Employing Fairness

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Introduction

Legal scholars and courts have observed that, as compared with court judgments, the decisions of administrative tribunals often have more immediate effects on people in their daily lives. In recognition of the importance of these effects, scholars and litigants have made claims for greater constraints on the power of tribunals, such as stronger procedural safeguards, and on the power of legislatures to impose their will through those organs, such as higher requirements of institutional independence and the capacity of tribunals to give no effect to laws they determine to be unconstitutional. Extended logically, however, the search for institutions of social control exerting substantial influence on people steps outside the set of government forums and reveals that employers daily wield considerable power as they structure the tasks and work environments of their employees and, particularly given the importance of money, as they choose the manner and amount of their employees' pay. Like that of administrative tribunals, employers' power of social control is not unlimited. Rather, it is regulated by competing orders of legal (both common law and legislative), moral, economic, managerial, and industry-specific constraints. Lawyers, however, typically presume the pre-eminence of legal regulation.

This paper's fundamental inquiry is the relationship between two competing orders of constraints on employers: legal restrictions and recommendations set out in management literature. A specific example, the design and operation of bonus incentives within large firms, is used for this exploration of the regulation of employers' social control. This example is timely because in recent years employers have increasingly adopted non-traditional means of providing incentives. Moreover, the limits on this exercise of employers' power have received far less attention than other employment matters, such as the norms around dismissal, regulated by the common law, or hours and pay equity, regulated by employment statutes. The paper restricts its view to non-unionized settings. Labour law provides an additional, highly specialized order of constraints and, for present purposes, it is more revealing to observe the interaction of regulatory orders absent formal collective agreements and detailed legislation.

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The inquiry operates on three levels. The first compares the legal and managerial discourses used in discussing bonuses by examining treatment of bonuses in decided cases and the recommendations in contemporary Anglo-American management literature for designing and operating bonus incentives. A sharp contrast emerges between the traditional legal view of the employment relation as a contract of exchange and the management literature's view of the firm as a managerial decision-maker. The management literature reveals a conception of fairness that should be followed in paying bonuses. The second level of inquiry explores the relationship between this "managerial fairness" and the duty of procedural fairness developed by lawyers in public law. Owing to the substantial similarities between the two, the paper inquires whether the relation is, in fact, causal—does the concept of managerial fairness derive from public law fairness? Is one order of regulation imitating another? Significant differences between the two, however—particularly substantive constraints deeper in managerial fairness than in public law—rebut the hypothesis of imitation and suggest that managerial fairness is self-generating. This notion of self-generating fairness leads to the third level of inquiry, the relationship between the systems of firms and governments. Teubner's important work on autopoietic, self-regulating systems provides the basis for a discussion of a role for state law other than that traditionally presumed by lawyers, the state as supplier of norms. The paper explores Teubner's argument that the role of the legal system may be to facilitate the internal self-regulation of firms. Applied to this example, that argument would entail the state's providing more space for the managerial sense of fairness.

To be clear, then, the argument is not that employers may treat employees unfairly. It is, rather, that the relevant sense of fairness may not be a legal one. The legal system needs to be cautiously more receptive to evidence of autonomous social fields with their own conceptions of appropriate conduct and organization. Moreover, recognition of subsystems' self-regulation is not necessarily exclusive of recognition of a role for public law norms or state regulation. Yet a better appreciation of the scope of non-state and non-legal regulation—which this paper seeks to further—is an important step towards delineating those spaces where an indigenous regulatory system will govern satisfactorily and those where it is necessary and appropriate for governments to intervene in pursuit of justice.

**Constraints on Performance-Related Pay**

A preliminary word about terminology is appropriate. Courts and management writers use the term "bonus" at least two different ways. In one sense, bonus schemes are systems of performance-related pay ("PRP") that give individuals or groups of employees a cash bonus in return for the achievement of predetermined performance targets. Another usage of the term refers to discretionary bonus plans with no predetermined performance expectations or outcomes. In reading case law and management literature,
bonuses should be distinguished from merit compensation or merit pay plans. Merit plans incorporate rewards on the basis of realization of set performance targets into the employee's base pay for the future. Nevertheless, much of the literature concerned with merit plans is, in fact, more general and applicable to bonus structures.

**Courts' Contractual View**

There is relatively little case law on PRPs, most of it treating bonuses. This is unsurprising, as bonuses have a longer history than the more sophisticated compensation plans discussed in the recent management literature. Reported judgments represent everyday practice imperfectly, but they reveal how lawyers and judges frame the questions. The Canadian bonus jurisprudence relates chiefly to three propositions.

The first point is that a bonus may lose its discretionary character and become an integral part of an employee's compensation (contractual expectation, reliance, indefinite consideration). In other words, in certain circumstances an employer's characterization of a bonus as discretionary is not determinative. Facts may signal that the bonus has become an integral part of an employee's compensation, particularly if the bonus constitutes a significant component of the total compensation.¹ Furthermore, the employer may have failed to exercise its discretion such that a bonus becomes fixed (tacit waiver).² Finally, other conduct by the employer may demonstrate that the bonus is not discretionary.³ Nevertheless, it is still possible for an employer's stipulation of the purely discretionary character of a profit-sharing plan to prevail.⁴ The inquiry whether a bonus forms an integral part of the remuneration under an employment contract arises typically in two contexts. If the employer has wrongfully dismissed an employee, and the bonus has been found to constitute an integral part of compensation under the contract, the court will add the bonus to the damages or notice period calculations.⁵ Alternatively, the failure to pay a bonus may constitute, solely or with other factors, constructive dismissal.⁶

Second, an employer is constrained in its power unilaterally to alter a bonus or other PRP scheme (duty to exercise contractual power in good

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² See e.g. Husband v. Labatt Brewing Co., [1998] B.C.J. No. 3193 (S.C.), online: QL (BCJ) (employer paying bonus as matter of course through each year of employee's contract).
⁵ See e.g. Ryshpan, supra note 3.
faith, rationally). By changing the method of measuring results or the benefit given, an employer can incur legal liability.\(^7\) Judgments supporting this proposition attest that the structure of a bonus is not merely a company policy, and that it may become an element of the total consideration bargained for under a long-term contract.

Finally, an employer is obliged to communicate clearly the details of a plan to employees (duty of information). This point typically arises in cases of implied terms of PRPs and the employer’s inability to rely on presumed characteristics of the plan. An employer should, for example, inform employees of the date a profit-sharing plan vests,\(^8\) and absent explicit communication or agreement, there is no presumption that an employee must remain employed until year-end to be entitled to a non-discretionary bonus constituting an integral part of his or her compensation.\(^9\)

The propositions outlined here developed within a contractual framework in which justice is achieved by both parties performing their part of the employment bargain, whatever it turns out to have been. As a result of the courts’ institutional function, their pronouncements on bonuses relate to pathological cases. In contrast, the management literature’s focus is prospective and more constructive.

**Managerial Fairness**

A cursory outline of the management literature’s recommendations situates the following discussion. The literature addresses several stages of a PRP. The first is design of the system; next comes implementation, in which the plan is introduced to employees and becomes operational; finally, in the course of operation, there may be further adjustments as conditions change and employees launch appeals respecting their individual assessments and pay allocations.

Significantly, for present purposes, the management literature makes a number of explicit references to some conception of fairness. The two predominant theories respecting employees’ pay are themselves part of a broader concern with fairness.\(^10\) Although there are numerous others, expectancy theory is the predominant theory respecting employees’ pay. According to this theory, the effort that an individual makes at work (motivation) depends on how that person perceives three factors. First, expectancy is the extent to which an employee perceives a difference between the effort made and the resulting levels of performance. Second, instrumentality is the extent to which an individual perceives a relationship between levels of performance and their potential rewards. Third, valence is

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\(^7\) See e.g. *Alpert v. Carreaux Ramca Ltd.* (1992), 9 O.R. (3d) 207 (Gen. Div.) (change from uncapped bonus based on net profits to capped bonus amounting to constructive dismissal).


the amount of importance or value that an individual assigns to the work’s possible rewards. In other words, the more an individual thinks he or she is able to do that which is expected of him or her, and the greater his or her expectation of more positive than negative results, the greater the effort that he or she will make to do what is expected.\textsuperscript{11}

The second significant theory concerning pay is equity theory. It argues that individuals constantly compare their contributions and rewards to those of another person they consider significant, their “referent other.” A state of inequity exists when individuals perceive that their contribution-reward ratio differs from that of their referent other. Individuals will then attempt to reduce the inequity by modifying their conduct or that of the referent other. In the employment context, equity theory typically hypothesizes that employees may work harder if they perceive themselves to be over-rewarded relative to their referent other and correspondingly less hard if they perceive themselves to be under-rewarded.\textsuperscript{12}

The management literature instructs employers to pay attention to the fairness or procedural justice of their PRP system. In empirical studies, the perceived procedural justice of a plan, particularly fairness in decision making, has proven to correlate significantly with the instrumentality perception.\textsuperscript{13} Given the importance of perceptions, it is impossible to separate the actual procedures from talk about procedures. For instrumentality beliefs, what is said about procedures and their enactment is as important as the procedures themselves. Indeed, the fairness of the formal procedures used in decision making matters more to employees’ instrumentality perception than the quality of relationships with decision-makers or the manner of enacting those procedures.\textsuperscript{14} In short, employees need to feel the plan is fair. Fair procedures may include appeal processes. The desirability of an appeal process should, however, be balanced against the need for stability in incentive plans. Overuse of flexibility can dilute the strong incentive effects of a rigid compensation plan and, unintentionally, undermine the perception of fairness derived from the sense that all employees are subject to decisions made by set criteria. Accordingly, a right to \textit{ex post} review of decisions should be used sparingly,\textsuperscript{15} indicative of an institutional and instrumental constraint on appeals processes generally.


\textsuperscript{13} See Thériault, supra note 11 at 335.

\textsuperscript{14} See S. St-Onge & M.L. Magnan, \textit{The Determinants of Pay-for-Performance Perception in a Merit Pay Environment} (Montreal: Faculty of Management, McGill University, 1992) at 12.

Even more interesting for this inquiry, there are also implicit dimensions to fairness in the management literature. These aspects emerge from the recommendations for structuring and operating performance-related pay, which centre around three notions. The first is inclusion of employees in design of the plan. Management authors agree that employee involvement is important for plan success. Moreover, consulting broadly and then designing a uniform structure for a large organization consisting of diverse units is insufficient. Behaviour-based incentives must be locally designed and managed, with performance criteria derived from specific business unit strategies. It may also be appropriate to conduct pre-testing of the proposed plan to determine its acceptability amongst the employees who would be affected.\(^8\) Procedurally, a mirror of the recommendation that system design include all relevant groups is the suggestion that the pay process be democratized, with each executive, manager, and supervisor accountable for his or her part of the compensation program.\(^9\) Moreover, this imperative for inclusion does not end once the design is completed. In keeping with the relational character of the employment contract, even a plan carefully designed through consultation should not be viewed as final. Employee feedback should be welcomed during implementation, and management must be open to consider changes in strategy or methods.\(^10\)

The second notion is the need for a plan to have a substantial instrumentality effect. In particular, this requires that the objectives and the performance to be measured must lie within the control or significant influence of the participants. A management incentive plan will influence conduct only if a line-of-sight relationship exists between the employees and the plan's performance measures, that is, if employees can see the immediate effects of their conduct. Performance plans that measure factors beyond the control of employees are, predictably, not only inadequate as incentives but also potentially demoralizing. A line-of-sight relationship is best achieved if the performance measures determining an award lie under the direct control of the participant or a team of which the participant is a significant member, with extraneous information filtered out.\(^11\) Indeed, whenever plan participants can influence the standard-setting process, the performance standard generates important incentives. Another instrumentality concern is the alignment in time of the performance evaluated. Generally the objectives sought should be achievable within one year, but good decisions yielding longer-term benefits should be recognized. A plan's objectives are not

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\(^{18}\) See Orens & Elliott, *supra* note 16.

furthered where, say, an employee having made a decision bearing positive long-term consequences leaves his or her post, never having been rewarded for that decision.

Fairness concerns also emerge from theoretical and empirical studies demonstrating that the measurement of performance is generally one of the most problematic elements of a PRP system. The pay-and-performance relationship is often tenuous, and it is difficult to eliminate the large idiosyncratic factor in performance ratings. A growing body of work, particularly psychological, questions the ability of managers to specify and measure individuals' performance correctly and consistently; for example, a broad range of extraneous factors frequently carry disproportionate weight in performance evaluations (the "noise" problem). Management must also consider ongoing adjustment of the financial bases used in measurement to reflect changes in products, production methods, and materials.\(^{20}\) Evaluators tend to avoid distinguishing between employees and, particularly, to avoid giving low assessments. Measurement of individual behaviour may be refined by better development of performance criteria, training of supervisors, and close monitoring of the process. Given the weaknesses in evaluation by managers, there is a growing interest in peer assessment, typically in settings where senior managers are too remote to have a rounded picture of performance.\(^{21}\) Economics insights—particularly work on transaction costs—prescribe that the rules for determination of bonuses should be simple. Complicated rules are not only costlier to design and maintain, but also more susceptible of manipulation and potentially yield greater unforeseen consequences.\(^{22}\)

The third notion is the importance of communication. Communication, in turn, comprises three elements. The first is the importance of pay as a means of communication between employers and employees. Managerial strategies for PRP can reflect motives such as institutional culture change or organizational transformation. In this light, PRP, particularly the change from a system not linked to performance (perhaps one emphasizing seniority), can play a symbolic role, communicating a new strategic intent to employees. Such specific deployments of PRP are grounded on the illuminating recognition that pay, however structured, is an organization’s most direct means of communicating with its employees, indicative of what

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\(^{21}\) The literature speaks of 360-degree assessment. But note the risk that establishing a direct link between these more rounded performance measures and pay awards may encourage dysfunctional behaviours, such as collusion.

\(^{22}\) E.g. caps on bonuses may invite strategic behaviour by employees, such as the transfer of transactions across periods at fiscal year-end to maximize rewards.
it values and considers worth paying for. The second element is the necessity of communicating the objectives and terms of the plan to employees prior to implementation. Thorough communication of plan objectives, performance criteria, and measurement methods is essential at initial implementation of a PRP plan if employees are to be motivated to behave appropriately. Employees must be told not just what they will be paid, but why and how they can better it. The object of this communication is to make monetary awards not just known and understood, but uppermost in employees' minds. The motivational value of the plan is severely blunted or negated if this communication does not occur openly and promptly. This point applies even to discretionary plans, which will be less effective if employees have no sense as to how the discretion will be exercised.

Indeed, the importance of communication highlights the management authors' discomfort with discretionary bonuses: employees cannot systematically alter their conduct if the criteria for rewards are variable. The third element of communication is triggered during operation of the plan. Interim feedback on performance informs participants whether their chosen behaviours are working, and if not, permits them to adjust appropriately. Continuing communication and regular updates ensure that the organization receives full value for the plan's operating costs.

These notions are justified primarily as requirements for effective incentive programs. Yet they reveal close connections with a concept of fairness in the management literature. For example, recommendations pursuing instrumentality dictate that it is arbitrary and unfair to reward employees based on factors beyond their control. Furthermore, there is a close link between communication generally and fairness. While the instrumental importance of communication is noted above (based on the premise that only an announced carrot motivates the donkey), some of the literature reveals a less immediately instrumental conception of the value of communication. Recommendations that implementation must include communication to eliminate fear and create employee buy-in, or to ensure that all employees know why a new system is being introduced and the effects that it will have on them individually and collectively, show a respect for employees as individual agents, not just as providers of labour. Perhaps the extent to which these recommendations are appropriately characterized as implicit fairness concerns turns on whether "buy-in" is read as going only to compliance or rather, more profoundly, to enlightened consent conferring

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23 Pay as communication is an important recurring theme in the management literature. See e.g. D. Pritchard, "Managing the Reward Process: Reconciling Work, the Individual, and the Market" in Fay, supra note 12, 194 at 194.

24 The general management literature is peculiarly silent on the psychological leverage that an employer may gain by retaining and wielding discretion respecting bonuses; fear and envy are not, evidently, sentiments that managers wish, explicitly, to be cultivating in their work environments, whatever their potential instrumental incentive utility. The instrumentalization of a PRP system as a power device would be a fruitful area for further study.

25 See e.g. Thériault, supra note 11 at 348-49, who outlines a number of standard formulas for calculating bonuses but ignores the purely discretionary bonus.
legitimacy.\textsuperscript{26} There may potentially be significant symbolic and cultural aspects to employees’ participation in the scheme. The vitality of these managerial fairness concerns suggests the aptness of a comparison with the judicial treatment of bonuses.

**A Revealing Contrast**

A couple of remarks arise in comparing the case law treating bonuses with the management literature. The case law confines itself within a traditional legal model of contract as exchange. For example, as noted earlier, the bonus questions most litigated turn on whether a bonus constitutes an integral part of compensation under the employment contract. The bonus cases reflect traditional private law conceptions of contract, according to which lawyers typically characterize communication as a negotiation step preceding payment, but do not view payment of the contract’s consideration as communication.\textsuperscript{27} It is as if the lawyers’ strict notion of employment contracts binds them to cast arguments about bonuses a single way. It is possible that, in the cases settled outside court, counsel for the employers had a more purposive sense of why they pay bonuses and how a proper incentive system should be set up, but it seems, at least in the reported cases, that courts maintain a grid perspective in viewing bonuses, taking their task as pigeonholing the benefit into the contractual box (i.e. compensation or not). This relatively narrow view of payment contrasts with the management literature’s emphasis on the communicative aspects of pay. In general, the management theorists take a dynamic view more alert to the energy and movement in incentive systems.\textsuperscript{28}

A related observation is that the management literature seems to view the design and implementation of a PRP system as a purely managerial decision. The repeated advice that the employer consult and structure an open process signals that, in the eyes of the management experts, the employer is not\textit{ a priori} bound to negotiate compensation as a matter of numerous individual bilateral employment contracts. The absence of bilateral negotiation is most glaring in the case of bonus programs affecting a comparatively large number of employees, such as salespersons or upper middle managers.\textsuperscript{29} Deakin has remarked that the actual operation of the program—the

\begin{itemize}
  \item This raises a question worth further study, the extent to which managerial fairness comprises a human dignity aspect. See Flannery, Hofrichter & Platten, \textit{supra} note 17 at 228.
  \item The grid and the energy dynamic are two of the four aesthetics in P. Schlag, “The Aesthetics of American Law” (2002) 115 Harv. L. Rev. 1047.
  \item The classic sense of contract as exchange, with negotiation and the employee’s consent, persists more in the case of senior executives, such as the chief executive, who are frequently much better positioned to bargain for customized compensation packages.
\end{itemize}
measurement of results or assessment of conduct, the determination of incentive pay based on those results or assessments—closely resembles the operation of an administrative discretionary decision-maker. Individual bargaining is rare, and performance appraisal systems tend to assume a wide, extra-contractual discretion.  

The conceptual distance from an individual bargain is likely proportionate to the size of the employer. In large firms, there is less likely to be identity of persons between the person who designed the pay system and those persons who will administer the mechanism. It is in smaller, less formal settings where the involvement of the supervisor is direct that the employer’s function may be closer to the adjustment of compensation within an incomplete bilateral contract.

If there is merit in the management literature’s implicit characterization of the employer as a managerial institution rather than a contractual party respecting PRP, there is perhaps an insight to be drawn more generally about the employment relationship.  

This paper’s study of PRP may bolster the argument that the classical legal characterization of the employment relationship as contractual in nature is too “inadequate and outmoded” to accommodate employment within firms and contemporary realities. Such conclusions are not, of course, new, but the management literature’s PRP recommendations provide a fresh way of reaching them. Indeed, arriving at these conclusions through a study of management norms raises the possibility that the solution is to replace the classical legal conception of the employment contract as exchange with a managerial conception of contract, one open to a variety of differently structured relations with significant power differentials, such as franchise. Alternatively, it may be productive to sharpen a focus on contracts for work and on workers, instead of the binary choice between a contract of employment and a contract for services.

In any case, two observations follow. First, the proximity between effectiveness and fairness in the management literature suggests a conceptual weakness in the formalist lawyerly imagination by which, in an administrative law context, it has historically been possible to imagine an effective system with “fairness” as an add-on that may or may not be

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33 The possibilities of a focus on work are further developed, along with a rich assessment of dimensions of asymmetry in the employment relationship, in G. Davidov, “The Three Axes of Employment Relationships: A Characterization of Workers in Need of Protection” (2002) 52 U.T.L.J. 357.
required. Second, within a management context, the instrumentality and communication requirements—the necessity of a link between effort and reward, the requirement that potential rewards be communicated—suggest awareness of lawyerly concerns, not respecting contract, but rather the more technical sense of fairness developed in the public law setting. It is worth, then, defining this lawyerly fairness and exploring the connections between it and the management literature’s fairness.

Parallel Fairnesses

The Public Law Analogy

The examination in this section stems, in part, from Deakin’s observation analogizing employers’ administration of performance appraisal systems with discretionary decision-makers, whose actions are reviewable, of course, under public law. In assessing the relevance of a public law concept in the private sector, this paper builds too on a body of research including Macaulay’s study linking firms and other complex organizations with public governments, identifying both as sites of governing. The argument is not a prescriptive one that the public law duty of fairness ought to apply, or even less that for some reason it already applies to regulation of incentive pay in private firms. Rather, the objective is to see what can be learned—about incentive pay, about employment relations, about public law fairness itself—from the exercise of viewing PRP plans and employers through the public law fairness lens. The inquiry may also yield insights for employees seeking greater justice and systems reform.

Fairness is used here in a specific way, meaning the public law duty of procedural fairness. The common law holds that statutory decision-makers exercising administrative functions, including discretionary decision-makers, bear the requirements of procedural fairness. Procedural fairness is required

34 Nakkuda Ali v. Jayaratne, [1951] A.C. 66 (P.C.), now over-ruled, represents the high-water mark of this rigid conception of fairness. Even the current position that the duty of fairness always applies to discretionary decision-makers, however, does not entirely recognize that fairness may be inherent in any well-designed system. The abstraction of “fairness” from its living social and psychological context (where fairness is inherent to “good” and “effective” processes) perhaps mirrors the abstraction of the judicial system from the whole social system.

35 Another area for further study would be the effect of employment statutes on areas not directly regulated by legislation. In other words, do employers ever voluntarily adopt the principles emerging from legislation? For a discussion of the application of statutes by analogy, see N. MacCormick, Legal Reasoning and Legal Theory (Oxford: Clarendon Press, 1978) at 193-94.


whenever a person’s rights, privileges, or interests are at stake, and the only functions exempt from the potential obligation of procedural fairness are those of a legislative or general character.  

Although the application of the duty of fairness is broad, its content varies according to context, and a number of criteria determine what procedural rights the duty of fairness requires in given circumstances. Accordingly, this usage of fairness is distinct from a vernacular sense in which fairness may be equivalent to justice, and something unjust may be called unfair. For the purposes of comparison, this usage is also narrower than a richer sense of procedural justice focused less on rules than on fairness’s fundamental constitutive requirements.

The intention here is not to apply the determining factors from administrative law to the PRP example to reach the set of fairness’ contextual requirements, but rather to examine the procedural rights most functionally relevant to PRP. In any event, the management literature seems to prescribe, as a business decision, what would constitute, by public law standards, a relatively intense content for the duty of fairness. The relevant duties or good practices, as they apply in appropriate circumstances, include procedural fairness during the investigative stage, telling the person the case to be met, giving the person an opportunity to respond, decision by an impartial and independent decision-maker, and opportunity for an appeal. Applied in an employment setting, these rights would require that assessment of employees be conducted fairly, according to objective criteria; that employees be told the criteria at the beginning of the measurement period; that employees have some input as to their performance or issues arising from the application of the criteria; that bonus decisions be made by an impartial and independent decision-maker, and according to administrative law, the one who had heard the case; possibly that reasons for decisions be provided; and that the employer provide an opportunity for review or appeal. There thus appear to be clear similarities between the management literature’s fairness and that developed in public law.

Since incentive pay operates within a setting at least traditionally characterized as contractual, it is also worth examining the relationship between the public law duty of fairness and the contractual duty of good faith. Although the two concepts may seem roughly analogous, they are quite different in their substantive content and how they operate. For example, the duty of fairness is a unilateral burden imposed on the governmental decision-maker. Good faith, in contrast, is generally seen as reciprocal. Applying fairness in an employment setting would obviate two difficulties associated with good faith. First, defining good faith is

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38 See the contextual interpretation of the duty to act fairly in Baker v. Canada (Minister of Citizenship and Immigration) [1999] 2 S.C.R. 817 [Baker].

notoriously difficult. It has been observed to be an "excluder," serving to
eclude many heterogeneous forms of bad faith.\textsuperscript{40} Absent a positive global
definition, doctrine and jurisprudence seem to be developing a number of
subsidiary good faith duties. Typically these duties apply in specific areas
and fall asymmetrically on one party more than another: consider the
commercial client's duty to inform or the employee's duty of loyalty. In
contrast, the duty of fairness is more amenable to definition. Admittedly, the
content of the duty of fairness depends on the institutional context, so a
weightier duty will bear on some decision-makers than on others. But the
question in those settings is not what constitutes fairness abstractly, but how
much of it is required in each setting. In contrast with good faith, it is more
or less possible to list exhaustively the requirements of procedural fairness:
an impartial and independent adjudicator, the right to be heard, a possibility
of appeal.\textsuperscript{41} Today in Canada the most intense duty will include the
requirement to give reasons.\textsuperscript{42} Moreover, unlike good faith, the duty is not
directly or indirectly contingent on community standards.

Second, good faith raises insoluble or at least unresolved difficulties
about the relationship between the contracting agents. A positive articulation
of the duties required by good faith confronts questions about the extent to
which it is appropriate within a contract to insist that one party subordinate
his or her self-interest to that of the other.\textsuperscript{43} The idea of the impartial
decision-maker—a delegated party within the firm—eliminates the
complicated questions that arise in contractual good faith of the extent to
which one party is required to make sacrifices for the other or to bear his or
her losses. These questions are not germane to the relationship between a
large firm employer and all but the highest level of managerial employees.
Such relationships are not constructed around the employees' potentially
bearing or sharing the firm's losses; the power differential renders it absurd
to characterize the relationship as a joint venture such that agents perform
honestly and effectively without monitoring, sanction, and incentive
mechanisms.

Perhaps the duty of fairness seems prima facie workable in the incentive
pay setting because it is primarily procedural rather than substantive. Judges
encounter difficulties with good faith because of its substantive dimensions;
judges are uncomfortable interfering with what they perceive to be strictly
business decisions. While fairness as it has evolved has substantive
implications, they are more restrained. Furthermore, fairness, more than
good faith has so far succeeded in doing, would integrate the concerns

\textsuperscript{40} See R.S. Summers, "'Good Faith' in General Contract Law and the Sales Provisions of the
\textsuperscript{41} See "Rights Paradigm and the Efficiency Paradigm," supra note 37 at 585.
\textsuperscript{42} See Baker, supra note 38 at para. 43.
\textsuperscript{43} See e.g. S. Whittaker & R. Zimmerman, "Good Faith in European Contract Law:
Surveying the Legal Landscape" in R. Zimmerman & S. Whittaker, eds., Good Faith in
repeatedly raised by the Supreme Court of Canada about the importance of work in an individual's life. After all, in public law, the importance of the interest affected is a significant factor in determining the application and content of the duty of fairness, so the very application of the duty has validating non-instrumental symbolic dimensions.

Fairness is concerned with appropriate procedures that will accommodate all users of a system. Its focus is institutional design, rather than maintenance of particular relationships. There are, for example, correlations between the remedies provided for breach of the public law duty of fairness—typically the issuance of directions to the decision-maker and remand for a fresh hearing and decision—and certain components of the firm PRP system, notably job assessment and performance evaluation. In a systems design way, the return to the administrative decision-maker with proper instructions has a prospective corrective dimension to catch future like cases. In this respect, the legal duty of fairness reflects the concerns repeated in the management literature on design of PRP programs. I do not mean to suggest that fairness and good faith cannot apply simultaneously. But given how fairness is more readily defined and relates to systems, it is easier for employers to design ex ante a PRP system that reflects fairness concerns than to ensure good faith.

Moreover, the management literature and case law already reflect administrative law’s bias against unfettered discretion. Administrative law is uneasy with pure discretion, automatically seeking to constrain its exercise. These concerns align with the management literature’s practical concern that incentives, to be effective, must yield high instrumentality perceptions. Discretion is not immediately compatible with high instrumentality because the results do not flow predictably from the employee’s output or results.

This discussion has compared the management and public law senses of fairness without positing a causal relation between them. The similarities are substantial enough, however, to raise the hypothesis that the management literature’s fairness imitates public law’s fairness.

**Mimesis**

Socio-legal research has explored the ways in which firms have absorbed elements of state law. For example, Edelman and Suchman hypothesize that large bureaucratic organizations have internalized important elements of the legal system. They speculate that firms strategically create and formalize internal policies approximating the core principles of legality—due process and substantive justice—to preempt and displace interventions by public

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46 See Baker, supra note 38 at para. 53.
legal authorities. They identify this internalization in firms’ internal practices of law-like rule making administered through rationalized formal procedures, lawyering performed by in-house counsel, and reliance on private security forces. Indeed, Edelman and Suchman’s title suggests that the “haves” create their own internal legal systems. In their view, the extent to which firms demonstrate practices resembling public law norms results in part from implicit but intentional initiatives to avert incursions by the state legal order. Their thesis, while admittedly speculative, suggests the primacy of state law for regulating employment, and that “lawlike” fairness standards within that context are predominantly derivative from state legal standards. Similarly, Arthurs has argued, in a discussion of corporate codes of conduct, that firms deliberately mimic the “rhetoric, forms, and processes of law” to earn the support of their stakeholders and critics.48 In short, pushing this mimetic hypothesis to its logical conclusions, the employment relation would appear to be governed more by reflected state norms than by a non-legal internal morality or organizing logic of its own, and the relationship between firms and the state legal system—what Macaulay would call private and public governments—is one of defensive imitation.49

There are important respects, however, in which public law fairness fails to account for all the concerns in the management literature. These respects trouble the mimetic hypothesis. First, while fairness requires that the person whose interest is affected have an ability to make his or her case—whether by written submissions or oral hearing varies with the facts—fairness does not require that the person or even a representative group participate in or be consulted during the design of the system. Fairness, then, is not democracy. Fairness sees value in individual input in a particular case, but not in global design. In contrast, the management literature calls for significant representative involvement in design. Second, fairness captures basic procedural concerns, such as telling the person the case to be met (roughly equivalent to publicizing PRP rules and evaluation criteria ex ante), but it fails to grasp the instrumentality concerns so central to management writers.50 The requirement that results follow in a line-of-sight relationship to employees goes beyond procedure to substance. This instrumental concern touches the sort of measure and goals; in this employment setting, it is the equivalent, along with how much employees should be paid, of decisions by public governments properly classified as legislative or policy

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48 See H. Arthurs, “Private Ordering and Workers’ Rights in the Global Economy: Corporate Codes of Conduct as a Regime of Labour Market Regulation” in Conaghan, Fischl & Klare, supra note 30, 471 at 476 [“Private Ordering and Workers’ Rights”].


50 But for an argument linking public law fairness with the efficiency norms of the firm by claiming that recognizing the former will advance the latter, see “Recent Developments in Individual Employment Law,” supra note 45 at 52.
and thus exempt from judicial review. Third, expectancy theory and equity theory provide persuasive bases for incorporating fairness concerns within the design of incentive pay programs unconnected with public law fairness. Indeed, expectancy theory may be seen as providing a basis for substantive satisfaction of legitimate expectations, one exceeding the scope of legitimate expectations in public law, at least in Canada.\footnote{See Mount Sinai Hospital Center v. Quebec (Minister of Health and Social Services), [2001] 2 S.C.R. 281 at paras. 35, 37, 2001 SCC 41, Binnie J., concurring.} Fourth, while the public law duty has substantive justifications, the need to maintain the state’s legitimacy is perhaps the strongest component and is not present in the same way in “private” settings.\footnote{See E. Tucker, “The Political Economy of Administrative Fairness: A Preliminary Enquiry” (1987) 25 Osgoode Hall L.J. 555 at 590-92. But on the problem of legitimacy for firms, see “Private Ordering and Workers’ Rights,” supra note 48 at 487.} Finally, it is not evident that the fairness demonstrated in the management literature fits readily with conceptions of legality. Recommendations that certain practices are more or less effective because of their instrumentality and procedural fairness perception outcomes do not necessarily engage the legal/illegal binary code that is one marker for legal norms.\footnote{See G. Teubner, “The Two Faces of Janus: Rethinking Legal Pluralism” (1992) 13 Cardozo L. Rev. 1443 at 1451. It is arguable, however, that even a self-evidently “legal” exercise of using a pragmatic and functional approach to find a place on a spectrum is only arbitrarily pushed into that code.} In other words, the management literature’s constraints penetrate deeper than administrative law’s duty of fairness and have other motivating justifications.

It is arguable, then, that the duty of fairness is inadequate as a way of understanding the internal normativity of bonus pay in employment settings. Moreover, the hypothesis that the firm merely internalizes the state legal order is challenged by a recognition that firms’ norms, or at least the recommendations of the management literature, are relatively consistent across national boundaries, while public law notions of fairness or due process are not.\footnote{On the trans-border consistency of firms’ internal social orders, see J.-P. Robé, “Multinational Enterprises: The Constitution of a Pluriversal Legal Order” in G. Teubner, ed., Global Law without a State (Aldershot, U.K.: Dartmouth, 1997) 45 at 65. A basic consensus obtains amongst Anglo-American states as to what constitutes fairness, but there remains variation over points as significant as the duty to give reasons and the doctrine of legitimate expectations.} The origin of the substantive constraints observed by the management literature respecting PRP requires further investigation. Do these constraints in fact demonstrate an internal morality, to use Fuller’s phrase?\footnote{See L.L. Fuller, The Morality of Law, rev. ed. (New Haven, Conn.: Yale University Press, 1969).} Will an instrumentally efficient pay system be “good,” or if so is it a coincidence?\footnote{There is a rich and growing corpus of work on morality and economics. See e.g. A. Etzioni, The Moral Dimension: Toward a New Economics (New York: Free Press, 1988).} The management literature demonstrates that there is an internal logic, and that if performance objectives are not communicated \textit{ex ante} and objectives are not within the employee’s control, the system cannot
function as a real, effective incentive plan.\textsuperscript{57} Perhaps, then, it is enough to view the instrumental constraints as indicating the internal logic of a motivating incentive program, and to table the question of morality. In any event, viewing the employment setting primarily through a public law fairness model obscures the normative richness of the "indigenous law of the workplace."\textsuperscript{58} This workplace normativity interacts with the written law of the official compensation plan. For example, in the bonus example, workers evaluated as teams regulate each other's conduct outside formal company policies.\textsuperscript{59} These reflections suggest that it is inadequate to presume that the sense of fairness—the normative procedural and substantive content—here echoes or imitates public government's fairness. For present purposes, however, it suffices to remark that there are other normative forces at work that need further explanation and recognition for a satisfactory understanding of the interaction of regulatory systems within firms. Such further research is important because a better understanding of those forces may be a precondition for reform. This paper turns now, however, to a consideration of the implications for the state legal system flowing from the recognition, preliminary as it is, of the self-generating managerial and workplace normativity regulating PRP. How should the system of the state legal order relate to the internal systems of firms?

\textbf{Facilitating Self-Regulation?}

Since PRP programs demonstrate an internal logic, perhaps the legal system may be primarily facilitative of that logic. Teubner has identified what he sees as the next stage in legal evolution, from the substantive regulation of the twentieth-century welfare state to a reflexive rationality and guidance philosophy.\textsuperscript{60} As instrument of reflexive rationality, law would be relieved of its task of regulating social areas; instead, it would control self-regulating processes.\textsuperscript{61} Instead of pursuing substantive outcomes, law would confine itself to the regulation of organization, procedures, and the redistribution of competences.\textsuperscript{62} It would influence relationships indirectly, providing external stimulation of internal self-regulation, inducing rather than

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\textsuperscript{57} I am speaking here of norms—internally logical requirements—resulting institutionally from the system itself, not arising relationally from particular long-term or relational contracts.


\textsuperscript{61} An example of such reflexive regulation is a multilateral trade treaty that imposes no uniform environmental standard but will require each party signatory to comply with its own self-determined standards.

\textsuperscript{62} See the account of the potential difficulties of applying an abstract definition of procedural law to concrete cases in B. Lange, "Economic Appraisal of Law-Making and Changing Forms of Governance" (2000) 63 Mod. L. Rev. 294 at 303.
commanding actions. The notion is that well-designed internal organizational structures will exercise a pedagogical function, sensitizing the organizations concerned to the social effects of their field-specific maximization strategies. Practically speaking, then, the role of law in a functionally differentiated society is to ensure the integration of the political, economic, social, and other spheres. This conception of law’s role is premised on autopoiesis, the notion of normatively closed self-referential and self-generating systems. These systems or discourses—legal, economic, medical, religious, scientific, military—attribute or deny significance to communications from other systems only in accordance with their own respective system imperatives and only by translating them into their own normative terms.

This reflexive conception highlights a potential difficulty with comparing public and private social systems. Macaulay problematizes the public/private distinction by identifying functional similarities between public and private governments. This exercise gives the impression that norms can be transferred seamlessly from one system, the legal system of public government, to a system of private government, one driven by other forces, such as those of the market. Saying, as he does, that it is impossible to distinguish sharply between public and private should not be taken as saying that ways of operating and norms flow freely between various entities. When observers detect norms of fairness within organizations—such as due process rights at GM—they typically suppose that public law norms have bled into private law settings. It does not occur to them that they may be witnessing the development of system-specific norms of fairness, driven instrumentally by efficiency concerns or, less directly, by employee satisfaction concerns. It turns out that the private government analogy has the potential to privilege public law norms, a result that is counter-intuitive since the analogy appears to highlight and emphasize the power of private social systems. Teubner’s work, combined with specific research on aspects of particular systems, such as the present paper, can perhaps act as correctives to that tendency. That being said, however, functional similarities between state and non-state systems invite and lubricate interrelationships and mutual re-enforcement. The corrective, then, is not an


65 See J. Black, “Constitutionalising Self-Regulation” (1996) 59 Mod. L. Rev. 24 at 24. The spheres metaphor conveys the autonomy of systems but does not represent how different systems occupy and overlap within the same geo-political space.

66 I should not wish to imply that Macaulay falls for this position concerning normative transferability—he engages actively with Teubner’s work on the system-specificity of norms (supra note 36 at 492ff.)—but the risk is deeply embedded within the private government analogy.

67 See ibid. at 487-88.
equally rigid corresponding position that the "private" system is the exclusive source of its norms, but rather recognition that the public law system is not the sole or even dominant source.

One may ask what attempting to follow Teubner's reflexive rationality would mean in the PRP context within firms. A reflexive rationality orientation would shift the emphasis on the origin of so-called fairness norms observable in a private government setting from public law to the semi-autonomous system itself and the self-regulation it generates. It requires a more radical shift than the notion that the state law of contract may be open to alternative sources of norms which would be incorporated into legal standards. The "centre" would no longer be state law. The process would involve restructuring law's role towards one in which law and the courts would be open to technical and specialized arguments radically different from ones reflected in the bonus jurisprudence above. The practices and culture of the social subsystems would provide the material rationality or substance components of the fairness ideal. More fundamentally, however, and more disruptive for the legal profession, the courts' role might become much smaller than their customary part. There would be room in the system for economic considerations to function as legal principles, independently from juridical conceptions of justice. The foundational notion of justice—the ultimate intended outcome of the legal system—would need to be recognized as contingent and contextual. In return, it is reasonable to suppose that a more context-specific, facilitative approach to regulating employers would generate higher compliance, at least with internal self-regulation consistent with the context's operational inner logic, than a blanket application of a transplanted public law conception of fairness. The objective, then, would not be a substantive unification of state law with the private normativities of firms and other social systems, but rather an invitation to systems to comply with their own standards. In the PRP example, those standards would be of instrumentality and managerial fairness as opposed to lawyerly, public law fairness.

Ultimately, however, the vision of Teubner's reflexive rationality applied to the employment setting yields ambiguous results. The focus on the

68 See Collins, supra note 27 at 93.
69 For example, judges operating reflexively might consider arguments not that X was a breach of the employment contract, but rather claims that X was inappropriate because it was inconsistent with the systemic internal logic of efficient compensation programs. The legal understanding of a contract has been enriched by sociological and psychological research (see e.g. D.M. Rousseau & J. McLean Parks, "The Contracts of Individuals and Organizations" (1992) 15 Research Org. Behav. 1, but the dominant model remains the legal one.
70 For a conception of a more technical reflexive law, such as one relying on economics, see Lange, supra note 62.
functioning of systems results in a vision from which individuals are eerily absent. Teubner himself is frank that the main goal of a reflexive rationality is neither the reduction of power nor an increase in individual participation in the sense of participatory democracy. Indeed, Macaulay remarks upon the “curiously apolitical” character of Teubner’s work. Legal pluralist critics contend, cogently, that Teubner’s focus on the relationship between discourses reductively obscures certain levels of social phenomena, such as the interactions of agents. The absence of individual agency is most stark when Teubner develops the notion that a system has the ability to think independently from the minds of its individual actors. The reliance upon abstract instrumental systems for norm development is troubling because, to return to a question raised above, it is not established that the internal logic of a system does, in fact, amount to what can appropriately be called an internal morality. It is possible to imagine conditions, such as a loose labour market, where exploitative pay or other employment practices might nevertheless generate the desired economic outputs. Admittedly, reflexive rationality does not totally oblitrate the state’s traditional role as supplier of norms, but it severely abridges it. Perhaps the crucial question is whether it is possible to facilitate a system’s self-regulation in circumstances where its internal logic yields norms and practices at least roughly commensurate with community standards, without abdicating in advance the ability to intervene more substantively in other cases where a system’s logic produces unacceptable results.

Conclusion

This paper has revealed that in the management literature there are consistent standards for performance-related pay programs relating to inclusion, instrumentality, and communication. These standards resonate with administrative law’s duty of procedural fairness. These similarities and the sense that administration of PRP is a managerial decision further demonstrate the unsuitability in a large firm setting of traditional notions of the employment contract. As the paper has argued, however, the management literature’s fairness cannot be satisfactorily explained as deriving from public law fairness. This insight is important in light of claims that employment norms are imitative of state norms or that public law fairness should be imposed on employers. Moreover, impressing public law conceptions of fairness on PRP within firms risks cramping the development of managerial fairness. The public law requirements have the potential to be viewed as maximum, not minimum, requirements. The argument, then, is

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73 See Macaulay, supra note 36 at 500.
not that employers should or may act unfairly, but rather that they are already regulated by prior norms arising from their own directory efficiency requirements. This conclusion better arms employees to seek reform in settings that do not yet reflect the management literature’s ideals. It has been argued that reform must seek to engender changes to dominant narratives;\textsuperscript{76} it is possible, more modestly, that reformers may begin by framing their fairness arguments in the language of the relevant system, here using a vocabulary of instrumentality and efficiency.

On another level, research connecting efficiency and fairness should challenge lawyers to rethink their design of legal processes. It may be counter-productive to view efficiency and rights as polar opposites or mutually incompatible.\textsuperscript{77} Furthermore, the lessons from examining the internal logic of incentive pay may illuminate other areas of systems design. The requirements for an effective incentive system might indicate directions for development, in a disciplinary setting, of the requirements for effective correction. Lawyers can also learn from management’s emphasis on the communicative and symbolic dimensions of pay. The notion of payment as communication has implications for legal analysis beyond the employment setting. It, for example, assist lawyers and judges as they examine fraudulent preferences cases where debtors have paid creditors even when strictly rational financial considerations dictated that they should not.

This study suggests that, just as there are benefits to be derived from examining the suitability of public government norms within the private sector, it may be fruitful to reverse the exercise. What might be learned from subjecting governmental processes to a comparison with norms from private enterprise, from examining state governments as “public enterprises”?\textsuperscript{78} Indeed, as it partners with the private sector, government is increasingly exposed to the regulation of contract law. Perhaps administrative law, in applying to government decision-makers, could consider not only jurisprudential and doctrinal developments from other Commonwealth countries, which it does readily, but also literature on the development of fairness and efficiency norms within private businesses. Public law’s orientation towards dealings with individuals might benefit from the analysis, in a commercial setting, of discrete transactions and reputation.\textsuperscript{79} Fairness might be more fully integrated within the workings of administrative decision making if it were linked with trust, itself tied to efficiency in commercial settings.

\textsuperscript{77} This opposition is used as the fundamental structuring device in “Rights Paradigm and the Efficiency Paradigm,” supra note 37.
\textsuperscript{78} From the wealth of new public management literature, see e.g. P. Aucoin, The New Public Management: Canada in Comparative Perspective (Ottawa: Institute for Research on Public Policy, 1995).
\textsuperscript{79} See Collins, supra note 27.
These speculations are less important for present purposes, however, than the humbling (at least for lawyers) recognition that, in a specific social setting, managers design systems according to their own highly developed instrumental logic, not the law. They, their books, and their consultants draw on a diverse multidisciplinary corpus, but they rarely cite cases or legal literature. It may be impossible to distinguish sharply public and private spheres, and it may be inaccurate to ever speak of an entirely “private” space, but it is evident, too, that the governance of social fields such as large firms is not “public” in the sense of state governmental, nor is it nearly as “legal” as lawyers might once have liked to think.

Résumé

L’auteur, à partir de l’exemple de la pratique des grandes entreprises de payer à leurs employés des primes basées sur leur performance, fait état de deux types de contraintes s’appliquant aux employeurs : d’une part, les règles imposées par la loi ; d’autre part, les recommandations des manuels de gestion des ressources humaines. Le droit considère les primes à travers le prisme droit et traditionnel des règles portant sur les modalités de rémunération dans le cadre de la relation contractuelle avec l’employé. À l’opposé, la science de la gestion les traite comme une forme de communication avec l’employé et établit des recommandations concernant la conception et la mise en œuvre de programmes de primes qui révèlent une certaine notion d’équité administrative. L’auteur s’interroge sur les liens que cette notion d’équité administrative entretient avec le principe d’équité procédurale du droit public. Les différences entre ces deux conceptions de l’équité suggèrent que, contrairement à l’hypothèse mimétique, les entreprises qui adoptent des pratiques se voulant équitables ne font pas que reproduire les normes issues du contexte gouvernemental. Au contraire, l’équité administrative semble s’auto-générer à l’intérieur du champ social semi-autonome des entreprises. S’inspirant des travaux de Teubner sur les systèmes auto-potétiques, l’auteur considère comment le système juridique peut faciliter cette auto-régulation tout en conservant une certaine capacité d’intervention.

Abstract

This paper uses the example of performance-related or bonus pay in large firms to examine two competing orders of constraints on employers: legal restrictions and recommendations set out in management literature. Case law treats bonuses as compensation within a contract of exchange, viewing contract in a narrow, traditional way. In contrast, management literature views bonuses as communication with employees, and its prescriptions relating to pay system design, implementation, and operation reveal a notion of managerial fairness. The paper then inquires whether managerial fairness is derivative from the public law duty of procedural fairness. Differences between managerial and public law fairness (the former imposes more substantive constraints) suggest that, contrary to a mimesis hypothesis, firms, when adopting fair practices, are not replicating norms developed in the governmental context. Managerial fairness appears to be self-generating
within the semi-autonomous social field of firms. Drawing on Teubner’s work on autopoiesis, the paper then considers how the legal system can facilitate this self-regulation, while still retaining some ability to intervene.

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