioning. Targeted engagement was valuable, and we heard a range of views, but this remains anecdotal evidence, so our assessment of the impacts is necessarily imprecise.

89. There are risks in intervening, particularly if the legislative framework disrupts or undermines a current practice that, whilst unenforceable, appears to work well for those who use it. There is a risk that legislating could make this practice more complex, there may be uncertainty whilst the Court develops relevant case law, or the existing practice could be expanded to employers and employees who benefit from the current settings. We consider the policy choices recommended in this paper to make this a contractual choice rather than automatic, to mitigate these risks.

We consider that an income threshold is unlikely to raise te Tiriti o Waitangi/the Treaty of Waitangi interests

90. We consider that the proposal is unlikely to raise te Tiriti o Waitangi/the Treaty of Waitangi interests, as the proposal is unlikely to impede Māori employees' and employers' ability to uphold tikanga in their employment relationships, or access mediation services when a relationship breakdown occurs. According to Census 2018 data, Māori are under-represented in high-income employees[21], so the impact on Māori access to unjustified dismissal is likely to be comparatively smaller. Officials engaged with Te Rūnanga o ngā Kaimahi Māori o Aotearoa to understand the potential impact on Māori kaimahi.

Minister's proposal

91. The Minister for Workplace Relations and Safety proposes the following policy settings:

- a threshold based on income only; set at a level of $200,000,
- with an automatic exclusion of employees who earn over the threshold, with a contracting in mechanism, and
- with no minimum severance payments for dismissed employees (the Minister's preferred threshold).

92. The key benefits of the Minister's proposal are that it provides a simpler dismissal process than both the status quo and MBIE's recommended package, as the removal of unjustified dismissal protection applies to all employees earning over the threshold. The simplest approach is to adopt a solely income-based threshold. For employers, this approach is the simplest to comply with and will provide the most certainty over which employees are covered by the threshold. However, this option targets all high-income employees, irrespective of their influence on the organisation and their bargaining power. This risks creating non-mutually beneficial arrangements. There may be a potential increase in other legal claims (eg breach of contract).

[21] Census 2018 data indicates that Māori make up 6 percent of high earners, compared to 13 percent for all income ranges.

How do the options compare to the status quo/counterfactual?

	Option One – Status Quo (High-income employees have access to unjustified dismissal protection)	**Option Two – Minister's proposal** (High-income employees earning over $200,000 are automatically excluded from unjustified dismissal protection, with a contracting-in option)	**Option Three – MBIE's recommended package** (Senior executives earning over $200,000 can contract-out of unjustified dismissal protection)
Simpler dismissal processes	**0** The status quo does not provide for simpler dismissal processes. Some senior executives and employers have agreed to contract-out of unjustified dismissal protection, allowing for simpler dismissal processes, but these are legally unenforceable.	**++** This option simplifies dismissal processes, as it applies to all employees earning over the threshold.	**+** The option simplifies dismissal processes where employers and senior executives agree to contract out of unjustified dismissal.
Targeting	**0** Unjustified dismissal protection applies to all high-income employees. The practice of contracting out does appear to only occur with senior executives, who have a significant impact on organisation performance and high bargaining power.	**--** This option targets all high-income employees, irrespective of their influence on the organisation and their bargaining power.	**++** This option targets employees with significant impact on firm performance and high bargaining power.
Costs of administration	**0** The status quo generates negotiation costs to employers (through severance agreements).	**-** Increased negotiation costs for employers and high-income employees. Likely increase in bespoke dispute resolution processes that sit outside of the current processes.	**-** There will be a cost associated with identifying who is a senior executive and the process to contract out of dismissal protection.
Unintended consequences or risks	**0** No-fault termination clauses are unenforceable and there is a risk that they could be challenged at the Authority, though we consider this risk to be low.	**--** Capturing highly-paid middle managers and non-managers risks creating non-mutually beneficial arrangements. Potential increase in other legal claims (eg breach of contract).	**-** Definition of senior executive creates some uncertainty, and a risk of misclassification and potential legal challenge.
Overall assessment	**0** Under the status quo, the legislation does not allow for a simpler dismissal process. A practice of contracting out has developed which provides a simpler dismissal process that is well targeted and comes with low risk of unintended consequences. However, contracting out is legally unenforceable.	**-** Under this option, the coverage of the policy will be wide and certain, but does not meet the targeting criteria.	**+** Under this option, the impact of the policy will be narrow and the targeting complex, but it will allow employers to dismiss employees who have significant impact on firm performance without the risk of a legal challenge.

What are the marginal costs and benefits of the option?

MBIE's recommended package

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of MBIE's recommended package compared to taking no action			
Regulated groups	Ongoing. Employees and employers – those that may meet the income and occupation threshold would negotiate whether the employee is covered by unjustified dismissal protections. This negotiation may lead to additional costs, including: • greater employment insecurity for senior executives, and • higher costs for employers to compensate for the insecurity (eg higher salary, or longer severance payment). As this already occurs, the marginal costs may be low and only occur if the threshold is used more widely than currently. Uncertainty for some over whether they meet the definition of senior executive, and this could be challenged by employees if they were dismissed.	Low	Medium - Targeted stakeholder engagement.
Regulators	One-off implementation costs (eg providing updated guidance, training).	Low	High - Consultation with government departments.
Others (eg, wider govt, consumers, etc.)	This approach would allow employees to challenge their status as a senior executive, however we consider the risk of this is low because of reputational risks arising from a personal grievance. The judiciary may be required to develop new case law in relation to the threshold.	Low	Low - Targeted stakeholder engagement.
Total monetised costs	Low	Low	Medium - Targeted stakeholder engagement and departmental consultation.
Non-monetised costs	There are risks in intervening, particularly if the legislative framework disrupts or undermines current practices that, whilst unenforceable, appears to work well for those who use it, and there is a risk that legislating could make this practice more complex, or expand practice to employers and employees who benefit from the current settings. The option creates increased complexity for employers, employees, the wider employment system and the different stakeholders in the employment system as they would all need to gain an understanding of the complexities related to this option.	Low	Medium - Targeted stakeholder engagement and departmental consultation.
Additional benefits of MBIE's recommended package compared to taking no action			
Regulated groups	Provides access to simpler dismissal process by allowing contracting out of unjustified dismissals. This ensures employment relations legislation is not preventing otherwise mutually beneficial agreements. The additional certainty may encourage more employers and senior executives to negotiate mutually-beneficial agreements. Where contracting out occurs: • the employer has access to a simpler dismissal process, and • the employee will likely have traded this off for additional benefits.	Given this approach largely codifies the status quo, we expect it to have a relatively small overall impact.	Medium - Targeted stakeholder engagement.

	Effectively targets senior executives, ensuring the threshold is tailored to the problem definition, as well as avoiding the risks of covering highly-paid middle managers and non-managers. Ability to contract out allows: • flexibility for an employer in attracting staff, and • employees to negotiate for higher salaries and other benefits which could attract employees from domestic and international market.		
Regulators	Low and ongoing	Low	High - Targeted stakeholder engagement and legal advice.
Others (eg, wider govt, consumers, etc.)	N/A	N/A	N/A
Total monetised benefits	Aligning the legislation with current practice will have ongoing benefits for employers and employees. It will create certainty for employers and employees, employers gain access to simpler dismissal process, and employees could benefit from higher salaries or other benefits.	Low	Medium - Targeted stakeholder engagement.
Non-monetised benefits	Ongoing - Provides greater certainty of agreements to contract out of unjustified dismissals and ensure employment relations legislation is not preventing otherwise mutually beneficial agreements. The additional certainty may encourage more employers and senior executives to negotiate mutually-beneficial agreements. Effectively targets senior executives, ensuring the threshold is tailored to the problem definition, as well as avoiding the risks of covering highly-paid middle managers and non-managers.	Medium	Medium - Targeted stakeholder engagement.

Minister's proposal

Affected groups *(identify)*	**Comment** *nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.*	**Impact** *$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.*	**Evidence Certainty** *High, medium, or low, and explain reasoning in comment column.*
Additional costs of the Minister's proposal compared to taking no action			
Regulated groups	Highly-paid middle managers and non-managers (earning above the income threshold) will not be able to raise an unjustified dismissal personal grievance. Employees would be incentivised to negotiate bespoke dispute resolution clauses to mitigate the risk of a sudden dismissal. May incentivise parties to use private dispute resolution services. This may disincentivise some employees from taking high income positions, given the risk loss of employment security (this could relate specifically to those receiving marginal pay increases that shifts them above the income threshold). Capturing highly-paid middle managers and non-managers risks creating non-mutually beneficial arrangements, such as dismissing employees who otherwise would have been successfully performance managed at a reasonable cost, and dismissing employees who are less able to mitigate the negative impacts of job loss. Employees may lose the opportunity to "clear their name" if they feel like they have been unjustifiably dismissed.	High	Medium - Targeted stakeholder engagement.
Regulators	One-off implementation cost	Low	Medium - Targeted stakeholder engagement and departmental consultation.

Others (eg, wider govt, consumers, etc.)	Option is likely to lead to an increase 'breach of contract' claims in the employment jurisdiction. May require the judiciary to develop new case law in relation to dismissal processes that are in employment agreements, as most of these claims would currently be raised as unjustified dismissals. The option creates increased complexity for employers, employees, the wider employment system and the different stakeholders in the employment system as affected stakeholders (for example, those earning close to $200,000, employers with employees earning more than $200,000, and employment lawyers) need to gain an understanding of the complexities related to this option.	Low	Medium - Targeted stakeholder engagement.
Total monetised costs	Total monetised costs could increase, as the option creates increased complexity for employers, employees, and the different stakeholders in the employment system as they would all need to gain an understanding of the complexities related to this option. Increased complexities leads to greater negotiations between employers, employees and unions.	Medium	Medium - Targeted stakeholder engagement.
Non-monetised costs	Capturing highly-paid middle managers and non-managers risks creating non-mutually beneficial arrangements, such as dismissing employees who otherwise would have been successfully performance managed at a reasonable cost, and dismissing employees who are less able to mitigate the negative impacts of job loss. Removal of ability to challenge a dismissal will lead to instances of perceived injustices as there is no ability to 'clear your name'.	Medium	Medium - Targeted stakeholder engagement.
Additional benefits of the Minister's proposal compared to taking no action			
Regulated groups	Ongoing – This approach provides the most certainty to employers and employees who are affected by the threshold; as those above a set income are excluded from raising an unjustified dismissal personal grievance. A contracting-in provision in legislation could allow this to happen, meaning: • employees are excluded from raising a claim by default, but employees and employers have the ability to agree that an unjustified dismissal claim could be raised. Where contracting in occurs the employee has employment security at the opportunity cost of a higher salary or other benefits. Employers could benefit due to lower salary and other benefits, which employees could trade off for greater employment security. Ability to contract in allows: • flexibility for an employer in attracting staff, and • employment security to attract employees from domestic and international market.	High – Because the income threshold of $200,000 encompasses senior executives and highly-paid middle managers and non-managers executives. The contracting in approach will create relatively more negotiations between employers and employees and unions, which could allow mutually-beneficial arrangements. Additionally, employers could benefit from relatively lower costs arising from salaries and other benefits.	Medium - Targeted stakeholder engagement.
Regulators	Low and ongoing	Low	Medium - Targeted stakeholder engagement and departmental consultation.
Others (eg, wider govt, consumers, etc.)	Ongoing – Provides a simple method of understanding when a personal grievance can be raised. Could incentivise employers and employees to use private employment dispute resolution services, which would benefit them.	Low	Low - Targeted stakeholder engagement.
Total monetised benefits	Ongoing and medium – Creates certainty for employers and employees, employers gain access to simpler dismissal process, or trade that off for reductions in costs in salaries and other benefits.	Medium	Medium - Targeted stakeholder engagement.
Non-monetised benefits		Medium	Medium - Targeted stakeholder engagement.

Section 3: Delivering an option

How will the new arrangements be implemented?

93. An income threshold will need to be implemented through amendments to the Act. The intention is that the income threshold will be introduced in 2025. The aim is to have the legislation passed into law by end of 2025.

94. MBIE is responsible for administering the Act. It provides information for businesses, unions, and employees through its website, contact centre, and provides other customer services on an ongoing basis.

95. Part of the implementation will involve reviewing and, where applicable, updating web content on the Employment New Zealand and MBIE web pages. It will also include providing updated information and guidance to MBIE Employment Services Operational units, the Labour Inspectorate, Disputes Resolution, Triage & Allocation, and the Service Centre.

96. As part of implementation, MBIE will develop and deliver stakeholder engagement and communication plans. These are directed to external parties who may be affected by the legislative changes, such as employers, employees, unions, and other relevant professional bodies. This implementation programme is being undertaken within MBIE's existing baseline funding and will align with the required timeframes regarding commencement of the legislation.

97. The legislative change could potentially shift the nature of conversations between employers and employees, resulting in a change in the advice provided to employers and employees from Employment Services operational units. As a result, additional training and amendments to training documentation, internal policies and procedures may be required for MBIE Employment Service operational units.

The transitional arrangements could create uncertainty

Other legal avenues to raise work-related complaints will remain available

98. Section 113 of the Act states that the only way for an employee to challenge their dismissal, or any aspect of the dismissal, is by raising an unjustified dismissal personal grievance.

99. While challenging a dismissal will no longer be an option, employees earning over the threshold will still have access to other legal avenues to raise work-related complaints, including:

    a. *Personal grievances grounds (other than unjustified dismissal)*: Employees may raise personal grievance claims other than unjustified dismissal, including unjustified disadvantage, sexual harassment, discrimination and in relation to specific employment obligations (eg health and safety).

    b. *Other actions under the Act:* Aside from personal grievances, there are a number of remedies in the Act that an individual may seek if they encounter an issue with their employer. For example, section 134 of the Act provides that any party to an employment agreement who breaches that agreement is liable to a penalty.

    c. *Actions under other Acts:* Employees can raise complaints under other Acts in relation to specific aspects of their employment, for example:

        i. the *Parental Leave and Employment Protection Act 1987* which include parental leave complaint procedure,

ii. the *Privacy Act 2020* which allows an employee to raise a complaint relating to breaches of an individual's privacy, and

iii. the *Human Rights Act 1993* which provides remedies for complaints relating to discrimination, sexual and racial harassment.

iv. Complaints in relation to breach of minimum entitlements, eg the *Equal Pay Act 1972*, *Minimum Wage Act 1983*, the *Wages Protection Act 1983* and the *Holidays Act 2003*.

v. A breach of contract claim, which could only be raised in the Employment Relations Authority (the Authority) or Employment Court (the Court).[22]

Arrangements negotiated over and above minimum legal requirements could be used to raise a legal challenge

100. The Act sets terms and conditions that must be included in employment contracts, and other legislation (eg *Holidays Act 2003*) sets minimum terms. Parties are free to agree to terms and conditions over and above the minimum terms set out in the Act.

101. Employment agreements, as with any other contract, are subject to the general rules of contract law. If employees or employers consider a breach of contract has occurred, they can raise a breach of contract claim.

102. The Employment Relations Authority (the Authority) and Employment Court (the Court) have exclusive jurisdiction to consider employment to make determinations about employment relationship problems. Breach of contract claims would therefore be taken through the Authority.[23]

103. Employees and employers currently have the ability to negotiate procedural arrangements in relation to a dismissal and, if these are not followed, either a personal grievance or a breach of contract claim could be raised. These agreements will hold after the threshold has come into force.

The Act requires that employment agreements include a plain language explanation of the services available for dispute resolution

104. The Act requires that individual and collective agreements include a plain language explanation of the services available for resolving employment relationship problems, including a reference to the time limitations on raising personal grievances.

105. Some agreements simply state that an employee may raise a personal grievance for unjustified dismissal. Some agreements will go further and set out a prescribed and detailed process the parties will follow when there is an employment relationship problem, which may reflect what the law requires, or go above it. For example, an agreement may state that, if a competency issue is raised, the employer must raise their concerns with the employee, place appropriate assistance around the employee, and provide an opportunity to improve.

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[22] Breach of contract claims differ from personal grievances in a number of ways; notably that the limitation for raising a claim is significantly longer (6 years, compared to 90 days for most personal grievances) and the remedies that can be claimed are different. Common law remedies include compensatory, aggravated and exemplary damages, injunctions and declarations. Generally speaking, contractual damages are intended to put the wronged party in the position they would otherwise have been in had the relevant breach not occurred.

[23] However, there are exceptions for human rights and privacy-related complaints.

106. Even where an employer's procedures are not included or incorporated into the employment agreement, they will still likely be required to follow them due to the implied term of fair dealing and the statutory obligation of good faith.

107. While the Government receives copies of collective agreements, it does not collect individual employment agreements. This means we do not know the proportion of agreements that meet the bare minimum, compared to those setting out more detailed and prescriptive processes.

The impact of pre-existing contractual arrangements will vary across high-income employees and employers

108. While introducing a threshold will mean an employee can't bring a personal grievance for unjustified dismissal, it won't extinguish other contractual requirements related to dismissal (such as setting a process which the employer must follow). Employers who wish to dismiss employees earning above the threshold will need to observe pre-existing arrangements or requirements embedded in employment agreements. If they do not, a successful legal challenge for breach of contract may be raised.

109. These pre-existing arrangements may limit the immediate impact of the threshold. The initial impact will vary across high-income employees, depending on their existing employment agreements:

- Some agreements will limit the impact of the threshold, for example, where their employment agreement commits to raising employment relationship problems and significant internal dispute resolution processes.
- Some agreements will not have significant pre-existing arrangements and allow for flexibility regarding dismissals.
- Some agreements will already include no-fault dismissal clauses, so the legislation will enable what is already in place.

110. The potential interaction with pre-existing arrangements would arise if the threshold comes into effect immediately and applies to all employment relationships over the threshold. This contrasts to 90-day trials, which must be expressly negotiated into an employment agreement before the employment begins. This means an employer can ensure that the terms of the employment agreement align with, and do not undermine the intent of, the 90-day trial period.

There are options which would change the level of uncertainty when the threshold is introduced

111. These options are discussed in this section as they relate to how the core policy package could be implemented.

Options to manage this issue

112. **Option 1 - Apply the threshold to all existing employment agreements:** Have the threshold apply to all existing employment agreements, including those agreements which include provisions that limit the impact of the threshold. This would lead to an inconsistent impact of the threshold across employers and employees depending on the terms of their employment agreement.

113. Employers and employees would need to assess their employment agreements and internal policies to understand what procedural requirements are required when dismissing an employee earning over the threshold. This is likely to lead to uncertainty and potential legal challenge.

114. Over time, we expect this to dissipate as employees and employers negotiate new provisions (eg when changing job or negotiating a new collective agreement). The immediate ability for employers and employees to negotiate new arrangements will vary:

- Employees and employers covered by collective agreements will likely have to wait until the renewal of the collective agreement to bargain for process requirements or contracting-in dismissal protection. Unions are likely to have sufficient bargaining power to negotiate such arrangements with the employer.
- New employees who are recruited for a role on an individual employment agreement will negotiate arrangements in light of the threshold. The outcomes will depend on the preferences of the employee and employer and their relative bargaining power.
- For those on existing individual employment agreements, the relative bargaining power will depend on the pre-existing arrangements in the agreement. If they benefit the employer, the employee is unlikely to have great bargaining power to negotiate new provisions. If they benefit the employee, the employee has greater bargaining power, and the impact of the threshold may be limited.

115. **Option 2 - Apply the threshold to new or varied employment agreements (MBIE recommends):** Alternatively, the threshold could only apply to new employment agreements (or variations to agreements) agreed to after the legislation commences. For existing employee agreements agreed to before commencement, a varied employment agreement would be required to state whether the employee is covered by the threshold and would have to be agreed to by both parties.

116. This would ensure consistency of impact and mean that an employer and employee's legal rights are not dependant on provisions negotiated prior to, and without knowledge of, the law coming into effect. New or varied employment agreements would also be negotiated with the knowledge of the impact of the threshold and allow employers and employees to agree to terms that provide greater certainty about the threshold's impact.

117. This would lower the immediate impact of the threshold, as high-income employees in existing employment would not be affected by the threshold. It would also lead to an inconsistent impact, as only those new to the job or to the organisation would be subject to the threshold by default, whereas existing employment agreements would have to agree to opt-out of unjustified dismissal protection.

118. MBIE's recommended option is to apply the threshold to new or varied employment agreements (Option 2) as it is the simplest for businesses to implement and provides the greatest certainty to employers and employees.

119. The Minister's proposal is to apply the threshold to all agreements (but pre-existing arrangements continue to apply).

Legislative changes

120. A key benefit for employers of the threshold is that it provides flexibility to dismiss high-income employees by not requiring employers to follow standard processes required by the Act. To fulfil the intent of the contracting-in provision, employers and employees require the ability to contract back into the standard processes.

121. The following legislative amendments are proposed to ensure employers do not have to follow the standard processes required by the Act for employees earning above the threshold, whilst providing flexibility to contract back into these processes.

Removing the obligation to provide access to relevant information and an opportunity to comment on decisions that would adversely affect employment

122. The Act[24] requires employers, before making a decision that could adversely affect an employee's employment, to provide:

    - access to relevant information about the decision, and
    - an opportunity to comment on the information to their employer before the decision is made.

123. This creates process requirements for employers and, if these are not followed, raises the risk of legal challenge.[25] We therefore recommend removing this requirement for employees above the threshold, but allow it to be contracted back into if agreed to by employers and employees.

Removing the requirement to provide a statement of reasons for dismissal

124. The Act[26] requires employers to provide a statement of the reasons for dismissal within 14 days of the dismissal, if requested by the employee. If the employer fails to provide a written statement, the employee can claim a breach of statutory obligations under the Act.

125. We recommend removing the obligation to provide a statement of reasons for dismissal to accelerate the dismissal process for employer and to avoid the risk of employees challenging the reason for dismissal. If employers and employees contract back into unjustified dismissal protection, we propose that this requirement would apply. Employees would be able to raise breach of good faith claims for breaches of other good faith requirements.

Restricting access to unjustified disadvantage when it relates to the dismissal

126. A personal grievance relating to the process leading to a dismissal could also be raised as an unjustified disadvantage claim. An unjustified disadvantage is where an employee's employment was disadvantaged by an employer's unjustifiable action. There is no restriction on the type of action that can create a disadvantage.

127. 90-day trial periods are intended to provide the flexibility for employers to dismiss by removing unjustified dismissal protection as well as the restrictions listed above. However, there have been two cases[27] relating to 90-day trial periods, one from the Court and the other from the Authority, where an employee successfully challenged the procedure surrounding the dismissal, even though the 90-day trial period prevents the dismissal being challenged.

128. To mitigate the risk of unjustified disadvantage claims being used this way, we recommend restricting access to unjustified disadvantage when it relates to the dismissal and the process leading up to it.

129. Restricting unjustified disadvantage claims for the high-income threshold, but not trial periods, may lead to the judiciary inferring that procedural fairness should be upheld for 90-day trials, because it is not explicitly restricted like for the threshold.

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[24] Section 4(1A)(c) of the Act

[25] The legal challenge would likely be a claim that the employer breached their statutory good faith obligations under the Act.

[26] Section 120 of the Act

[27] *Evans v JNJ Management* [2022] NZEmpC 16, and *Ward v Edenvale Home Trust Board* [2022] NZERA 82

What is determined to be 'income' for the purposes of the threshold

130. A detailed design question is what counts as 'income' for the purposes of the income threshold.

131. We consider that a good definition would result in high-income employees being captured by the threshold as intended, provide certainty for employers and employees on who is covered by the threshold, be simple to understand, and minimise perverse incentives.

132. An employee's income can include different elements, including predictable income such as regular salary and KiwiSaver contributions, through to unpredictable income such as bonuses and Employee Share Schemes, as well as non-financial benefits such as vehicle use.

133. There are two approaches to defining income: a narrow test that covers base income only (ie regular salary and wages), or a wider test that includes all of the elements of pay. There are four key differences between the approaches:

- *Impact*: Some high-income employees may have a significant portion of their remuneration as incentive payments (eg bonuses or shares). Taking a wide approach would capture these employees and increase the coverage of the threshold, but we do not have the data to estimate the impact.
- *Certainty*: Taking a narrow approach would prioritise certainty; as the income is predictable, both employer and employee could be certain whether the threshold has been met, and whether an unjustified dismissal could be raised.
- *Complexity*: Taking a narrow approach would also allow a simple determination of income, as the Act requires that an employment agreement include "the wages or salary payable to the employee".[28] Adopting a wide approach to defining income would require assessments of the value of benefits (eg shares in an Employee Share Scheme or vehicle use), and calculations to assess variable income (like those in the *Holidays Act 2003*).
- *Gaming*: All options contain a risk of gaming at the margins of the threshold. Under a narrow approach, employees who earn an amount near the threshold are incentivised to negotiate non 'base-pay' benefits to retain unjustified dismissal protection. This is counterbalanced by employers' incentive to have the employee over the threshold. Under the wide approach, employers could provide a discretionary payment to an employee to lift them above the threshold, and then dismiss them. In targeted engagement, some employee groups noted employees may be discouraged from taking overtime to avoid meeting the threshold.

134. MBIE recommends the narrow approach to provide certainty for all parties including the courts, to reduce unintended consequences such as refusing to work hours that attract overtime or penal payments and to avoid the complex calculations of a wide approach. The Minister also agreed to this option.

How the threshold applies to part-time employees

135. There are two options as to how the threshold applies to part-time employees:

[28] Section 65(2)(v) of the Act.

- Annual income: The threshold is set at $200,000 annually. If an employee's salary is at or above this level, the threshold would apply regardless of full- or part-time status, or

- Full-time equivalent (FTE): The threshold is set at $200,000 on an FTE basis. The threshold for a part-time employee working 0.5 FTE would be $100,000.

136. Annual income approach is consistent with other systems, which consider an employee's income (eg: income tax, accident compensation, Working for Families, and the Australian high-income threshold), but it has a slightly narrower coverage.

137. The FTE approach has a slightly wider coverage and is likely to target employees on high salary who have high bargaining power. This option is the hardest option to communicate, as the threshold would be $200,000 for a full FTE, and less for part-timers. Also, it wouldn't reflect part-time employees' likely proportionately lower impact on organisational performance.

138. MBIE recommends an annual income approach, as we consider it would be the simplest to communicate and understand and be consistent with other systems that deal with an employee's income. The Minister also agreed with this option.

Income threshold is updated according to upward changes in average weekly earnings

139. Using 2023 data, the proposed threshold covers approximately 2.15 percent of wage and salary earners. As wages generally increase over time, a static threshold would gradually capture more wage and salary earners. This can be illustrated with historical data:

- In 2004, a threshold of $99,000 would have covered 2.15 percent of wage and salary earners (the same proportion of earners as the proposed threshold).

- By 2023, a $99,000 threshold would cover 16 percent of wage and salary earners. This is half of the proposed threshold and would not meet the policy rationale of covering employees with significant impact on organisational performance, bargaining power, and resilience to job loss.

140. We therefore recommend that the threshold is updated over time (or 'indexed', in the technical language).

Average weekly earnings align with the purpose of the income threshold

141. There are broadly two approaches to updating the income threshold. The first is to use inflation via the Consumer Price Index, which measures changes in the price of the goods and services New Zealand households buy. However, inflation relates to purchasing power rather than wages and salary.

142. The second approach is to update the threshold using changes in wages and salaries. There are two key measures for wage growth:

- The Labour Cost Index, which measures changes in salary and wage rates for a fixed quantity and quality of work[29] and is intended to measure the cost an employer pays for the same amount of work completed to the same standard. It generally increases at a slower rate than other wage and salary measures. The

[29] This means the Labour Cost Index excludes improvements in the quality of labour, such as productivity improvements, promotions, or changes in hours worked.

Labour Cost Index measures the price of a fixed quantity and quality of work, rather than the actual wages paid by employers, or

- Average or median wages, which measures the wage bill for employers and can be split into average hourly and weekly wages, and can be measured using the number of employees, or total number of full-time equivalents.

143. Updating the threshold over time in line with average weekly earnings best aligns with the purpose of the income threshold. The threshold is based on the income received from the employer; and average weekly earnings measures the income actually received from an employer. The median measure is intended to measure of the income of the 'typical' worker, and not be affected by changes at the top of the income distribution, who this policy is intended to target.

144. An alternative option is to legislate that the threshold is set at a level to capture the top 2.15 percent of wage and salary earners. This would require developing a novel measure to determine the threshold. Given the robustness of the existing Statistics NZ surveys, which are already used for indexing a range of different policies[30], we do not recommend this option.

Average weekly earnings would capture a consistent proportion of wage and salary earners

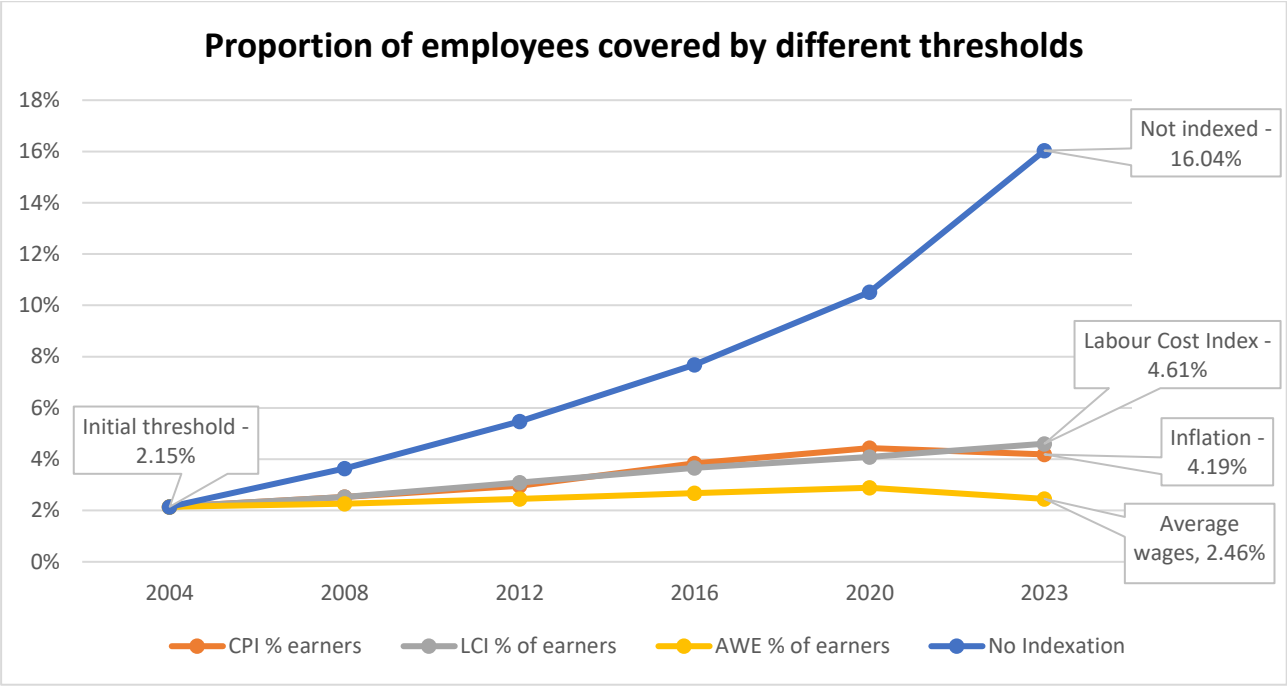
145. As well as being conceptually related to the purpose of the threshold, the measure should capture a similar proportion of employees over time.

146. This can be illustrated using historical data. Using the $99,000 initial threshold in 2004, the different measures would lead to significantly different thresholds in 2023 (rounded to the closest $1,000):

- Consumer Price Index: $160,000.
- Labour Cost Index: $155,000.
- Average Weekly Earnings: $192,000.

147. These different measures would lead to different proportions of employees being over the threshold.

[30] For example, Paid Parental Leave is indexed to upward changes in average ordinary time weekly earnings, and main benefits under the *Social Security Act 2018* are indexed to upwards changes in the Consumer Price Index.



148. Overall, we recommend updating the threshold over time using average weekly earnings, as it is most closely related to the purpose of the threshold, covers a similar proportion of employees over time, and is simple to administer. The Minister also agreed with this option.

We propose that the threshold is only updated in response to upward movements in the indexation measure

149. There is a choice on whether the threshold is only updated when:

- there is an upward or downward change in the measure. This means the threshold could decrease in some years. Over the past twenty years, there have been no periods of deflation, no decreases in the Labour Cost Index, and average wages went down in one year (2019/20), or
- when there is upward change in the measure. Where there is a decrease in the measure, the threshold would remain unchanged. This means the threshold could only increase or remain stable over time.

150. This choice is finely balanced. Decreases are likely to only happen in a recession; where the impact of a high-income earner on firm performance may be particularly impactful in a tight economic environment, but an employee's bargaining power and resilience to job loss is likely lower (given a likely reduction in other employment opportunities).

151. The threshold could decrease and cover some employees who had not expected to be over it, and therefore may not have had the opportunity to negotiate appropriate mitigations into their employment agreements. This group is likely less able to negotiate mitigations, given the likely context are those already in employment during a recessionary period. For context, if the threshold had decreased in response to a reduction in average weekly earnings in 2020, an additional ~1400 employees would have been covered by the lower threshold.[31]

[31] Using the measure of total earnings and full-time equivalents. The threshold would have reduced from $159,000 to $158,000.

152. On the other hand, allowing upward and downward changes would best capture a similar proportion of employees over time.

153. On balance, we consider that covering employees who had not expected to be over the threshold during recessionary periods could risk poor outcomes, so recommend updating the threshold in response to *upward* increases only. The Minister also agreed with this option.

How will the new arrangements be monitored, evaluated, and reviewed?

154. The Minister for Workplace Relations and Safety is responsible for the *Employment Relations Act 2000.* MBIE is responsible for the administration of this Act and the stewardship of the employment system.

155. MBIE can monitor the implementation of the policy through media reports, monitoring collective agreements, and data from the use of mediation services, case law and determinations of the Authority. MBIE can also monitor the implementation of the policy through Minister's meetings with stakeholders and officials meetings with stakeholders.

156. As this policy is a Coalition Agreement commitment, the monitoring and evaluation of this policy will largely depend on Ministerial priorities and resourcing constraints.

Annex One: The Employment Relations Act 2000

The Act establishes institutions to resolve personal grievances, with some claims also having access to human rights processes

157. If employees and employers are unable to resolve the grievance, the Act establishes a tiered framework of dispute resolution that can be accessed through an escalation process:

    - Mediation: Mediation services are the primary resolution mechanism to enable parties to resolve problems quickly and preserve the employment relationship. The Act embodies a general presumption that mediation will be the first avenue for dispute resolution before any determination-making forum is sought.

    - Employment Relations Authority: The Authority is an investigative body that has the role of resolving employment relationship problems that cannot be solved through mediation, by establishing the facts and making a determination according to the substantial merits of the case, without regard to technicalities. The Authority also ensures recorded settlements are complied with.

    - Employment Court: The Court has exclusive jurisdiction (and corresponding powers) to deal with a range of employment related issues, including hearing a matter previously determined by the Authority.

158. Employees are generally required to raise a personal grievance with their employer within 90 days of when the grievance arose (except for sexual harassment, which has a limit of 12 months). The Authority may hear a personal grievance lodged after the time limit in exceptional circumstances but must direct the parties to mediation first. There is a three-year limitation on commencing proceedings in the Authority or the Court.

159. If the claim relates to discrimination, employees may progress their grievance either through human rights or employment institutions. Human rights institutions include:

    - Dispute Resolution Services: The Human Rights Commission provides early resolution and mediation services.

    - Human Rights Review Tribunal: An independent body that can review decisions about human rights.

The Act establishes remedies, including reinstatement, remuneration, and compensation

160. Where it has been determined that an employee has a personal grievance, one or more of the following remedies may be awarded:

    - reinstatement of the employee in the employee's former position or in a position no less advantageous to the employee,

    - the reimbursement of wages or other money lost as a result of the grievance (up to a maximum of three months ordinary pay), and/or

    - compensation for humiliation, loss of dignity, and injury to the feelings of the employee, or the loss of expected benefit.

161. The Authority or the Court may reduce the remedies awarded if the employee's behaviour contributed to the situation that gave rise to the grievance.