

Legal update - Business decisions now under the spotlight in redundancies

Peter Chemis, Hamish Kynaston, Sherridan Cook, Susan Rowe, Alastair Sherriff, Andrea Pazin

23 April 2013

In another significant change to redundancy law, last month the Employment Court ruled that it can scrutinise an employer's decision to make an employee redundant to ascertain whether there were sufficient business reasons for the redundancy. In *Totara Hills Farm v Davidson*, the Chief Judge of the Employment Court analysed the reasoning behind the cost savings the employer said it would achieve through Mr Davidson's redundancy and found that those savings would not be delivered. As a result, the redundancy was unjustified. In terms of section 103A of the Employment Relations Act 2000, the business decision was not one that a fair and reasonable employer could have made in all of the circumstances.

Change was in the wind

As we reported in November 2012, the Employment Court indicated in *Edwards v Two Degrees Mobile* that section 103A may be wide enough to include an analysis of the employer's business decision to make an employee redundant, and it seemed that this would be tested in the near future. Many expected that this would take a full Employment Court (ie three judges) as it would appear to overturn the Court's 2006 ruling in *Simpsons Farms v Aberhart*. In that case, the Court held that section 103A did not change the long-standing principle that so long as an employer acts genuinely and not for ulterior motives (such as misusing redundancy to get rid of a poor performer), then the business decision is for the employer to make and not for the Employment Relations Authority or the Employment Court to second guess. However, in *Totara Hills*, the Chief Judge took the approach of further explaining and developing his reasoning, rather than expressly overturning what he had said in *Simpsons Farms*.

Mr Davidson's redundancy unjustified

In *Totara Hills*, Mr Davidson believed that the real reason for his dismissal was his employer's unhappiness with his performance and Mr Davidson's challenges to his manager's demeaning and bullying conduct towards him. The Court found, however, that these were not the causes of his dismissal and that the redundancy was not a charade. Based on what was previously understood to have been held in *Simpsons Farms*, it could have been expected that the Court would not have looked any further into the substance of the employer's decision, and any deficiencies found would relate to process only, such as a failure to consult adequately.

However, in reliance on section 103A and the explanation of its decision in *Simpsons Farms*, the Court went further than it had done previously, and examined closely the basis on which Totara Hills Farm decided to make Mr Davidson redundant.

Totara Hills Farm's written advice to its employees was that by disestablishing Mr Davidson's position and creating a junior shepherd's position in its place, it would reduce its wage bill by almost 10%. In fact, the difference in salaries between the two positions was \$6,000 p.a., which the Court found was less than 10% of the farm's wage bill and more in the region of 6%. Staff had suggested other ways of making savings, which were not accepted by Totara Hills Farm because they were only "minimal", but there was apparently no evidence of what those savings were and how they compared to the \$6,000 saved by disestablishing Mr Davidson's position. Overall, the Court found that the evidence of justification for Mr Davidson's dismissal was scant.

In the Court's view, this threw "into doubt the genuineness and, therefore, the justification of making Mr Davidson's position redundant". While it is not entirely clear how this sits with the Court's earlier finding that the redundancy was genuine, the key point is that the employer did not provide sufficient and robust reasons for taking the significant step of terminating Mr Davidson's employment.

The Court also found that rather than inviting Mr Davidson to apply for the new junior shepherd position, it should have been offered to him, given that he was "well regarded" and it was well within his capability. This follows the themes in *Wang v Hamilton Multicultural Services Trust*, which we reported on in [May 2011](#).

Our comment

Totara Hills signals a significant extension of the scope of the Authority and the Court's assessment of whether a redundancy is substantively justified. Previously they were concerned only with genuineness – in the sense of whether the

redundancy was for a proper business purpose and not as a charade for other ulterior motives – and whether the position was actually disestablished (ie that it ceased to exist and was not essentially the same as any new position created). Now it seems that the Authority and the Court will consider whether the business case for the restructuring is objectively justifiable having regard to the cost savings, efficiencies or other operational outcomes that the employer wishes to achieve.

In our view, what the decision does not do is change an employer's prerogative to run its business as it sees fit. So the Authority or the Court may find that a decision, for example, to disestablish a marketing role is unjustified if it is made to save costs and the employer either did not have sufficient and robust information at the time to show that it would save costs, or it was acting on incorrect assumptions or information. However, we expect that the Authority or the Court will not second guess an employer's decision to disestablish the same role because it no longer wants its marketing to be done in-house, or it wants to reduce staff numbers and prioritise work in other areas.

For those employers who apply best practice by first ensuring that there is a sound business case for implementing a redundancy, *Totara Hills* should not change the way they operate. Even so, *Totara Hills* does move the boundaries and it is not certain where they will settle. It will create some uncertainty for employers, and is likely to increase the number of challenges to redundancy dismissals – at least for a time.

We therefore recommend that employers take the following approaches when restructuring:

- Ensure that the outcomes that the employer wishes to achieve are based on sound business reasons, that those reasons are articulated in clear and comprehensive terms in the proposal document and other communications, and that all assertions and assumptions can be supported factually
- Consistent with *Massey University v Wrigley & Kelly*, ensure that all information relevant to the reasoning and the outcomes desired is provided to employees
- If employee feedback on the proposal is not accepted, the employer should engage with employees about that and explain why during the consultation process
- Redeployment should be fully considered as part of the process from the beginning and throughout. If any existing or new roles are not intended to be offered to employees whose positions are being disestablished, then the employer should ensure that there are sound reasons for this and that they are explained to the employees concerned
- If a redundancy decision is challenged, clear and comprehensive evidence should be presented to the Authority or the Court to help justify the employer's decision – even if it was not presented in the consultation process.

If in doubt, we are very happy to assist.

Auckland

**PwC Tower
188 Quay Street
Auckland 1010**

**PO Box 1433
Auckland 1140
New Zealand**

**P: +64 9 358 2555
F: +64 9 358 2055**

Wellington

**Aon Centre
1 Willis Street
Wellington 6011**

**PO Box 2694
Wellington 6140
New Zealand**

**P: +64 4 499 4242
F: +64 4 499 4141**

Christchurch

**83 Victoria Street
Christchurch 8013**

**PO Box 322
Christchurch 8140
New Zealand**

**P: +64 3 379 1747
F: +64 3 379 5659**