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# A Contingency Approach to the Employment Relationship: Form, Function, and Effectiveness Implications

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*In the United States, the at-will doctrine purports to give employers the right to terminate employees with or without notice or "good cause." However, numerous exceptions have made protection afforded by the doctrine illusory, and wrongful termination litigation often results. Other countries such as Canada and New Zealand legally prohibit at-will employment, and require reasonable notice or justification when terminating employees. On the basis of comparison of nonunion employment in those countries with that typical in the United States, we examine alternative approaches to employment relationships (independent contractor, employee rights, and at-will), and offer suggestions for choosing among them strategically based on environmental contingencies, work characteristics, and outcomes valued by a given firm. Although the choice may be limited by law in some jurisdictions, we offer a more systematic approach for U.S. firms wishing to deal with the consequences of terminations proactively as part of their overall strategic planning process.*

**KEY WORDS:** at will; wrongful termination; Canada; New Zealand; strategic HR planning.

> *"Laws control the lesser man; right conduct controls the greater one."*
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> —Chinese proverb
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> *"People don't sue their employers because they think their civil rights have been violated; they sue them because they're pissed off."*
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> —U.S. District Court Judge (overheard)

As the U.S. economy grows more volatile and society more litigious, the number of wrongful termination complaints remains high, focusing attention directly on the hiring—and, more particularly, firing—practices of organizations. In the United States, the "at-will" doctrine, which prevails in the absence of an agreement to the contrary, appears on its face to give an employer the unfettered right to terminate an employee at any time, with or

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without "reasonable" notice, and with or without "good cause." Yet, the doctrine has become riddled with exceptions so numerous that they threaten to swallow the rule (Ballam, 2000), and employers often wind up having to defend their actions notwithstanding the presumptive or explicit at-will status of terminated employees. Other Western countries such as Canada and New Zealand find it workable to treat the employment relationship quite differently, most notably with respect to the notice, compensation, and justification requirements for terminating employees. The question thus arises: if employers increasingly have to justify employee terminations in any event, why not do so proactively rather than in response to lawsuits or administrative complaints? Given the devastating potential consequences of such complaints in both practical and legal terms, should conclusion of the employment relationship not be given as much attention as its inception?

This paper addresses these questions by comparing alternative forms of the employment relationship found in the United States, Canada, and New Zealand, evaluating their function in practice, examining their effectiveness for achieving desired organizational outcomes, and suggesting a contingency approach to the choice of employment arrangement that considers environmental conditions, work characteristics, and outcomes valued by the firm. Where collective bargaining agreements apply, terminations are dealt with up front by explicit contractual terms regarding notice, good cause, grievance and arbitration procedures, and severance pay, among other things. Although form of the employment relationship in the nonunion sector may be limited by law to varying extents, it would seem that an equally systematic approach to dealing with the consequences of terminations would be sensible in this context as well. To that end, this paper evaluates purported advantages of at-will employment that may or may not be realized in practice, and offers suggestions for electing strategically among legally available forms.

The paper is organized as follows. First, we describe prevailing legal forms of the employment relationship in the United States, Canada, and New Zealand, examine the function of that form in practice for each country, and discuss the apparent effectiveness of each form for achieving desired organizational outcomes. (For example, within the U.S. section, we provide detailed descriptions of how former employees can typically force their former employers to show cause for terminating them, notwithstanding the at-will doctrine, by bringing disparate treatment or adverse impact discrimination claims.) Second, we discuss independent contractor relationships as they are used in all three countries. Third and finally, we match elements of each of these forms with environmental and organizational contingencies to suggest a more systematic approach to structuring employment relationships proactively as part of the overall strategic planning process.

## THE AMERICAN APPROACH

### Form

In the United States, where union collective bargaining agreements apply to only about 10% of the private sector workforce, the default form of employment status for the vast majority of workers is presumed to be "at will" under state law (e.g., Cal. Labor Code Section 2922) unless there is an explicit agreement to the contrary (see generally Ballam, 2000; Dunford & Devine, 1998). Under the at-will doctrine, either party to the employment relationship may terminate it at any time for any reason or for no reason at all. However,

numerous categories of exceptions have gained recognition from both statutory and judicial (common law) sources. These include implied contract (as where written or oral statements, such as those in recruitment messages or employee handbooks, represent that termination will occur only for good cause); public policy (as where an important policy such as having jurors available for court cases overrides an employer's right to terminate an employee for taking off work to serve jury duty); whistle-blowing (as where the public's interest in having individuals report wrongdoing by their employer overrides the employer's right to discharge an employee in retaliation for doing so); and the covenant of good faith and fair dealing (an implied agreement not to fire someone solely to deprive them of earned but unpaid commissions, benefits, or to prevent pensions from vesting).

In addition to these restrictions on *whether* someone can be terminated, employers may also incur civil (tort) liability for monetary damages because of *how* they handle a termination. Such bases of liability include defamation (as where false, career-damaging statements about the reason for a person's termination are made to third parties); invasion of privacy (as where an employee permissibly refuses to take a drug test but is fired as a result); and infliction of emotional distress (as where a supervisor excessively berates a terminated employee for poor performance on a personal level). Further, even where an employer never says the exact words "you're fired," an employee may be able to quit and sue for "constructive discharge" if they can show that they were wrongfully subjected to intolerable working conditions that no reasonable person should have to endure. Finally, State or Federal statutes such as the Worker Adjustment and Retraining Notification Act (WARN) may entail particular notice or severance pay requirements (e.g., 60 days) in the case of mass layoffs by large employers (see generally, Bennett-Alexander & Hartman, 2001; Dunford & Devine, 1998). It thus becomes clear that anyone relying on the at-will doctrine as an ironclad defense to wrongful termination claims, even where explicit written language reinforces presumed at-will status, does so at their peril.

## Function

While much has been written about the foregoing sources of liability, in practice there is an additional category of issues that can prove even more troublesome to an employer who fails to justify terminations in reliance on the at-will doctrine—that of alleged civil rights violations. The primary source of civil rights protection for employees at the federal level is Title VII of the Civil Rights Act of 1964, which protects individuals from discrimination in employment based on race, color, sex (gender), religion, or national origin. This statute was supplemented in 1967 by the Age Discrimination in Employment Act (ADEA), which prohibits discrimination based on age of 40 years or older. Individual state human rights laws add further protection for group membership or status such as pregnancy, medical history, disability, marital status, or sexual affinity orientation (see, e.g., California's Fair Employment and Housing Act, Govt. Code Sections 12940 *et seq*.). Retaliation against an individual for alleging a civil rights violation is also prohibited, and affords an additional source of liability under both state and federal law.

Previously, employers could find some solace in the fact that former employees often had difficulty finding an attorney to take such a case. After all, out-of-work individuals could usually afford to pay little in the way of legal fees, and, even if victorious, could recover only "make-whole" relief (reinstatement and back pay), which provided little incentive to

take the case on a contingent fee (portion of recovery) basis. However, since enactment of the Civil Rights Act of 1991, prevailing plaintiffs in discrimination cases can also recover compensatory and punitive damages, as well as costs and attorneys fees, and may have their case heard by a jury rather than by a judge. Along with passage of the Americans with Disabilities Act in 1990, which required workplace accommodations to be phased in and allowed lawsuits to go forward as of 1992, these developments have led to a notable overall increase in civil rights complaints during the last 10 years. For example, Equal Employment Opportunity Commission statistics reflect at the federal level alone an increase in total discrimination charges since 1992 from about 72,000 to over 80,000 charges in 2001 (these peaked in 1994–95 following the televised Supreme Court confirmation hearings of Clarence Thomas and allegations of harassment from Anita Hill). In addition, retaliation charges doubled to over 22,000 during the same time period.

To appreciate why so many discrimination cases continue to be brought, it is important to understand how such cases are proved in court. Based on U.S. Supreme Court decisions dating back to the 1970s and still in effect today, there are two ways to prove discrimination: Disparate Treatment (intentional discrimination) and Adverse Impact (unintentional discrimination based on a facially neutral employment practice that disproportionately affects one race, gender, national origin, age group, or other so-called "protected class"). In either case, it is not difficult in practice to force an employer to justify a termination, notwithstanding presumptive or explicit at-will status.

### *Disparate Treatment*

In *McDonnell-Douglas Corp. v. Green*, 411 U.S. 792 (1973), the U.S. Supreme Court recognized that a plaintiff in a discrimination case may not always be "lucky" enough to have direct evidence of discriminatory intent (e.g., a "smoking gun" memo or tape recording showing a purpose to treat someone less favorably because of their membership in a particular demographic group). Green was a Black civil rights activist who had been terminated for protesting McDonnell-Douglas' allegedly racist employment practices, and who helped stage a "stall-in" whereby vehicles were positioned in front of the employer's parking lot entrance to prevent workers from entering the premises. When Green later reapplied for work, McDonnell-Douglas rejected his application, citing the stall-in as "disruptive and illegal activity" which warranted refusing to rehire him. The Supreme Court responded with the now commonly applied burden shifting process that continues to govern how discrimination cases are proved today.

The process has three parts. First, in the absence of direct evidence, a plaintiff can raise an *inference* of discrimination (a "prima facie" case) by showing (1) that they are a member of a racial minority or other protected demographic group, (2) that they applied for or held a position for which they were qualified, (3) that they were rejected or let go despite being qualified, and (4) that the position remained open after their rejection or was filled by someone outside of their demographic group. The burden then shifts to the employer to articulate some legitimate, nondiscriminatory reason for its action (e.g., the stall-in). However, the plaintiff can still prevail if he or she can convince the finder of fact (a judge or, more commonly post-1991, a jury) that the stated reason is merely a pretext for discriminatory intent (e.g., if McDonnell-Douglas had rehired White reapplicants involved in the stall-in, but not Black ones). While developed in the context of alleged race

discrimination, this process is now recognized as applicable to virtually any type of protected class, and can be applied to terminations as well as hirings by casting the employment decision as one of selection for retention.

Of course, at each stage of this process, the parties have to persuade a finder of fact that they have met their respective burdens by a preponderance of the evidence (i.e., that their version of events is more likely than not). In practice, however, this can be much easier for a plaintiff employee or former employee than for a defendant employer, and in effect requires the employer to justify its actions even though the at-will rule says no reason for dismissal is necessary.

By way of example, consider a wrongful termination complaint based on age where it is alleged that a younger worker was retained over a qualified older worker during a reduction in force (RIF). Here, the issue is one of selection among existing employees (the "applicant" base) for retention in a reduced number of jobs. To show membership in a protected class (i.e., 40 years old or older), a plaintiff need merely introduce an authenticated copy of their birth certificate. To show that they "applied for" one of the remaining positions, verbal testimony regarding the desire for continued employment will suffice, as will a copy of one's written application for retention or the initial job (either would typically be discoverable through a pretrial request for document production from the employer and a request for admission that the document is genuine and was received for a position for which there was an opening at the time). To show that they were qualified, the employee's past performance appraisals will usually be offered (presumably these will be at least somewhat favorable, else the employee should have been let go long since). Finally, to show that the position was filled by someone under 40 (or even over 40, but "substantially younger"; see *O'Connor v. Consolidated Coin Caterers*, 116 S. Ct. 1307 (1996)), the employer's records, requests for admission, or cross-examination of the employer's human resource director are ready sources. There are typically few credibility issues regarding this sort of straightforward documentary or testimonial evidence.

At this point, the employer must articulate—and, in practical terms, convince a jury of—a legitimate, nondiscriminatory reason for the discharge (usually some performance-based reason, e.g., that those retained were more qualified than the plaintiff). It must also rebut any assertion that the stated reason was merely a pretext for age-related discrimination (e.g., that performance standards used to select for retention, such as "ability to learn new technologies," were adopted to target older workers for layoff, or were unfairly applied; see, e.g., *EEOC v. Texas Instruments, Inc.*, 72 FEP Cases 980 (5th. Cir. 1996)). This sort of evidence by definition involves issues of credibility, unlike the less controversial material a plaintiff must introduce; in particular, where no reason was given initially for a termination in reliance on the plaintiff's at-will status, an employer runs the risk of being seen as wholly self-serving (and unfair in the eyes of a jury) when a reason is forthcoming only after litigation is under way. Moreover, the Supreme Court has recently reaffirmed that a justification found to be pretextual almost naturally leaves discrimination as the most likely possible explanation (see *Reeves v. Sanderson Plumbing Products, Inc*., 120 S. Ct. 2079 (2000)).

In summary, even where the "at-will" doctrine applies, it is relatively straightforward, by way of a disparate treatment complaint, to force the employer to show "good cause" for a termination. Given that more than two thirds of the U.S. workforce can now claim membership in one or more "protected classes" under federal law (see Terpstra, 1995), and that this number increases when additional classes protected under state law are considered,

it is clear that any comfort afforded an employer by the at-will doctrine must be viewed as rather cold.

### *Adverse Impact*

In *Griggs v. Duke Power Co*., 401 U.S. 424 (1971) and *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975), the Supreme Court recognized that impermissible discrimination may occur even in the absence of invidious intent. In these cases, the Court held that selection criteria (the requirement of a high school diploma or minimum scores on intelligence tests) that adversely affect a protected demographic group (African Americans) must be "demonstrably a reasonable measure of job performance." Both employers were unable to demonstrate an acceptable relationship between satisfaction of the selection criteria and performance on the job: Duke Power had allowed White workers who had neither completed high school nor passed the intelligence tests to remain in their jobs after adopting these requirements "without meaningful study of their relationship to job performance," whereas Albemarle had commissioned an expert in industrial psychology to "validate" (examine the job relatedness of) its testing program, but only shortly before trial and in a manner unacceptable to the Court.

As the Court noted in *Albemarle*, validation is regulated by the Equal Employment Opportunity Commission's Uniform Guidelines on Employee Selection Procedures (the Guidelines). Under the Guidelines, evidence that the selection rate for one group is not at least 80% as positive as that for the more favorably treated group (the so-called "Four-fifths Rule") indicates discrimination, and is illegal unless the selection criteria are validated according to the Guidelines (Section 1607). For example, assume that 100 men and 50 women apply for jobs with a particular employer, and a minimum test score is required for selection. Using this criterion, 30 men and 10 women are selected. The selection rate for women is thus $10/50 = 20\%$, whereas the selection rate for men is $30/100 = 30\%$. Applying the 4/5 rule, the selection rate for women must be at least 80% of that for men, or 80% of $30\% = 24\%$. Because it is only 20% and not at least 24%, there is now a showing of adverse impact discrimination, and the employer will be held liable unless it can meet its burden of showing that its selection criteria have "a manifest relationship to job performance" consistent with "business necessity" (*Griggs*, 401 U.S. at 431).

Under the Guidelines, it means that the employer must introduce statistical evidence that test scores correlate significantly with performance on the job, or that the content domain of the test corresponds closely enough with that of the job that a relationship with job performance can reasonably be inferred. Both types of evidence are typically introduced through expert witness testimony, which again runs the risk of lacking credibility with a jury as having been proffered by the employer's own "hired gun." Where, as in *Albemarle*, validation evidence is developed only shortly before trial, it runs the added risk of being attacked as having only been conducted for litigation defense rather than to monitor the fairness and legality of the employer's selection practices on an ongoing basis.

Returning to the age discrimination context, let us now suppose that the numbers in the previous example refer instead to 100 current employees 39 years of age or under and 50 employees 40 years of age or older who are of necessity competing for a smaller number of positions that will remain after a planned RIF. Assume also, as is often the case, that the selection criterion is some minimum acceptable score on previous performance appraisals.

Upon obtaining documents or other discovery from the employer regarding the relevant demographics and retention decisions, a straightforward calculation will demonstrate the 4/5 rule violation shown above, and the employer's entire performance appraisal system, as well as the process used to arrive at its layoff decisions, will come under scrutiny as it attempts to "validate" ( justify) the resulting layoffs. This is not a favorable position in which to find oneself in front of a jury. Although economic considerations (e.g., using salary as a layoff criterion, which often results in selecting an inordinate number of older workers) have been upheld against adverse impact challenges in age cases in most jurisdictions (see, e.g., *Marks v. Loral Corp. et al*., 57 Cal. App. 4th 30 (1997), although this result was legislatively "overruled" in California, thus restoring the status quo ante in that state), the putative at-will status of those laid off will provide little comfort in other types of cases, particularly when effectiveness implications are considered.

## Effectiveness

If at-will status is supposed to afford an employer flexibility to adjust the size of its workforce on an immediate as-needed basis without having to worry about justifying layoffs or terminations as based on "good cause," then it appears to have done a questionable job. As Dunford and Devine (1998) point out, costs associated with employment litigation include preparation time and related disruptions among key personnel, lowered morale among remaining workers (already a problem in the typical RIF), a tarnished public image, and attorney and expert witness fees, not to mention the price of an actual judgment or settlement if defense is unsuccessful. Moreover, even successful defense of a wrongful termination suit can run into the hundreds of thousands of dollars, with negative effects on the employer's stock price also a common consequence (Cascio, 2000). To be sure, many employers have tried to limit such costs and negative publicity by requiring employees to sign mandatory arbitration agreements upon hire. However, the enforceability and effect of these agreements has come increasingly into question in recent times, rendering their overall value open to debate (see, e.g., *Armendariz v. Foundation Health Psychcare Services, Inc*., 24 Cal. 4th 83 (2000); *EEOC v. Waffle House, Inc*., 534 U.S. 445 (2002)).

At least one further issue merits attention: the possibility of negative applicant/employee reactions to the at-will language typically confronting them at the point of hire and beyond. This issue becomes particularly problematic when considering skill shortages that have occurred on a regular basis as economies have shifted away from manufacturing and toward a service and information technology emphasis (Gomez-Mejia *et al*., 2001).

At the height of the internet hiring boom that preceded the more recent economic downturn, it was not uncommon to find scarce and highly valued personnel such as software developers and engineers moving frequently from employer to employer for ever-escalating salaries. In this environment, recruitment and retention of such "free agents" (Gould *et al*., 1997) were among the issues most hotly discussed in human resource and line management alike. Nevertheless, employment law attorneys continued to counsel employers to zealously guard the right to terminate without notice and without good cause by drafting stronger and stronger at-will language in their offer letters and employee handbooks. As a result, a rather ironic situation occurred; highly sought-after recruits, enticed by promises of signing bonuses, stock options, company cars, catered meals, free dry cleaning, and

other perquisites, and being wined and dined before finally accepting the employer's offer, would typically be greeted with a "welcome aboard" letter indicating that the company retains the right to fire them with or without reasonable notice, and with our without good cause. If recruitment and retention were truly the hot issues, with "brain drain" and other loss of valuable human capital the primary concerns, then perhaps long-term employment contracts with tiered bonuses and benefit vesting schedules should have been used to reward loyalty and reduce turnover. Prior research has found that the use of formal at-will agreements may lead to a variety of negative inferences about the employer (Roehling & Winters, 2000). Although the magnitude of attitudinal and behavioral impacts of such language on valued employees or recruits has yet to be fully investigated, it seems careless to assume away such effects, given the stakes involved. The argument for proactively designing the employment relationship with strategic contingencies in mind once again seems compelling.

## THE CANADIAN APPROACH

### Form

In Canada, all employment relationships are treated as contracts. As with the analogous state law system in the United States, employment law in Canada is primarily provincial. By law, all nonunionized workers are entitled to "reasonable" notice (or equivalent compensation in lieu thereof ) for the typical termination unless notice requirements or duration of employment were explicitly determined in advance, or unless there is "just cause" for dismissal (see generally Smyth *et al.*, 2001; Yates *et al.*, 2002). The burden of showing reasonableness of notice is on the employer, who is generally seen to stand in a superior economic position to the employee. Accordingly, the Canada Labour Code and provincial employment standards (e.g., Alberta's *Employment Standards Code*, R.S.A. 2000, Ch. E-9, Sections 54–59) prescribe minimum notice periods for termination. These periods correspond to length of service, and are presumptively reasonable; any attempt to reduce them or to create an at-will status comparable to that found in the United States will be void and unenforceable.

It should be noted that the notice requirement is reciprocal; employees must give the employer equivalent reasonable notice of their intent to leave. However, this requirement is rarely enforced, and is waived under circumstances amounting to constructive discharge (as where harassment or dangerous working conditions persist to the point of being unreasonable). In addition, civil rights prohibitions similar to those in the United States are found in provincial human rights statutes, as well as the Charter of Rights and Freedoms at the national level.

The reasonable notice requirement is not, however, absolute; an employer may immediately discharge an employee whose serious misconduct, such as violence, drinking or using drugs on the job, excessive absenteeism, tardiness, insubordination, harassment of other employees, or gross incompetence constitutes "just cause"—a unilateral and significant breach of the contract of employment that undermines the fundamental purpose of an employment relationship. However, as under U.S. law, care must be taken to ensure that such charges are substantiated, are not communicated to third parties in a defamatory or invasive manner, and are not merely a pretext ("near cause") for discrimination.

## Function

In practice, although notice requirements can be left to the applicable statutory minimum, contracts limiting the employee to this period are rarely seen, perhaps because of the uncharitable perception of the employer that it might convey at the time of hire. Where there is no written contract to refer to, the dominant rule of thumb has been 1 month of notice for each year worked. Although the issue of reasonableness is still a matter that varies with the facts and circumstances of each case, general parameters have developed, with typical findings in the range of 3–6 months, but with certain contexts such as executive employment giving rise to requirements of as much as several years' salary in lieu of notice (see, e.g., *Kilpatrick v. Peterborough Civic Hospital*, 38 O.R. 3rd 298 (1998)). Moreover, "reasonable" notice may be quite significant even for new employees, as where an employee incurs substantial hardship relocating to a new position in reliance on the employer's promise of employment and is unceremoniously terminated shortly thereafter (see, e.g., *Zylawy v. City of Edmonton*, 8 C.C.E.L. 93 (Alberta Q.B. 1985); this fact pattern is comparable to the doctrine of equitable estoppel, which may be used to seek relief under similar circumstances in the United States and elsewhere).

As is also the case in the United States, particular judges may be more generous than the statute requires; some have been willing to grant extended notice or equivalent compensation periods based on factors including the age of the employee, the job market at termination, specialization and level of work, or the circumstances surrounding the dismissal (e.g., public humiliation, or "repulsive" conduct of the employer overall; England & Wood, 1998). The same may be said with respect to proving just cause for termination; judges now generally expect employers to warn, impose progressive discipline, and work with their employees to salvage the employment relationship, especially with long-term workers. Moreover, the Supreme Court of Canada has recently articulated an implied covenant of good faith and fair dealing in employment, which differs somewhat from its American counterpart; in *Wallace v. United Grain Growers Ltd.*, 3 S.C.R. 701 (1997), the court imposed an obligation on employers to treat employees fairly and respectfully upon termination, which includes the duty to refrain from making unsupportable allegations of misconduct in defense of a wrongful dismissal action.

## Effectiveness

Although inconsistencies created by judicial activism remain problematic, juries are not that big an issue for employers, as they are virtually unheard of in Canadian wrongful dismissal litigation. Although they are legally permitted, they are seldom summoned by the parties. Further, unlike the situation in the United States since 1991, punitive damage awards have been difficult to obtain in employment cases, and when awarded, have been modest by American standards. Discrimination charges are always possible, but a prima facie case is not as easy to prove as it would be in the United States. Practical or economic issues may still lead dismissed workers to sue and employers to settle, but many employers have responded with generous notice and severance provisions in an attempt to reduce litigation and corresponding adverse consequences of their dismissals. Because damages are usually assessed on the basis of rate of pay and reasonable notice periods that should have been applied, the uncertainties associated with wrongful termination actions seem to be far fewer and much less worrisome than those in the United States.

## THE NEW ZEALAND APPROACH

### Form

In New Zealand, recent passage of the Employment Relations Act (2000) has made explicit some of the basic aspects of both forming and terminating an employment relationship. Whereas the previous Employment Contracts Act of 1991 had been criticized as unduly favoring employers and disproportionately impacting lower paid workers (Greene, 2000; McLaughlin, 2000), the new law acknowledges "the inherent inequality of bargaining power in employment relationships," and seeks to promote "mutual trust and confidence in all aspects of the employment environment" by imposing an overarching obligation of good faith in every aspect of the employment agreement (Sections 3 and 4). Like the United States and Canada, New Zealand law also affords protection against discrimination (the Human Rights Act of 1993) and harassment (see generally Keith, 2000). However, the manner in which such complaints may be brought, including those in the context of wrongful termination, is also governed by the Employment Relations Act ("the Act"), which applies to any "employment relationship problems" (Section 101). The Act also reaffirms the jurisdiction of a special Employment Court (already extant under the previous Employment Contracts Act) to review administrative disposition of personal grievances against current or former employers involving any such problems, including those for unjustifiable dismissal (Sections 102 and 103).

Unlike the presumptive at-will situation that prevails in the United States, individuals who are not union members in New Zealand must be employed by way of a written employment agreement that contains, at minimum, a job description and other terms and conditions of employment. Further, an individual must be given a reasonable opportunity to review any such agreement and seek advice before entering into it (Sections 64 and 65). The Act also prohibits entering into a fixed term contract for improper purposes (e.g., to avoid the operation of remedies for unjust dismissal) without "genuine reasons based on reasonable grounds" (Section 66).

Under Section 120 of the Act, an employee who is dismissed is entitled to request, within 60 days, a written statement setting forth the reasons for dismissal, and must receive such a statement within 14 days of the request. Where dismissal is challenged by way of a personal grievance, it must be raised with the employer within 90 days of its occurrence (Section 114). Reinstatement is intended to be the primary remedy for a meritorious grievance, but relief is still available in the form of compensation for "humiliation, loss of dignity, and injury to the feelings of the employee," as well as for the loss of "any benefit, whether or not of a monetary kind, which the employee might reasonably have been expected to obtain" had wrongful dismissal not occurred. However, any such amounts may be reduced by "the extent to which the actions of the employee contributed towards the situation that gave rise to" the terminating event (Sections 123–125).

### Function

To put the practical function of these new provisions into historical perspective, it should be noted that the bases for wrongful dismissal claims had long been widened by New Zealand judicial decisions, and procedures to settle personal grievances had been greatly

extended since first introduced by the Industrial Conciliation and Arbitration Amendment Act of 1970. Initially covering only wrongful dismissal, and applying only to workers covered by union-negotiated agreements, grounds for grievances continued to be added over the years (Anderson, 1988). The situation was increasingly viewed as out of step with statutory protections afforded workers employed under union contracts, and in 1991, the Employment Contracts Act extended coverage to all workers (Anderson *et al.*, 1997). New Zealand employers now face comprehensive restrictions on their ability to terminate employment under the Employment Relations Act of 2000, and on their ability to use fixed term contracts of service to avoid these restrictions.

Nonetheless, New Zealand employers continue to enjoy wide latitude when they terminate for *economic* reasons (i.e., dismissal for "redundancy"). Under the Employment Contracts Act, the Court of Appeal had adopted an approach described by one academic as "extremely pro-employer . . . which gives only the most minimal protection to employees" (Anderson, 2001, p. 113), and early Court decisions indicate little change from its previous stance under the new Act. For example, in *Coutts Cars Ltd. v. Baguley* , ERNZ 660 (CA, 2001)), the Court observed, "We do not see that the new statutory obligation on employers and employees to deal with each other in good faith introduces any significantly different obligation to that the courts have placed on the parties to employment contracts over recent years." Apparently, then, the good faith obligations imposed by the new Act are "unlikely to involve any substantive rights or any ability to counter abuses of contractual power" (Anderson, 2002, p. 20).

The Court of Appeal has also held that redundancies are a matter of managerial prerogative, and that managers' business decisions are not to be second-guessed by the courts (e.g., *G N Hale & Son Ltd. v. Wellington*, 1 NZLR 151 (CA, 1991)). That said, however, courts will still review the manner of dismissal to determine whether it meets the standard of a reasonable employer acting fairly (e.g., *Coutts* ). Generally, a court will review whether appropriate alternatives to dismissal have been considered, whether reasonable notice has been given, whether selection of staff for dismissal has been made in good faith and without reference to irrelevant criteria, and whether consultation with employees has taken place. Failure to carry out dismissal even for redundancy in a procedurally fair manner leaves employers open to remedies as for any other type of dismissal. Whether this constitutes "minimal" protection for employees is a matter of perspective, but the Court of Appeals' approach still leaves employers with considerable leeway for genuine, business-related terminations.

## Effectiveness

A renewed emphasis on the practical resolution of employment problems is reflected in dispute resolution machinery established under the new Act. The Act establishes an Employment Relations Authority to resolve employment relationship issues. Unlike its predecessor under the Employment Contracts Act, this investigative body is empowered to disregard "technicalities" (Section 157), and new mediation services are provided to "assist persons to resolve, promptly and effectively, their employment relationship problems" (Section 144).

To be sure, terminated employees still find redress for wrongful termination; in the first 18 months of the new Act's operation, 86% of successful grievants received compensation

for humiliation, and 50% for wage reimbursement, whereas only 8% saw their awards reduced for having contributed to the circumstances leading to termination (McAndrew, 2002). However, the New Zealand system overall emphasizes expeditious and mutually acceptable outcomes. Under the new Act, mediation is the primary method for resolving employment problems, and appears to be quite effective thus far; of almost 4,000 applications for mediation assistance brought during the first 8 months under the new Act, only 14% had not been settled by July 2000 (Department of Labour (NZ), 2002).

The model adopted by the Employment Relations Authority has already been credited with speedier and better accepted outcomes than those previously achieved. Of almost 500 applications disposed of by the Authority in its first 8 months, 42% were actually withdrawn (Department of Labour (NZ), 2002), and determinations were ultimately required in only 26% (Taylor, 2001). Even in those cases, over 90% of the awards for unjust dismissal were for fewer than $5,000. This stands in marked contrast to jury verdicts for similar charges in the United States.

Some employer advocates continue to argue that restrictions brought about by the new Act impose onerous burdens on employers that pose a disincentive to hiring (e.g., Burton, 2001), but New Zealand's overall growth in employment during this time is inconsistent with that argument. It can in fact be said that the new institutional arrangements for resolving employment problems allow for speedier resolution and reduced costs to employers; even one of the most vociferous opponents of the new regime has noted with approval the "quick and efficient" services provided by the Mediation Service and Employment Relations Authority (Tritt, 2001). In sum, the majority of contested dismissals are now resolved privately, voluntarily, and informally, with only a few cases needing formal adjudication. Even should employers lose at that point, the likelihood of substantial monetary awards such as those in the United States remains small.

## THE CONTRACTOR APPROACH

### Form

One point that should now be apparent is that the comparative staffing flexibility sought by U.S. employers under the at-will doctrine comes with a price: uncertainty as to whether litigation will arise to challenge at-will terminations for which no reasons are given, and the outcome of such litigation if and when it is brought. It is perhaps these reasons, coupled with desires to reduce costs and related burdens associated with administering taxes, compensation, insurance, and other benefits for employees, that have led organizations to rely more heavily on the independent contractor approach to getting work done for hire. Other reasons for using this approach may include the need to obtain specialized services or skills not central to the organization's core competencies on a short-term or as-needed basis, coping with temporary peaks in labor demand, or the worker's own preference for self-employed status (Greene, 2000).

However, it has become clear that merely labeling an individual an independent contractor will not stand up to legal scrutiny if the circumstances of the work relationship do not justify it. For example, New Zealand's Employment Relations Act requires a determination of "the real nature of the relationship . . . [based upon] all relevant matters" and does not consider determinative "any statement . . . that describes the nature of the relationship"

(Section 6). In Canada, the substance of the relationship will also triumph over language used to describe it.

### Function

The now rather notorious case of *Vizcaino v. Microsoft Corp*., 97 F.3d 1187 (9th Cir. 1996), provides an example of the risks of misclassifying as independent contractors workers who are later determined to be employees. In that class action, a group of workers who had signed written agreements acknowledging their status as independent contractors—and nonentitlement to benefits—successfully sought a determination that they should be able to participate nonetheless in benefit plans that were available to Microsoft's regular employees. Microsoft had not withheld taxes from these workers' wages, had not paid the employer's share of FICA contributions, and had paid them out of accounts payable rather than payroll. However, these workers performed services extremely similar to those of other workers classified as employees, and did so over continuous time periods often exceeding 2 years.

In short, Microsoft had "fully integrated" these workers into its workforce; they often worked on teams along with regular employees, shared the same supervisors, performed identical functions, and worked the same hours. They also received access to the premises, as well as office equipment and supplies from the company. The IRS therefore determined that Microsoft should have been withholding and paying taxes because, as a matter of law, these workers were "de facto" (common law) employees rather than independent contractors. On the basis of these findings, and notwithstanding their written acknowledgment to the contrary, these workers were able to obtain benefits and other terms of employment similar to Microsoft's "regular" workforce. Clearly, whatever costs and administrative savings the employer may have hoped to obtain not only were not realized, but also were further offset by litigation costs, back taxes, interest, penalties, disruptions, loss of reputation, and the like.

### Effectiveness

The Microsoft case illustrates that effectiveness of the independent contractor form will depend not only on the purposes for which the organization adopts it and the extent to which these are realized in practice, but also on the extent to which it conforms in fact with the label, thus supporting its legal viability. If the purpose of independent contractor status is to shift responsibility for work outcomes to the contractor, increase the predictability of work cessation, reduce overhead costs, and reduce litigation (or at least limit it to issues dealing directly with terms of a contract and its performance rather than at-will traps for the unwary), then various conditions must be met. These are discussed more fully in the sections that follow.

## A STRATEGIC CONTINGENCY APPROACH

In a perfect world, employers would be able to anticipate labor demand at a precise strategic and tactical level that allowed them to specify in advance the exact duration and performance specifications required of each and every individual hired to perform work. Obviously, no such situation exists, so the choice—or choices—regarding the form of

**Table I.** Examples of Strategic Contingencies Relevant to Choice of the Employment Relationship

| Type of employment relationship | Environment | Work characteristics | Outcomes |
|---|---|---|---|
| Independent contractor approach | Stable or unstable | Discrete, limited duration; outside core competencies of organization; within unique contractor expertise | Avoid benefit/tax administration; shift liability to contractor |
| Employee rights approach | Stable and predictable | Routine, static skill levels; employees largely interchangeable; projects consistent over time | Continuity, loyalty, predictability; avoid complex litigation |
| At-will approach | Unstable or unpredictable | Nonroutine, evolving skill levels; new employees better suited to emerging future projects | Flexibility; acquire new skills as needed; risk more litigation |

employment relationship can at best attempt to reflect an approximation of such a world. To assume, however, that one size fits all (e.g., at-will status), as seems to be the default approach in the United States, misses the opportunity to more closely tailor employment relationships to fulfill the specific needs of organizations under differing conditions at different times.

To develop a strategic contingency approach to the choice of how work for hire should be structured, both independent contractor and formal employment relationships will be considered. These forms do not represent an exhaustive list, but rather are points on a continuum of employer discretion to terminate if and when desired. The use of independent contractor relationships is considered first (we do not separately address so-called "dependent" contractors, Arthurs, 1965, a hybrid form whereby self-employed individuals work primarily for one entity over an extended period of time; this phenomenon was considered in an earlier version of New Zealand's Employment Relations Act, but did not survive to the final Bill; Rudman, 2000, p. 14). Two differing approaches to employer–employee relationships are then considered: one involving explicit employee rights, and the other involving an employer's stated right to terminate at will. For each approach, examples are offered of environmental, work-related, and outcome contingencies that can help determine when their use would likely be appropriate (see Table I).

## Independent Contractor Relationships

Lonsdale and Cox (1998) have categorized the reasons organizations have been found to use the independent contractor approach into three general decision frameworks: "Iterative/Entrepreneurial" (the "appropriate" or recommended approach, based on ongoing assessment of both present and future labor demand and whether it can best be fulfilled internally or externally); "Core Competency" (the most widely used approach, based on a present-sense evaluation of whether the work to be done is closely associated with the core dimension of a firm's business); and "Cost/Headcount Reduction" (a short-term reactive approach, based on ad hoc pragmatism rather than strategic human resource planning (see

Greene, 2000; Reilly & Tamkin, 1996)). The Microsoft example appears to illustrate the latter of these three approaches.

In practice, some combination of the "appropriate" and "core competency" approaches would seem advisable, particularly if care is taken to monitor shifts in the elements of a business that can be considered "core" (i.e., those that are firm-specific and a source of competitive advantage, or critical to the production process; Greene, 2000). Using such an approach, and mindful of the *Microsoft* issues discussed earlier, some suggestions can be offered as to when use of the contractor approach makes sense. In both practical and legal terms, independent contractor status should be workable as long as its duration is not too extended (e.g., 6 months to a year or less), control of the manner and means of the work can and should remain largely with the contractor, the work to be performed is relatively discrete and distinguishable from the present or future core operations of the employer's business, and the form is not used in bad faith to circumvent reasonable notice and just cause termination requirements that would otherwise apply under statutory or common law.

However, as Greene (2000) has noted, one of the major disadvantages of contractors has to do with loss of control. Thus, where possible trade secret issues may be involved (e.g., loss of technical information, customer lists, or other information having independent value because it is not widely known; see Cal. Uniform Trade Secrets Act Section 3426), the decision to afford contractors access to the premises or proprietary information of the employer should be accompanied by adequate security precautions and appropriate contractual remedies in the terms and conditions of hire. Organizations should also periodically reassess the extent to which contracted work may be approaching "core" status within an organization as technology or economic conditions evolve, and should seek to ensure its availability either externally or internally at the necessary performance level.

## Employer–Employee Relationships

On the other hand, where the importance of ongoing relationships among workers, management, and customers or clients suggests the need for workforce loyalty, commitment, confidentiality, and other aspects of performance monitoring and control, some form of an employer–employee relationship would be more in order. Employees have knowledge of an organization's culture, operating procedures, work practices, performance standards, and "the ropes" that may be critical for achieving the consistency required in many types of businesses.

The form that the employment relationship should take, however, is not entirely obvious. Even outside the union context, some U.S. employers have chosen to develop detailed personnel policies that spell out the rights of employees regarding appraisal procedures, performance improvement, training and development, positive discipline, and notice for terminations should economic or effectiveness concerns require them. Others have adhered to the at-will doctrine no matter what environmental changes may have occurred. What would a strategic contingency approach suggest as to which form of the employment relationship is more appropriate?

Some years ago, Miles and Snow (1978) developed a typology of generic competitive strategies that has since become fairly well known. Originally, this typology reflected three forms: "defender" (organizations seeking to compete in narrow and stable markets by more efficiently producing and selling existing products), "prospector" (organizations

seeking to compete in new and emerging markets via innovation and new product development), and "analyzer" (organizations seeking to compete by imitating the best efforts of organizations reflecting the other two forms; a fourth form, "reactor," was not considered to be a viable long-term strategy). Subsequently, the first two typologies have been used to examine linkages among work flows, staffing processes, separations, and other aspects of strategic human resource planning. For example, Gomez-Mejia *et al*. (2001) have noted that defender strategies will typically reflect a control emphasis through explicit job descriptions and work specifications, firm-specific training and socialization processes (to "make" needed skills), internal recruitment (to maintain existing skill bases), uniform performance appraisals, and preferential rehiring policies where layoffs prove necessary. Conversely, prospector strategies will typically reflect an innovation emphasis via flexible work planning and execution, generic training and socialization, customized performance appraisal procedures, and external recruitment (to "buy" new skills on an as-needed, real-time basis). We find this analysis useful to apply in a heuristic sense (cf. Zahra & Pearce, 1990) to the strategic choice among forms of the employment relationship. We do so by matching general aspects of defender and prospector strategies to employee rights and at-will approaches, respectively.

### *Employee Rights Approach*

If stability and efficiency go hand in hand with specificity in work rules and consistency in staffing practices, then it seems natural to manage employee relations through an explicit approach to employee rights where those are the primary concerns. This approach is mandated by law in Canada and New Zealand (and elsewhere), but there is no reason that nonunion employers in the United States should not adopt such an approach by setting forth the rules of the game in their personnel policies, particularly in capital-intensive businesses where necessary skill levels and task performance do not change greatly over time (see generally Wright & Snell, 1998). For example, to enhance performance continuity under such circumstances through better applicant and employee attitudes (e.g., affective commitment; see Tsui *et al*., 1997, regarding outcomes associated with "overinvesting" in employees by offering the promise of continued employment), it would seem appropriate to spell out employee rights regarding performance standards, improvement processes, notice requirements, severance pay, and other elements of an ongoing employment relationship rather than leaving termination to chance under an at-will system.

Moreover, if stability is a primary characteristic of the industry or market in which an organization seeks to compete, and employees are relatively interchangeable in terms of their abilities and skill sets, then there would seem to be little downside to institutionalizing expectations for continued employment, and a reduction in litigation might well result. Prior research has found that employee knowledge and awareness of personnel policies and procedures, adequacy of explanation regarding personnel actions taken, and the existence of basic due process such as reviewability of appraisal and related staffing decisions, can be significant negative antecedents of propensity to sue and positive correlates of legal defensibility (Dunford & Devine, 1998; Werner & Bolino, 1997). In summary, some form of employee rights system having elements of the Canadian and New Zealand approaches seems more likely than an at-will system to achieve the desired consistency in human resource management suggested by a stable economic and industrial environment.

### *At-Will Approach*

On the other hand, when dealing with rapidly changing technologies and accelerating product cycles as are typical in the labor-intensive service and information sectors of the economy, it may be necessary to "buy" rather than "make" workers with the requisite knowledge, skills, and abilities, and a more flexible use of the external labor market may be required to compete effectively. In such an environment, it is more likely that the right to achieve real-time replacement of current workers with better qualified new ones will be critical to protect via use of an at-will system. There may also be advantages in terms of creativity and innovation to maintaining a workplace environment "on edge" where employee complacency is discouraged by lack of a more secure employment relationship (see, e.g., Hornsby *et al.*, 1999, comparing perceived conditions for corporate entrepreneurialism and innovative behaviors across Canadian and American firms).

This is not to say that there is no value to retaining existing employees if they are in fact best suited to fulfill the next project specifications as well as previous ones, and the at-will doctrine need not pose an impediment to doing so if this turns out to be the case. However, the expectation of continued employment should be reduced by at-will language to the extent possible under such circumstances unless there are demonstrable reasons for doing otherwise. Once again, organizations should continually reassess the costs and benefits—including those related to attitudinal and behavioral implications of using an at-will approach—as economic, legal, and other environmental conditions continue to evolve.

## CONCLUSION

The complexity and variability of the at-will doctrine across state boundaries have led to efforts to standardize employee rights in the United States with respect to termination of employment in a manner that would resemble elements of the Canadian and New Zealand approaches (see, e.g., the Model Uniform Employment Termination Act, promulgated in 1991 by the National Conference of Commissioners of Uniform State Laws, which would institute a just-cause termination requirement as well as mandatory arbitration of wrongful termination claims). However, little progress has been made toward adoption of such uniform provisions as a matter of law, and the suggested provisions have not gone uncriticized (see, e.g., Navaretta, 1996, characterizing the Model Act as a "menace to employment tranquility"). Meanwhile, it may still be worth asking why there should not be a mutual obligation of good faith and respect between labor and management in *any* employment relationship.

Further empirical research will undoubtedly be needed to better explicate relationships among a range of employment and organizational effectiveness dimensions. However, there would seem to be relatively little cost, and perhaps substantial benefit (e.g., in terms of improved employee and public relations, and perhaps less frequent—or at least less costly and complex—litigation), to explicitly setting forth employees' rights in appropriate situations, and limiting use of at-will language to where it is needed rather than adhering to it in blind faith. In any event, the consequences of alternative forms of the employment relationship should at least be systematically considered from a competitive standpoint as part of the overall strategic planning process. This paper offers a starting point for doing so.

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