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A First Look at Incidence and Outcomes of Unfair Dismissal Claims under *Fair Work, WorkChoices* and the *Workplace Relations Act*

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Abstract

Debate over regulation of dismissals has been intense in recent years, and renewed in the lead-up to the 2012 review of the operation of the Fair Work Act. This paper reviews the economically relevant aspects of the legislative changes from the Workplace Relations Act which operated from 1993-2006, WorkChoices from 2006-2009 and the Fair Work Act from 2009 and compares the lodgment patterns and outcomes based on the data provided by Fair Work Australia on the operation of the unfair dismissal system, as required under the Fair Work Act. Our findings reinforce earlier work that showed costs imposed on business and employment are modest, but further work is required on productivity effects of dismissal regulation.

JEL Classification: J63, J68, K31

1. Introduction

The regulation of dismissals has been one of the most controversial public policy issues in Australia in recent years. However, little hard evidence is available to adjudicate claims about the employment and other effects of unfair dismissal regulation. Interest of economists in the issue has waned since a few studies were undertaken of the impact of the dismissal provisions of the *WorkChoices* legislation which operated from 2007-2009.[1] There have been no studies by economists of the impact of the *Fair Work Act* dismissal provisions which replaced *WorkChoices* in 2009, though there are

[1] For instance Harding (2002), Chelliah and D'Netto (2006), Freyens and Oslington (2007), Freyens (2010, 2011), Sloan (2010).

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lively legal and human resources literatures on the changes to dismissal rules. One of the frustrations in this area is how little interaction there is between researchers from different disciplines interested in dismissal regulation. Research on the topic seems now to have been reignited by the release of data about dismissal claims in the annual reports of Fair Work Australia, the body which administers the legislation, and the review scheduled for 2012 of the operation of the *Fair Work Act* (see Sloan, 2010; Fair Work Australia, 2012).

The purpose of this paper, building on our previous work (Freyens and Oslington, 2007) is to compare the impacts of the different regulatory regimes on the number of cases lodged, probabilities of success, and awards to dismissed employees as far as is possible with data provided by Fair Work Australia and its predecessor bodies.

The paper continues with a brief review of the economics of dismissal regulation in section 2, an outline in section 3 of the main changes in dismissal regulation (from the Workplace Relations Act 1993-2006, through *WorkChoices* 2006-2009 to the *Fair Work* system which began operation in 2009) and a description in section 4 of our data sources and methods. After this scene setting we turn in sections 5 and 6 to comparisons between the three regulatory regimes.

2. Economics of dismissal regulation

Unfair dismissal regulation raises the cost of employing labour as there is a probability that any worker hired will be dismissed at some stage and may lodge a claim, leading to administrative costs, legal costs and the possibility of a compensation payment.[2] These costs and probabilities can be estimated (as we did in Freyens and Oslington, 2007 using employer surveys in combination with ABS labour market data), and a simple labour demand model can be calibrated to estimate the impact of dismissal costs on employment.

There are other effects of dismissal regulation. Firing costs increase bargaining power and create rents for incumbent workers, which can be exploited depending on the environment in the form of higher wages or reduced effort.[3] Regulation reduces turnover, and the capacity of the firm to get rid of workers who reveal themselves after hiring to be less productive types of workers, reducing the average productivity of labour (assuming there is a distribution of worker types with different productivities, and some productivity information is only revealed after hiring). Reduction in turnover can also reduce productivity by reducing the quality of matches. Another argument made by employers is that dismissal regulation reduces worker discipline and effort, reducing productivity.

One of the subtle effects of dismissal regulation may be to penalise high-risk workers, such as those returning to the labor force after a break to rear children, or those with a disability or criminal record. If the employer is choosing between a standard experienced worker with a known record, and a more risky worker then

[2] Surveys of the economics of dismissal regulation include Hammermesh and Pfann (1996), Addison and Teixeira (2003) and Boeri and Van Ours (2008). A nontechnical account is Oslington (2005).
[3] Early discussions of rent creating effects of firing costs are Gregory (1986) and Lindbeck and Snower (1988). Hiring and firing can be embedded in a general equilibrium model to consider their impact on inequality and unemployment (Oslington, 2002).

dismissal regulation will reduce the capacity for the employer to undertake post hiring sorting, and tip the employment decision towards the safe worker.

The effect of regulation on wages of incumbent workers and the subtle discrimination against risky job seekers induced by dismissal regulation mean that the 'social justice' arguments are not all on the side of those advocating stronger employment protection. Overall employment impacts are the key issue though, and can only be resolved by empirical evidence about the magnitudes of the costs and their effect on labour demand.

3. Institutional background

Commonwealth regulation of dismissals[4] began with the Keating government's 1993 *Industrial Relations Reform Act*, which utilised the Commonwealth's external affairs power, and was modeled on the International Labour Organisation's *Convention on Termination of Employment*. Some dismissals were defined as unlawful (for instance for pregnancy or other discriminatory reasons) and a further class was defined as unfair if they could be shown to be 'harsh, unjust or unreasonable'. Redundancy, defined as a situation where no worker is required to do the job, was a valid reason for dismissal, and redundancy payouts to the employee specified. The Australian Industrial Relations Commission handled unfair dismissal cases and could make orders for reinstatement or compensation to employees. States, beginning with South Australia in 1972, had introduced their own dismissal regulations which continued after the introduction of the Commonwealth legislation, leaving a complex web of regulations with jurisdictional ambiguities. Many cases were brought in the early years of the Commonwealth Act, generating howls of protest from employers. The legislation and procedures were refined in the years which followed until a more workable balance appeared to have been achieved under the renamed *Workplace Relations Act 1996*.

The election of the Howard government in 1996 triggered renewed pressure from employer organisations to remove unfair dismissal regulation, especially for small business. When the Howard government achieved control of both Houses of Parliament in 2005, reform of unfair dismissal regulation was announced as a major component of the government's WorkChoices changes, embodied in the *Workplace Relations Amendment (Work Choices) Act 2005*. Coverage of workplaces increased as the legislation utilised the Commonwealth's corporations power, but businesses employing less than 100 workers were exempted from unfair dismissal claims, scope was reduced for employees making claims on procedural grounds, and a new definition of redundancy as a dismissal for 'genuine operational reasons' (such reasons only had to exist, not be required by these operational reasons) ruled out claims many which would have succeeded under the previous regulatory regime.

After the election of the Rudd/Gillard Labour government in 2007 the *WorkChoices* legislation was repealed, replaced by the *Fair Work Act* which came into force in July 2009, administered by a new body Fair Work Australia. Coverage of workplaces increased further with the transfer of State powers to the Commonwealth

[4] This section and the appendix which summarises differences between dismissal regulation under the three regimes draws on the legal literature including Stewart (2011), Stewart and Forsyth (2009) and Chapman (2009). Coverage estimates are from Fair Work Australia (2012), but their basis is unclear other estimates of coverage vary widely.

by all states except Western Australia. Employees of businesses with more than 15 employees were now eligible to claim, with others covered by the *Small Business Fair Dismissal Code* with a longer qualifying period and limited redress provided employers can show they have followed the code. Protection for workers was increased by the restoration of the older definition of 'genuine redundancy'. New general provisions against adverse action provide an additional avenue of action against employers who dismiss workers after various types of complaints or exercises of workplace rights.

4. Data and method

Fair Work Australia is required under the Fair Work Act to publish certain information about unfair dismissal claims, mostly about numbers of claims and how they are resolved.[5] The information is limited and presented in a way which does not facilitate comparisons between the different regulatory regimes. We will nevertheless make use of this data.

One approach to comparing the impact of dismissal regulation under the three regimes would be to recalibrate the labor demand model used in our earlier work (Freyens and Oslington, 2007) with the dismissal cost information from the new database we have constructed and compare results. There are number of problems with this. Firstly our earlier work relied on survey data on conciliation outcomes and indirect costs which we do not have for the *Fair Work* period. Secondly, some of the ABS data we relied on for our earlier calibration work is inexplicably no longer collected, and we cannot be confident that variables like probabilities of various types of dismissals and separations (fires; redundancies, quits, retirements) remained unchanged over the ten years and three regime changes. Consequently, we restrict the scope of the present analysis to the study of changes in lodgment and claim outcomes for which we have data.

5. Results

The first question is which of the three regulatory regimes generates more claims? Table 1 presents data collected from the annual reports of Fair Work Australia and its predecessor organisations on the numbers of lodged cases in different years and cases finalised, with a breakdown of finalised cases into those dismissed on procedural grounds, cases resolved by conciliation, cases withdrawn or resolved post-conciliation but pre-arbitration, and those which went to substantive arbitration.[6]

[5] Fair Work Australia under item 20A of Schedule 18 of the Fair Work (Transitional Provisions and Consequential Amendments) Act 2009 is also required to report on the operation of the unfair dismissal system, including amounts of compensation paid, specifically for small business, but this information does not appear to be part of the reports released so far. Fair Work staff indicated this report will be released in a report approximately six months after the first three years of operation of the Fair Work Act, which unfortunately will be too late for it to be considered in the review of the operation of the system which is currently in progress.

[6] To get an idea of the overall incidence of claims we need to also consider claims lodged in the state courts which were important until the system was centralised by WorkChoices in 2006, taken further by Fair Work in 2009. Damian Oliver has kindly provided data for a representative State South Australia where there were approximately 1000 cases lodged per year from 2000 to 2005, falling to about 130 in the WorkChoices years. This means the total number of State cases is running at about half the number of Federal cases in the pre-WorkChoices years, falling to an insignificant number afterwards and we have excluded the state cases from the analysis which follows.

Table 1 - Incidence of dismissal claims (from AIRC/FWA annual reports)

Cases	*Lodged*	*Dismissed (procedure or jurisdiction)*	*Finalised*	*Conciliated*	*Finalised pre-Arbitration*	*Substantively Arbitrated*
2000-2001	8,109		7,809	6,096 (78%)	1,422	291 (3.4%)
2001-2002	8,658	223	8,658	6,719 (78%)	1,648	291 (3.4%)
2002-2003	7,121	average for	7,326	5,876 (80%)	1,209	241 (3.3%)
2003-2004	7,044	period	7,125	5,763 (81%)	1,139	223 (3.1%)
2004-2005	6,707	1997-2006	6,841	5,654 (83%)	985	202 (3.0%)
2005-2006	5,758		6,006	4,739 (79%)	1,143	124 (2.1%)
2006-2007	5,173	357	5,531	4,508 (82%)	922	101 (1.8%)
2007-2008	6,067	531	6,281	5,282 (84%)	930	69 (1.1%)
2008-2009	7,994	598	6,980	5,972 (86%)	913	95 (1.4%)
2009-2010	14,242 (includes 1188 under general protection provisions)	350 (of which 241WCh, 109 FWA)	12,745 (of which 1176 WCh 10545 FWA)	11,823 (93%)	780	142 (1.1% (of which 55 WCh 87 FWA)
2010-2011	16,768 (includes 1871 under general protection provisions)	190 (of which 5 WCh 185 FWA)	14,342 (of which 97 WCh, 14245 FW)	11,893 (83%)	1,922	367 (2.6%) (of which 5 WCh 362 FWA)
2011-2012 (1st quarter)	3,933 (includes 516 under general protection provisions)					
2011-2012 (2nd quarter)	4,031 (includes 526 under general protection provisions)					

Notes:
- Note in the 2010-11 annual report the arbitrated cases included those dismissed on procedural or jurisdictional grounds were included, so we had to remove these to reconstruct the number substantively arbitrated above.
- Note that number of lodged include those under s394 of the Fair Work Act, plus general protection dismissal actions under s365. Other general protection matters s372, of which there were 137 in the most recent quarter, are excluded.

Dismissal claims lodged under the Commonwealth legislation declined steadily from the 8,000 or so cases in 2000-2002 (the first *Workplace Relations Act* year for which we have data) to 5,758 cases in the last full year of the Act. This pattern is consistent with anecdotal evidence of gradual refinement of the unfair dismissal system after problems in the early years. The number of cases lodged then fell sharply to approximately 5,173 in the first full year of *WorkChoices* 2006-2007. Compared to the previous regime the most economically significant changes were increased coverage (through invoking the Commonwealth's corporations power), excluding claims against small businesses (defined as employing less than a hundred workers), and excluding claims for dismissals that could be attributed to 'genuine operational reasons' (a far stronger exclusion than the *Workplace Relations Act* redundancy test that the job was no longer being performed by anyone). The sharp fall in claims under Work Choices indicates the significance of these exclusions, though it should

be remembered the trend was down before the legislative change. In the first year of operation of the *Fair Work Act* 2009-2010 dismissal claims almost doubled to 14,242 (including general provisions claims involving dismissal), then further increased to almost 16,768 in 2010-2011, and the information released for the first quarter of 2011-2012 suggests they are continuing at about that level.

Note that we have included the Fair Work general protection cases in our comparison of claim numbers. We do not know the extent to which the general protection (or adverse action) dismissal cases are (i) substituting for claims that previously would have been brought as unlawful dismissal claims, or (ii) substituting for claims that could have been brought as unlawful dismissal, or (iii) new claims that would not have existed in the absence of the general provisions. Our reading of a sample of cases suggests that (ii) and (iii) predominate, so including them in the comparison is appropriate.

It is difficult to separate the contributions to the increase in numbers of claims of greater coverage (through the extension of unfair dismissal protection to small business, and the transfer of cases which would have previously been heard in State courts) and increased propensity to claim, because we have no accurate comparative information on coverage under *WorkChoices* and *Fair Work*. Determining the proportions of employees in workplaces with less than 100 employees, and the number of employees who would have submitted claims in State courts if jurisdiction had not been transferred is no small task. On an approximation that coverage increased from fifty percent of the workforce under *WorkChoices* to 90 per cent under *Fair Work* the increase in claims from the last *WorkChoices* year to the initial *Fair Work* year is almost exactly in line with the increase in coverage (eight per cent vs seventy nine per cent This suggests that coverage is the main reason for the increase in claims, though the situation is complicated by claims rising in subsequent *Fair Work* years.

It is striking how many cases are settled through conciliation, with only about three per cent of cases (see table 1) going to arbitration during the *Workplace Relations Act* years, falling to a little over one per cent during the WorkChoices years. The situation under *Fair Work* is unclear. If we accept at face value the 2.6 per cent figure for the latest Fair Work year 2010-2011 it would appear that far more claims are going to arbitration under *WorkChoices* than *Fair Work*. It is puzzling why only 1.1 per cent went to arbitration in the previous Fair Work year. A possibility is that Fair Work Australia allowed more claims to proceed to arbitration in the most recent year that would have been previously dismissed on procedural or jurisdictional grounds. The otherwise puzzling drop in the number of cases dismissed by Fair Work Australia on procedural or jurisdictional grounds (see table 1 - at a time when lodgments were rising) and the fall in the reported claimant success rate (see table 2) over these years are consistent with this speculation. Why might more claims be allowed to proceed? Fair Work Australia like most public sector agencies likes to present itself as an effective organization based on activity measures in the absence of good effectiveness measures for the public sector. Allowing more invalid or dubious claims to proceed to arbitration helps the activity measure as these cases can then be quickly dismissed at arbitration.[7] Politically the plaintiff success rate for substantively arbitrated cases

[7] A referee pointed out the timeliness measure for Fair Work Australia is to 'improve or maintain the time elapsed from lodging applications to finalising conciliations in unfair dismissal applications' and so would be unaffected.

is sensitive, and invalid claims which are then dismissed would reduce this reported success rate.

We now turn to the outcomes of the cases. Unfortunately the Fair Work Australia annual reports give no information about payouts or other resolutions for cases settled by conciliation, so it is difficult to say much about employee success rates and costs to employers in such cases.[8] It would be a reasonable to assume that many of the conciliated cases involve some payment to the dismissed employee. Law firms advising the parties presumably would have information about conciliation outcomes for cases they deal with, and there would be benefits from getting this information into the public domain with appropriate confidentiality protection. There may be concerns about how representative the data from law firms would be, and of course economists would be wary of law firms' incentives to misrepresent case outcomes to create an impression that the services are valuable to potential clients.

Employee success rate in cases which went to substantive arbitration are shown in table 2 based on AIRC/FWA annual reports. The employee success rate reported by AIRC/FWA varies from around fifty per cent in the *WRA* years, falling to an average of 45 per cent in the WorkChoices to (with a low of 38 per cent in 2008-2009), then 60 per cent for Fair Work cases in the first year of the Fair Work Act 2009-2010, though declining to forty percent in the following year 2010-2011. For the reasons given above the reported success rate for 2010-2011 may be artificially low. It does seem to us a reasonable conclusion that the WorkChoices employee success rate is lower, acknowledging that the success rates are volatile and we don't have enough data for proper statistical testing. It is also difficult to draw conclusions with only two full years of Fair Work data, and the situation will become clearer with more data.

Understanding why employees succeeded far less frequently at arbitration under *WorkChoices* than under the *WRA* or *Fair Work* is not easy because as we have observed the main changes were to eligibility, which should not in principle affect arbitrated outcomes.

One explanation might be procedural or personnel changes. Another might be perceptions of *WorkChoices* created by the intense political debate around the legislation made it harder for employees to win cases. Another explanation[9] is that

[8] There has been an intriguing battle played out in the Senate estimates committee over the release of conciliation settlement outcomes by *Fair Work Australia*. The Opposition spokesperson Senator Abetz has repeatedly asked for this information, (which it is believed Fair Work Australia holds as they will be required to report it in late 2012) but nothing has been released so far. Nor has specific information requested on outcomes of adverse action unfair dismissal cases been released. The most recent exchange in estimates 19 October 2011 ended with the Fair Work Australia representative indicating that though the information 'is in place 'releasing it' would involve reconfiguring the case management system, training all of the staff and the ongoing administrative work of entering the data'. Subsequently some information was provided by Fair Work Australia (see Parliament of Australia, 2011) about conciliation outcomes over the period 1 July 2010 - 31 January 2011. Financial payment was made in 3,084 cases, which is 44 per cent of cases based on the annual number of conciliated cases reported in the 2010-2011 annual report. Payment amounts were reported in bands, with the most common being $2,000-$3,999, and the largest payment being in the $30,000-$39,000 band. An average payment can be calculated on the assumption that payments are evenly distributed within the bands, giving $4,860. We are grateful to our discussant at the Australian Labour Market Research Workshops Greg Connolly for drawing our attention to this information subsequently provided.

[9] This explanation was suggested to us by Andrew Stewart at the 2011 Economic Society conference session where we both presented papers on the Fair Work Act.

by excluding small business *WorkChoices* removed cases that employees were more likely to win because small businesses are usually less careful in their HR practices than large businesses, and don't have the resources to maintain knowledgeable HR departments. In other words if we consider a population of cases each with a probability of an employee win, the exclusion of small business cases truncates the distribution removing the high probability cases, lowering the mean probability.

Another reason for the higher employee success rate under *Fair Work* might be the general protection (or adverse action) provisions of the Act. Anecdotal evidence suggests they are now the remedy of choice for dismissed employees, given the burden of proof is on the employer and other employee-friendly features. Unfortunately Fair Work Australia reports do not currently separate the outcomes into general protection and other cases so it is difficult to determine the magnitude of the effect of the approximately fifty percent of general protection cases on the overall claimant success rate.

Table 2 - Outcomes of arbitrated cases (from AIRC/FWA annual reports)

Arbitrated Cases	*Substantive Arbitration*	*Compensation*	*Reinstatement*	*Dismissed on Merit*	*Plaintiff Success Rate in Cases Substantively Arbitrated*
2000-2001	291	96	42	142	51%
2001-2002	291	96	47	148	49%
2002-2003	241	81	24	136	44%
2003-2004	223	84	22	117	48%
2004-2005	202	69	18	115	43%
2005-2006	124	52	17	55	56%
2006-2007	101	35	8	58	43%
2007-2008	69	17	18	34	51%
2008-2009	95	22	14	59	38%
2009-2010	142 (of which FWA 87)	51 (of which FWA 35)	22 (FWA 15)	67 (FWA 35)	51% (FWA 60%)
2010-2011	367 (of which FWA 362)	126 (of which FWA 121)	25 (all FWA)	216 (all FWA)	41% (FWA 40%)

6. Conclusions

This paper is a first look at some of the patterns of claims under the *Fair Work Act*, in comparison with *WorkChoices* and the previous *Workplace Relations Act* regimes. Our strongest findings are that:

- lodgments have increased markedly under *Fair Work* compared to *WorkChoices*, though not out of line with changes in coverage;
- employee success rates are much higher under *Fair Work* probably because of the exclusion of small business cases by *WorkChoices* which are more likely wins for employees, and because of the new employee-friendly remedies under general provisions of *Fair Work*.

Overall there is no evidence to suggest that revisions are necessary to the conclusions of Freyens and Oslington (2007) that the actual costs imposed on business by unfair dismissal regulation are small, as are the impacts on aggregate employment. We must remember that these costs include payouts of statutory entitlements which would be recoverable in absence of an unfair dismissal claims system, and that the counterfactual is not the absence of an unfair dismissal claims system (Collier, 2011) but common law claims for breach of contract, damages etc (as emphasised by Howe, 2012).

The other economic arguments about impacts through workforce quality or effort are very difficult to model (though Freyens, 2012 is an attempt at this) and even more difficult to empirically estimate. Firm conclusions about the impact on employment and other labour outcomes awaits further research on *Fair Work* payouts and productivity effects of dismissal regulation.

If the expected costs to employers of unfair dismissal actions are indeed small, then why is there so much agitation about unfair dismissal regulation? Is it concern about anything that reduces the power of employers to exercise managerial prerogative? Are employers and the associations that represent them ignorant or playing some perverse political game? We think not. Behavioral economics (e.g. Kahneman, 2003) suggests an alternative explanation of their concern about dismissal regulation. A consistent experimental finding is that agents heavily weight large low probability losses when making decisions. To the extent that payouts capped at six months wages can be regarded as large losses then we would expect these to weigh more heavily on employers minds when making employment decisions than the expected cost calculations might suggest. Another explanation might be concerns about fairness (Fehr, Goette and Zehnder, 2009) of compensation payouts weighing heavily on the participants – employers don't like paying out when they are in the right.

A theme of most of the literature surveys on dismissal regulation is how little we know about the underlying behavioural relationships, and magnitudes. We plan to further investigate these relationships taking advantage of the unique Australian natural experiment with three major changes to dismissal regulation in a relatively short period of time.

Appendix

Comparison of Commonwealth Workplace Relations Act vs WorkChoices vs Fair Work Dismissal Regulation

	Workplace Relations Act 1993	*WorkChoices (the WR Amendment Act 2005) which operated*	*Fair Work Act which operated from*
Characteristic	Amended in 1996	from March 2006	July 2009
Coverage of Workforce	About 50%	About 50%, taking into account exemptions.	About 90%
Test for Unfair Dismissal	'harsh, unjust or unreasonable ' Some dismissals also unlawful	Same	Same
Employer Size Threshold for Claims	No threshold	>100 employees	>15 employees, with others covered by *Small Business Fair Dismissal Code*.
Qualifying Period of Employment for Claims	3 months	6 months	6 months for large
Time Limit to Lodge Claims			12 months for small
Exclusions	Casuals	Casuals	Casuals
	Contractors	Contractors	Contractors
	Trainees	Trainees	Trainees
	Fixed term employees	Fixed term employees	Fixed term employees at end of term
	High wage employees	High wage employees	Employees earning >113K indexed, if not covered by award or agreement.
Redundancy Definition	'job performed by no-one'	'genuine operational reasons'	'genuine redundancy'
	Reluctance of courts to intervene in employer judgments about economic reasons.	No need for employer to show that this was the only reason, or that the operational reasons made the dismissal necessary.	
Remedies	Reinstatement. Compensation, capped at 6 months	Reinstatement. Compensation, capped at 6 months	Reinstatement. Compensation, capped at 6 months
General Protections	None	None	Dismissal claims possible under adverse action provisions s365

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