

*Industrial Relations Act 1979*

**IN THE WESTERN AUSTRALIAN INDUSTRIAL RELATIONS COMMISSION**

**No. 784 of 2004**

**PARTIES** TRADES & LABOR COUNCIL OF WESTERN AUSTRALIA

**APPLICANT**

**-v-**

MINISTER FOR CONSUMER AND EMPLOYMENT PROTECTION,  
CHAMBER OF COMMERCE & INDUSTRY OF WESTERN AUSTRALIA  
and the AUSTRALIAN MINES AND METALS ASSOCIATION INC

**RESPONDENTS**

MINISTER FOR EMPLOYMENT AND WORKPLACE RELATIONS (CTH)

**INTERVENOR**

WESTERN AUSTRALIAN FARMERS FEDERATION, WA HOTELS &  
HOSPITALITY ASSOCIATION INC UNION OF EMPLOYERS, MOTOR  
TRADES ASSOCIATION OF WESTERN AUSTRALIA (INC), HOUSING  
INDUSTRY ASSOCIATION, WA RETAILERS ASSOCIATION (INC), WA  
SMALL BUSINESS ASSOCIATION, COMBINED SMALL BUSINESS  
ALLIANCE OF WESTERN AUSTRALIA (INC) and THE WESTERN  
AUSTRALIAN SMALL BUSINESS AND ENTERPRISE ASSOCIATION  
INC

**OTHER ORGANISATIONS**

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**INTERVENOR'S OUTLINE OF SUBMISSIONS**

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## **Directions**

1. The directions specified:

*THAT the Minister, the Federal Minister, the CCIWA and AMMA shall file their outline of submissions and list of witnesses to be made available for cross-examination by 10 November 2004.*

## **Witnesses to be called**

2. The Commonwealth wishes to cross-examine David Bryan Christmas, Acting Director Economic Policy Division, State Department of Treasury and Finance.

## **Commonwealth's contentions**

3. The Commonwealth's primary contentions are set out in the document *Commonwealth's Submission Materials* that is at tab 1 of the materials previously lodged with the Commission.
4. Set out below is the Commonwealth's preliminary response to some of the key contentions advanced by the Trades and Labor Council of Western Australia (TLC) in its written outline of submissions. The Commonwealth will respond in greater detail to the TLC's contentions in the hearings that have been scheduled from 22 November 2004.

## **Retention of the small business exemption from severance pay**

5. The TLC's contentions fail to respond seriously to much of the substantial body of evidence and analysis advanced in the Commonwealth's submission materials in support of the retention of the exemption. This material demonstrates that small businesses have significantly less capacity than larger businesses to cope with severance pay.

### *Profits and financial resilience*

6. The TLC relies primarily on ABS data about the profitability of small and large business to support its contention that small businesses do have the capacity to pay severance pay. Broadly, this data suggests that much the same proportion of small businesses as larger businesses make a profit in a given year.

7. However, there is clear evidence that this does not prove that small businesses are much the same as larger businesses in terms of their financial capacities, viability and ability to withstand financial shocks such as severance pay.

8. For example, small businesses are far more likely to fail than larger businesses. For example, the Productivity Commission Staff Research Paper *Business Failure and Change: An Australian Perspective*<sup>1</sup> indicates that over a particular two year period, small businesses with less than 20 employees ceased operation at twice the rate of all other businesses.

9. This proves beyond doubt that the viability of small business is significantly different to large business despite the fact that much the same proportions of each might make a profit in any given year. It shows that the TLC's simplistic argument that small businesses have much the same financial capacity as large business because similar proportions make a profit in a given year is wrong. Making a profit is obviously not the whole story.

10. The fundamental difference between the financial capacities of small and large businesses was also attested to by the evidence of the Australian Council of Trade Union's (ACTU) expert witness on insolvency matters, Mr Michael Humphris, in the federal redundancy test case. As outlined in the Commonwealth's submission materials, he pointed to the fact that small businesses are different to larger businesses in their ability to restructure to avoid failure. This is because they particularly lack the fixed assets acceptable to lenders for the purpose of advancing the necessary funds to restructure the enterprise.

11. The reason for these fundamental differences in the financial capacities of small and larger businesses is explained in detail in the Commonwealth's submission materials by reference to extensive academic research and other analysis. This research shows that the genesis of these financial differences is the lesser ability of small business to raise external finance on reasonable terms. For instance, the Industry Commission's Staff Research Paper *Small Business Employment* found that:

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<sup>1</sup> Bickerdyke, I., Lattimore, R. & Madge, A. (2000) 'Business Failure and Change: An Australian Perspective', Productivity Commission Staff Research Paper, December in AIRC Exhibit ACTU 3, Tag 2, pages 18 and 19 of the paper.

*Large businesses have advantages accessing finance — ultimately reflecting lower transactions costs. For example, large business:*

- *can access equity through organised stock markets. The fixed costs of flotation, prospectuses, appropriate due diligence requirements and other components of the cost of issuing formal equity are typically beyond small businesses.*
- *can obtain debt finance from the banks at lower interest rates and less onerous collateral requirements than small firms (BIE 1991) — reflecting the lower costs of monitoring and dealing with loan applications by larger enterprises. For example, the costs of assessing a loan for \$5 million to a large company are much less than 100 times the costs of assessing a loan of \$50 000 to a small business.*

*Large firms engaged in many diverse activities are also able to spread risks more effectively than small enterprises involved in few activities. Theoretically, in the absence of frictions in the formal equity market, risk spreading could be achieved by shareholders holding diversified share portfolios in many small enterprises. However, the transactions costs of organising a formal sharemarket for very small firms favours some degree of risk spreading within larger enterprises.<sup>2</sup> [our emphasis added]*

12. In summary, small businesses are generally unable to access finance on reasonable terms, are therefore chronically undercapitalised, and do not have the reserves or the capacity to raise the funds to meet large unpredicted impositions such as severance pay. This holds true whether or not a small business makes a profit in any particular year.

13. The fact that a small business might make a profit in a particular year does not mean that it is financially resilient. It does not mean that the business has sufficient reserves to cover severance pay. Nor does it mean that the business can obtain sufficient additional finance to cover severance pay. It therefore does not mean that the business can cope if an external shock causes it to have to retrench employees and pay significant amounts of severance pay. This is particularly the case if the shock is in the form of a sudden drop in demand or other financial stress.

14. The TLC's contentions do not respond to the extensive body of research and other analysis presented by the Commonwealth's submission materials to explain the relative lack of financial resilience of small business and its consequent lesser capacity to cope with severance pay.

15. However, at paragraph 191 and 192 the TLC attempts to portray evidence from the federal test case as supporting its view that whether or not a business makes a profit in a particular year is the key to

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<sup>2</sup> Revesz, J. and Lattimore, R. (1997) Small Business Employment. Industry Commission Staff Research Paper.

understanding its financial capacity. First, the TLC quotes from the cross-examination of Mr Taylor, a liquidator specialising in small firm liquidations. The line of question is directed at showing that profitability is the key to a small business obtaining bank finance for a restructure, and the TLC is apparently suggesting that Mr Taylor's answers concede this. They do not. Despite the pressure of the cross-examination, Mr Taylor makes no such concession, and in fact indicates that it is the security that can be given to a bank that is the key. As we indicate above, the evidence of Mr Humphris is that small businesses have a particular difficulty in financing restructures by providing such security from within the business. In summary, the evidence referred to by the TLC in fact confirms that whether or not a business makes a profit in a particular year does not determine its financial capacity.

16. Second, the TLC quotes a small portion of the cross-examination of Mr Humphris to suggest that profitability is the key. However, this is not the case when this portion is seen in the context of Mr Humphris' witness statement and all his oral evidence. As detailed in the Commonwealth's submission materials, Mr Humphris clearly distinguished between the financial capacities of small business and larger business. In fact, at the conclusion of the line of cross-examination quoted in part by the TLC, he clearly acknowledged this difference:

*But in the event that they do have to go for additional finance, as you point out in paragraph 13, small businesses are in a particularly difficult position compared with large businesses?---They can be, yes.<sup>3</sup>*

17. Once again, the evidence is clear that the financial capacities of small businesses are significantly different to those of larger businesses, despite the fact that the same proportion of each may make a profit in any given year.

*Small businesses that are closing and shedding staff are not profitable: misinterpretation of Productivity Commission Paper*

18. As part of its fallacious argument about profits, the TLC refers to ABS data about the proportion of businesses that make a profit in a year in which employment with the business decreases. The TLC fails to acknowledge that the data for small businesses cannot be properly related to the data for larger businesses because at the time larger businesses had to make severance payments, while small businesses did not.

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<sup>3</sup> Federal Redundancy Test Case, transcript, 29 May 2003 at PN2821.

19. The TLC's contentions then go on to claim that the findings of the Productivity Commission Staff Research Paper *Business Failure and Change: An Australian Perspective*<sup>4</sup> support the view that many small businesses that are reducing employment are profitable. The Commonwealth's submission materials provides a detailed analysis of the Paper to demonstrate that it does nothing of the sort. The TLC has not provided a detailed response to our particular assertions and analysis. Instead the TLC contentions provide a short and confusing commentary that accuses the Commonwealth of sleight of hand and muddying the waters.

20. The Commonwealth invites the Commission to examine closely the analysis of this issue contained in the Commonwealth's submission materials, and if there are any points that require clarification, we will be happy to do so at the programmed hearings. The Commonwealth considers that the material in the Productivity Commission Paper referred to by the TLC (and by the ACTU in the federal case) does not support the inferences they wish to draw, and that any decision that is built on it would be unsafe. We will give one specific example here to demonstrate this.

21. In support of the view that many small businesses that are reducing employment are profitable, the TLC cites the finding of the Productivity Commission Paper that *"the single greatest reason for business exit is realising a profit"*. Now the TLC's contention could be accepted if the Paper was saying that the single greatest reason for business exits that involve reductions in employment is realising a profit. But the paper is not saying that. Using the Paper's definitions, business exits include business sales as well as business cessations that involve retrenchments. An examination of the study from which the Paper drew this finding reveals that 83 per cent of the exits that were to realise a profit were cases in which the exit was a change in ownership. Only 17 per cent involved cessation of the business. The Summary of Chapter 2 of the Paper states clearly:

*Business exit should be distinguished from business failure. There are many reasons for businesses to exit, not least of which is taking advantage of an option of realising a profit from the sale of the business.*

22. So the Productivity Commission Paper is saying that the single greatest reason for change of business ownership (eg the sale of a business) is realising a profit. This does not at all support the contention

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<sup>4</sup> Bickerdyke, I., Lattimore, R. & Madge, A. (2000) 'Business Failure and Change: An Australian Perspective', Productivity Commission Staff Research Paper, December in AIRC Exhibit ACTU 3, Tag 2.

that many small businesses that are reducing employment are profitable. To claim that it does is to misunderstand the Productivity Commission's Paper, or to intentionally mislead. Unfortunately, the AIRC's decision accepted this contention put to it by the ACTU without discussing the Commonwealth's analysis of the Productivity Commission's Paper. This Commission's decision should not.

23. The TLC's contentions also claim in paragraph 202 that the Senate Employment, Workplace Relations and Education Committee Report on Small Business Employment in 2003 supported the view that small business should not be exempted for employment-related regulations. However, the TLC has not included in its contentions the fact that the Report was not agreed in full by Government Senators. In particular, Government Senators supported the exemption of small business from unfair dismissal regulation on grounds that are highly relevant to the small business exemption from severance pay. Contrary to the impression created by the TLC's contentions, the Report was split on this issue on political lines, and it certainly does not represent independent support for removal of small business exemptions from employment-related regulations.

*Misinterpretation of data about small businesses that already pay severance pay*

24. The second of the three reasons given by the AIRC's decision for its finding that small businesses do not lack the financial resilience to make severance payments was that some small businesses do make severance payments despite no legal obligation to do so. The Commonwealth's submission materials showed that the AIRC's decision seriously misinterpreted the key evidence that influenced it on this issue. However, the TLC's contentions do not refer to this evidence at all. This is despite the fact that the TLC's contentions rely in large part on the AIRC's decision. Has the TLC omitted to deal with this issue because it knows the AIRC's decision is mistaken? If so, it is disturbing that the TLC seems willingly to urge this Commission to adopt an approach to severance pay that is largely based on the AIRC's decision, without drawing to this Commission's attention a serious mistake in that decision.

*Simplistic comparisons across jurisdictions cannot prove anything*

25. The third reason given by the AIRC for its conclusion related to comparisons across jurisdictions. The Commonwealth's submission materials demonstrated why these simple comparisons could not identify

the effects of the different severance pay regimes in different jurisdictions. The TLC has not seriously addressed the Commonwealth's arguments in its contentions.

26. In paragraph 200 of its outline of submission, the TLC cites a Melbourne Institute Working Paper as evidence that "small business may be particularly resilient in times of recession". This working paper in fact did not itself research the issue of small business employment growth in recessions, but made the observation in reference to a paper titled "Employment growth by firm size category", by Johnson D, Kenyon P, and Ha V, published in the journal *Labour Economics and Productivity*.

27. In actual fact, the article by Johnson et al did not draw this conclusion. What they do observe is that net employment growth in small businesses is "overstated" during recessions and understated during upturns in the business cycle.<sup>5</sup> This is due to the fact that the numbers of people employed in the small business sector can increase during a recession due to large businesses "downsizing" during this time and "joining" the small business sector. Johnson et al are making the point that any job increases in small firms during economic downturns tend not to be the result of newly created jobs being generated, but rather a transfer of jobs from one firm size category to another. This does not mean that small businesses are less prone to job losses during a recession.

*Incapacity to pay provisions will not protect small businesses that should be protected*

28. The TLC's contentions go on to claim that if the small business exemption is removed, any small business that has an incapacity to pay severance pay will be able to obtain an exemption under the incapacity to pay provisions. In support of this view, the TLC was not able to identify even one case in any jurisdiction in Australia where an industrial tribunal has granted an incapacity to pay application to exempt a large business from severance pay.

29. In relation to this jurisdiction the TLC was able only to point to two cases – one in which the Commission refused to grant severance pay where severance pay had not applied previously, and one in which the employer reached agreement with the relevant union to exempt the employer from a pre-existing severance pay obligation.

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<sup>5</sup> Johnson D, Kenyon P, Ha V (1995), "Employment growth by firm size category", *Labor Economics and Productivity*, Vol 7, pp.49-72

30. In the face of the near-universal failure since 1984 of the incapacity to pay provisions to exempt larger business that cannot afford severance pay, the TLC contentions fail to demonstrate that incapacity to pay provisions will protect small businesses that warrant exemption. In addition, the TLC has not responded to our submission that the incapacity to pay provisions are not intended to serve the same purpose as the small business exemption.

*No authoritative arbitral precedent that has been properly informed has failed to support the exemption*

31. The TLC's outline of submissions referred to a number of decisions of this Commission and of other tribunals that have questioned the justification for the small business exemption from severance pay. However, these decisions generally reflect the fact that the tribunals were not presented with the substantial body of research and other evidence that demonstrated the relative inability of small business to cope with severance pay. Apart from the recent AIRC federal test case, none of these decisions emanated from proceedings which had the benefit of the large amount of significant material which has been put in these proceedings about the relative lack of financial resilience of small business.

### **Inadequacies in the TLC's costings**

32. The main part of the TLC's costings of their claim focus on estimating the cost of the claim as a proportion of the wage bill of the total Western Australian economy. This approach produces a very misleading impression of the economic impact of the claim. The immediate and direct impact of the claim does not fall on all employers across the Western Australian economy, covered by both federal and State awards. Instead, the direct costs arising from the claim fall only on those employers who actually retrench and whose costs would increase as a result of the claim. Contrary to the impression created by the TLC's costings, the claim does not represent a small cost increase born by all employers. Rather, it would impose a much more significant and potentially damaging increase on a much smaller subset of employers – those who actually retrench employees in any given year. In its recent TCR test case the Queensland Industrial Relations Commission (QIRC) acknowledged that treating the cost impact as if it is spread across all employers is inappropriate, finding that “[w]e do not consider it that helpful to estimate a cost spread across a

*whole community when many businesses would never have an occasion to make an employee redundant.”<sup>6</sup>*

33. At paragraph 237 of its outline of submission, the TLC eventually provides costings that are more relevant to assessing the real impact that its claim would have. It states that its claim would increase the total wages bill of firms covered by its claim by around 0.17 per cent, and would increase the total wages bill for firms that actually reduce their workforce by nearly 1 per cent (0.93). Strangely however, it derives these estimates not from its own costings, but by reworking the WA Government's estimates. We have filled this gap in the TLC's analysis by using its costings to calculate these two critically important estimates. Based on the TLC's costings, the estimate of the extent to which the TLC claim would increase the total wages bill of firms covered by the claim is 0.11 per cent, and the estimate of the extent to which it would increase the wages bill for firms that actually retrench is 0.62 per cent.

34. However, these estimates are only as good as the costings on which they are based. Unfortunately the TLC costings exhibit a number of deficiencies that have to be corrected before they can produce accurate estimates of the impact of the TLC claim on the businesses that are actually impacted by the claim, and on businesses that actually retrench employees in any year. We will demonstrate below that the estimates derived from the TLC costings are serious underestimates, particularly for small business.

*The retrenchment rate used by the TLC is far too low*

35. The most significant source of underestimate in the TLC's costings results from the retrenchment rate that it uses. The TLC uses a retrenchment rate that is substantially less than the rate recognised by Australian labour market economists and confirmed in uncontested evidence in the federal redundancy test case. The number of retrenchments used by the TLC in its costings equates to a retrenchment rate of about 1.9 per cent (this rate is calculated by dividing the annual number of retrenchments used by the TLC in its costings by the average level of employment over the relevant period). In stark contrast, the retrenchment rate that is repeatedly cited in material the ACTU provided in the federal redundancy case in exhibit ACTU 2 and that was given by Professor Webber in that case was around 4 to 5 per cent. Specifically, according to Murtough and Waite in their paper in exhibit ACTU 2 at tab 6:

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<sup>6</sup> QCU v QCCI [2003] QIRComm 383 (18 August 2003), 173 QGIG 1417 at paragraph 72.

*Since the mid 1970s, the aggregate annual rate of retrenchment (number of people retrenched relative to the number who had a job at some time in a 12 month period) has fluctuated in a counter-cyclical pattern around a relatively stable long term trend of about 5 per cent.<sup>7</sup>*

*The rate of displacement in other developed economies appears to be close to the 5 per cent retrenchment rate recorded in Australia. ... Other studies have estimated that the average annual rate of displacement is 5 per cent in Canada, Belgium and Britain ...<sup>8</sup>*

36. Similarly, Webber and Campbell in their paper in Exhibit ACTU 2 at tab 3 state that:

*Even in relatively good years, retrenchment is part of the experience of nearly one in every twenty workers.<sup>9</sup>*

37. ACTU witness Professor Webber under cross-examination generally indicated that the current retrenchment rate was between 4 and 5 per cent.<sup>10</sup>

38. In fact, Professor Webber went on to say that the rate has not fallen below 4 per cent in the last 30 years.<sup>11</sup> Why then does the TLC use a rate of around 1.9 per cent in its costings? Is the TLC seriously suggesting that Australia's labour market economists, including Professor Webber, have got it wrong to such an extent? If it does, it should have explicitly explained the reasons for its belief. But it has not done so. Its outline of submission does not even acknowledge that the retrenchment rate it uses in its costings is around half the rate recognised repeatedly in the other material that the ACTU presented in the federal test case. Apparently the TLC is unaware that the retrenchment data it uses to calculate the cost impact of its claim are contradicted by the expert evidence and material that the ACTU put in the federal redundancy test case.

39. The TLC's mistake is due to its use of highly problematic estimates of retrenchment rates from the ABS *Retrenchment and Redundancy* survey. Apparently due to a respondent recall problem, the retrenchment numbers in at least the first two years of the survey seriously underestimate actual retrenchment rates (a detailed demonstration of the problematic

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<sup>7</sup> Exhibit ACTU 2, Volume 2 - Redundancy General, Tab 6 at page 136.

<sup>8</sup> Ibid, at page 154.

<sup>9</sup> Ibid, Tab 3 at page 64.

<sup>10</sup> Federal Redundancy Test Case, transcript, 27 May 2003 at PN1091.

<sup>11</sup> Federal Redundancy Test Case, transcript, 27 May 2003 at PN1092.

nature of these retrenchment rates which are substantially below those indicated by Professor Webber is set out in Attachment A).

40. Because it uses these low retrenchment rates, the TLC's costings seriously underestimate true costs. However, it is a simple matter to adjust the TLC's costings to correct this flaw. If the costings are amended using 4 per cent as a conservative estimate of the long run retrenchment rate, then the numbers of retrenched used in the TLC costings increase by a factor of 2.1, and the TLC's cost estimates also increase by this factor.

41. Correcting the TLC's costings in this way increases the estimate of the impact of its claim on the total wages bill of firms impacted by its claim to around 0.23 per cent, and on the total wages bill for firms that actually reduce their workforce to around 1.30 per cent.

*Focusing the estimates on those employers that bear the cost of the claim*

42. A second serious problem with those estimates is that they do not in fact express the impact as a proportion of the total wages bill of firms actually impacted by the claim. This arises because the TLC has reduced its estimate of the cost impact by 20 per cent on the basis that an estimated 20 per cent of private sector employees in the Western Australian jurisdiction will already be entitled to severance pay at or above the level it seeks (see paragraph 227 of its outline of submissions).

43. It is therefore necessary to adjust for this 20 per cent when calculating the impact of the TLC claim on businesses whose costs would be increased by its claim. This can be corrected by increasing the TLC estimates by a further factor of 1.25.

44. Correcting the TLC's costings in this way increases the estimate of the impact of its claim on the total wages bill of firms whose retrenchment costs are increased by its claim to around 0.3 per cent, and on the total wages bill for firms that actually reduce their workforce and whose costs are increased by the claim to around 1.6 per cent.

45. There is a further problem with the TLC's costings that result in underestimation of the cost impact of the claim. As part of its costings, the TLC must estimate the average wages of employees who are retrenched. It needs to do this so that it can then estimate the cost of retrenching these employees given the severance pay entitlements that arise under the TLC claim. At paragraph 222 the TLC adjusts its estimate of the average wages

paid to retrenchees to account for the fact that private sector wages are, on average, less than public sector wages.

46. However, the TLC has ignored the equally important adjustment that has to be made to reflect the fact that permanent and full-time employees earn considerably more than average earnings. Instead it has used average private sector wages for all employees, including part time and casual employees, to derive its estimate. This average is considerably less than the average wages of retrenchees who are entitled to severance pay under the TLC claim. ABS data from the Retrenchment and Redundancy survey purchased by the Commonwealth show that 95% of private sector retrenchees who are entitled to severance pay under the TLC claim are full-time employees. The remainder are part time permanents.

47. Correcting for this source of underestimation in the TLC costings requires an estimate of the average wages of the class of employees that have the characteristics of retrenchees ie the class in which 95 per cent of employees are full time permanents, and in which 5 per cent are part time permanents. May 2002 Employee Earnings and Hours unpublished data on average earnings by full-time/part-time and permanent/casual were used to derive this better estimate of average wages for retrenchees. Incorporating this estimate increases the impact of the claim on the total wages bill of affected firms by 22 per cent to 0.36% of their wages bill, and the impact on firms that actually retrench by 22 per cent to 1.98% of their wages bill.

*The TLC costings further underestimate the impact on small business*

48. The TLC's costings further underestimate the impact of the TLC's claim on small businesses. The TLC estimates don't differentiate between small and larger businesses. They produce the same cost impact for both. But this is obviously incorrect. At paragraph 228 of its outline of submissions the TLC explains that it reduced its costings based on the assumption that 30 per cent of employees in the State jurisdiction in Western Australia were already in receipt of the severance pay at the old TCR standard for larger businesses. This assumption is obviously incorrect for small businesses that were exempted from severance pay under the old standard.

49. In adjusting its estimates to take account of the 30 per cent of employees in receipt of the old standard, the TLC calculated that the cost for businesses under the old TCR standard was equivalent to 0.016% of

the wages bill. The TLC then subtracted this from the cost of the new standard to come up with an estimated net cost. In order arrive at a better estimate of the cost to small business, we have added back into the TLC calculations the estimated cost under the old standard. After doing so, the cost to small businesses impacted by the decision is equivalent to 0.45% of their wage bill, and the cost to those small businesses which actually retrench would be equivalent to 2.5% of their wages bill.

50. A further adjustment needs to be made to the TLC's estimate of the impact of the claim on the wages bill of small businesses that actually retrench in any year. This is because the proportion of small businesses that retrench in any year is lower than the proportion of larger businesses. The TLC estimates assumed from the Australian Workplace Industrial Relations Survey data that 18 per cent of businesses retrench in any year. But the same data show that 13 per cent of small businesses do.

51. Correcting for this, it is estimated that the impact of the TLC claim on those small businesses which actually retrench would be to increase their wages bills by 3.5 per cent on average.

52. Once the TLC's estimates are corrected, they demonstrate that we do not live in some kind of fools paradise where severance pay can be increased significantly or imposed on small businesses with negligible cost impact.

*The Commonwealth estimates are appropriate*

53. Once all these significant corrections are made to the TLC's estimates, their methodology is broadly comparable to that used by the Commonwealth to develop its estimates of the impact on small business.

54. The TLC dismissed the Commonwealth's estimates on the basis that the AIRC in the federal redundancy test case had described the Commonwealth's estimates in that case as "probably an overestimate" (paragraph 121 of the decision). However, an examination of the reasons given by the AIRC in its assessment reveals that that comment is not applicable to the Commonwealth's estimates in this case, or to our criticism of the TLC's estimates.

55. The AIRC, at paragraph 121 of its decision, gave two reasons why the Commonwealth's estimate of the increase in wage costs on average for private sector employers covered by federal awards was probably an overestimate. First, the Commonwealth's estimate was based on

recessionary conditions. Second, no allowance was made for the fact that about 20 per cent of private sector employees covered by federal awards are entitled to severance benefits greater than those in the TCR standard clause. The first reason does not apply to our estimates in this case because we have calculated estimates for recessionary and non-recessionary conditions. Furthermore our adjustments to the TLC's estimates are based on a conservative estimate of the long run retrenchment rates, not on recessionary rates.

56. The second reason is not significant in this case because the Commonwealth's estimates deal only with the impact of the claim in relation to small business. The proportion of small businesses that are already paying severance pay above the level applying to large businesses is not likely to make a significant difference to the Commonwealth's estimates. In any event, the key estimates for determining the impact of the TLC's claim are those that estimate the average impact on the wages bill of businesses whose severance costs are increased by the claim. As we have seen above, these estimates are unaffected by the proportion of businesses that are already paying severance at the level claimed by the TLC.

*The cost impact will increase significantly in unfavourable economic conditions*

57. The TLC also strongly criticises the Commonwealth for providing estimates to this Commission of the cost impact of the claim in recessionary conditions as well as in non-recessionary conditions. The TLC argues that the cost impact of the claim when higher, recessionary rates of retrenchment apply is irrelevant. The TLC seems to suggest that the impact on employers of the claim would be less in recessionary conditions than in normal conditions.

58. The TLC's suggestion is obviously complete nonsense. In recessionary conditions the impact on employers of severance pay will be much higher because of the much higher rate of retrenchment. And, on average, employers will be less able to cope with the severance costs of a given level of retrenchment, let alone a much higher level, due to the impact of the recession on their businesses.

59. The cost impact of the claim in unfavourable economic conditions is obviously highly relevant and should be taken into account. Any severance pay standard has to be affordable and viable during the worst economic conditions. Since retrenchment rates are about 70 per cent higher in

recessionary conditions, the TLC's estimates can be readily adjusted so that their impact in recessionary conditions can be assessed. For small businesses, recessionary rates of retrenchment takes the TLC's estimates of the impact of its claim on the total wages bill of small businesses whose retrenchment costs are increased by its claim to around .76 per cent, and on the total wages bill for small businesses that actually reduce their workforce and whose costs are increased by the claim to around 5.9 per cent.

*The TLC has ignored the impact of the contingent liability*

60. The TLC's costings also ignore the impact of the claim on employers who are not retrenching. The TLC's costings are founded on the premise that costs arise from the claim only when an employee is retrenched. They assume that no costs arise for employers in relation to all employees who are not retrenched in any given year. The TLC's costings therefore attribute no cost to employers in relation to over 90 per cent of employees who are not retrenched in any year.

61. The TLC's approach is wrong and contradicted by the expert evidence of the ACTU witness in the federal redundancy case, Mr Humphris. Contrary to the TLC's position, the granting of the claim would have a very significant impact on all employers subject to the claim, regardless of whether they actually retrench employees in any given year. The claim, if granted, would create a very substantial additional contingent liability for all employers in relation to each of their employees subject to the claim. The contingent liability is the amount of severance pay that an employer would have to pay out to each employee if the employee was retrenched. It is the amount that an employer would have to set aside if unions succeeded in their objective of requiring employers to pay sufficient amounts into Manusafe-type funds to cover the severance pay entitlements of all employees. The ACTU's witness in the federal case, Mr Humphris, concurred that, should funds for severance pay have to be paid into a Manusafe-type fund, the full amount would be required to appear on the company's balance sheet.<sup>12</sup>

62. Most importantly, the contingent liability is also the amount that banks take into account when calculating the amount of security that a business could offer for loans, and when assessing the risk profile of a business. The ACTU's witness Mr Humphris indicated that when banks assess how much security a business could provide for a loan, they

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<sup>12</sup> Federal Redundancy Test Case, transcript, 29 May 2003 at PN2813.

consider the 'worst case scenario'. They consider the scenario where the business ceases operation and pays all employees their full entitlements, including severance pay. Mr Humphris also indicated that banks would take such a 'worst case scenario' into account when assessing the risk profile of a business and the interest rates they will charge the business. For example, he said:

*Well, when a bank does do an appraisal of a potential credit facility, they will make an assessment of the company's security position based on its assets and liabilities, and they will do that on the appraisal of the worst case scenario which tends to be in a liquidation sense. So they will value the assets at very low prices based on probably liquidation realisation values, and they will also then put value on the liabilities that would rank ahead of them which would clearly include employee entitlements and any contingencies in the circumstances of a redundancy payment. They will measure that. But banks will not lend based on security position. They will only lend on the ability of the business to actually repay its debt. So unless the business stacks up from an operating perspective and can clearly demonstrate its financial performance capabilities, they will not lend. They won't lend based on security alone.<sup>13</sup>*

63. The TLC has not provided the Commission with an estimate of the additional contingent liability that would be produced if the claim were granted. The Commonwealth's calculations show that the additional contingent liability created by the claim for small businesses would be significantly greater than the direct costs that would arise from the claim when employees are actually retrenched. These estimates are outlined in the Commonwealth's submission materials.

64. As we have indicated, the TLC's costings are founded on the assumption that costs arise only when employees are retrenched. The TLC attempts to justify this assumption on the basis that current accounting rules do not require employers to include severance payments in their accounts unless employees are actually to be retrenched. But the TLC is wrong to infer from this that no additional costs arise, for the following reasons.

65. First, prudent employers will put aside funds for severance entitlements where they are able to do so. The fact that accounting requirements do not force businesses to provide for severance pay does not mean that there are not good business reasons to do so. If a business is to be able to survive significant downturns in demand and lost contracts, it needs to ensure that it has reserves to deal with redundancies if they

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<sup>13</sup> Federal Redundancy Test Case, transcript, 29 May 2003 at PN 2716.

arise. In the recent Queensland TCR test case the Queensland Commission concluded that “[c]learly, a prudent employer would need to provide for a contingent liability”.<sup>14</sup> A number of employer witnesses in this case confirmed this. For example:

*[Mr Watson] So you are saying, are you, that your accountant has advised you that notwithstanding that you are not required to put money aside, that you should in any event put money aside?*

*[Mr Ali] He put the question to me. If this comes tomorrow, you are going to spend 15,000 or something like this on redundancy, where is the fund? I mean the cashflow is very tight. Where I have really to keep playing with when the creditors and debtors to satisfy both of them, where is the money coming from and he has to come up with an advice that you have to really put money aside and in the situation there where you face redundancies. So in a word, it is not required by law but by method of making business viable, you have to take this into consideration.<sup>15</sup>*

66. Although businesses may not accumulate unencumbered reserves to cover the full contingent liability for severance pay, the magnitude of the contingent liability is such that what they do put aside will have a very significant impact on their labour costs. The TLC’s costings are obviously wrong because they assume that no employer affected by the claim will accumulate any additional reserves if the claim is granted. The TLC assumes no impact at all.

67. Second, as we have indicated above, the evidence of the ACTU’s witness Mr Humphris is that banks take account of an employer’s full contingent liability for severance pay when they determine how much they will lend to a business, and when they set the interest rates they will charge. Again, the impact of this will be substantial if the TLC’s claim is granted. If the TLC’s claim is granted, an employer’s ability to provide security for loans will be reduced by the extent of the full contingent liability created by the claim. If businesses are required by lenders to provide the same level of security for loans that they do now, they will have to accumulate unencumbered assets or other security to cover the full additional contingent liability. The end result would be similar in cost to having to provide for the full additional contingent liability.

68. The TLC’s costings are obviously wrong because they ignore these factors. The TLC’s costings assume that no business would incur higher interest rates or have its borrowing capacity reduced or have to accumulate

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<sup>14</sup> QCU v QCCI [2003] QIRComm 383 (18 August 2003), 173 QGIG 1417 at paragraph 72.

<sup>15</sup> Federal Redundancy Test Case, transcript, 7 August 2003 at PN 5283.

additional unencumbered reserves if the claim were granted. The TLC's position is clearly contradicted by the evidence in the federal redundancy test case, particularly by the evidence of the ACTU's witness Mr Humphris.

69. To the extent that businesses choose to accumulate reserves to cover the severance pay liability, or are forced to do so by the lending policies of banks and others, it is clear that the economic impact of the claim is many, many times higher than the TLC's estimates. But employers who do not accumulate these reserves will also be detrimentally affected by the claim. If they do not have money set aside, and have to undertake retrenchments, they are likely to have difficulty in funding the severance payments. This is particularly the case if the retrenchments are necessitated by deterioration in the business cycle, falling demand or financial difficulties. Firms that have not provided adequately for severance pay will have a very powerful incentive to avoid retrenchments. This can produce risk-averse behaviour including reduced hirings, which will have wider economic costs. Most small businesses will fall into this category of businesses that fail to accumulate reserves. This is because they cannot use their business as security for bank finance, and must use their private home instead. As a consequence, they are not subject to the supervision by banks of their business that might otherwise force them to accumulate reserves.

### **Transmission of business provisions**

70. Clause 4.7.2 of the TLC's application seeks to limit the circumstances in which redundancy provisions, including severance pay, would not apply where a business is transmitted from one employer to another employer. These circumstances are:

- where the acceptance of employment with the transmittee is conditional on the employee being employed under an Australian workplace agreement (AWA); or
- where an employee was employed under a collective agreement with the transmitter, but acceptance of employment with the transmittee is conditional on employment being under a statutory individual agreement under the *Industrial Relations Act 1979*; or
- unless the employee is offered employment by the transmittee under an award, order or collective agreement under the *Industrial Relations Act 1979*.

71. The TLC does not appear to be taking this aspect of its application seriously. It devotes only two paragraphs of its outline of submissions to this element of its claim.

72. Nor does the TLC contest (or even comment on) the Commonwealth's key argument that its claim is inconsistent with arbitral history that confirms the inappropriateness of severance pay being paid where businesses are transmitted from one employer to another employer.

73. The TLC has ignored Commonwealth arguments that under the TLC's proposal an employee who suffers none of the losses or hardships for which severance pay is intended to compensate, may still receive severance pay purely dependent on the type of industrial arrangement under which he or she is employed by the transmittee.

74. The Commonwealth reiterates that this is a nonsensical claim. It would result in unnecessary inequities among employees and between employers.

75. The TLC further ignores the fact that both AWAs and federal certified agreements (CA) are protected by the legislative requirement of a no-disadvantage test. Although, in paragraph 41 it does allude to employees on AWAs being covered by the no-disadvantage test.

76. The no-disadvantage test provided in section 170XA of the *Workplace Relations Act 1996* prevents an AWA or CA from reducing the overall terms and conditions to which employees covered by the agreement are entitled under any relevant award/s and laws. Employees covered by these industrial instruments are in no way disadvantaged compared to employees who have their terms and conditions regulated by some other industrial instrument, say a State or federal award.

77. The TLC has provided no evidence to substantiate its contention in paragraph 106 that State collective agreements are the best way to ensure that employees do not end up on inferior wages and conditions.

78. Finally, the TLC has ignored that its application not only discourages the use of individual agreements, it also severely discourages the use of federal collective certified agreements and federal awards. Subclause 4.7.2(c) in effect provides that upon transmission, unless an employee is employed under a Western Australian State award, order or collective agreement, then severance pay will be payable irrespective of whether the employee experiences any losses of hardships.

## Stepping back the severance pay scale after nine years' service

79. Severance pay is payable as compensation for the loss of non-transferable credits and the inconvenience and hardship imposed on employees when their employment is terminated due to redundancy.

80. In paragraph 118 of its outline of submissions, the TLC accepts that this rationale for the payment of severance pay is also applicable to these proceedings. It is therefore anomalous that it does not similarly accept the rationale underpinning the stepping down of the severance pay scale after an employee has attained nine years' service.

81. A very substantial component of non-transferable credits that are lost to employees on retrenchment is their long service leave entitlement. The minimum severance pay standard includes an amount to compensate employees for these lost long service leave credits. The AIRC confirmed the significant part that long service leave entitlements had in the determination of the severance pay scale. The Full Bench stated:

*[154] Our decision to increase severance payments for employees whose employment is terminated by reason of redundancy after five or more years of service is based, to a significant extent, on the loss of non-transferable credits. The largest non-transferable credit is long service leave which accrues at the rate of 13 weeks' leave for 15 years of service.<sup>16</sup>*

82. However, the AIRC also recognised the potential for double counting of these significant long service leave credits where employees receive a pro-rata payment for accrued long service leave on termination. The Full Bench considered that such double counting was inappropriate in the establishment of the new severance pay scale. The standard long service leave provision included in federal awards provides that pro rata long service shall be paid to employees on termination after the employee has attained 10 years of service.

83. To ensure that such double counting did not occur the Full Bench decided on a severance pay scale which steps down from 16 weeks' severance pay for retrenchees with nine years' service to 12 weeks' severance pay for retrenchees with 10 or more years' service. The Full Bench stated:

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<sup>16</sup> Federal Redundancy Test Case – Decision, Giudice J, Ross VP, Deegan & Smith CC, 26 March 2004, Print PR032004 at paragraph 154.

*[154] ... The amount of 12 weeks severance pay for 10 or more years service, while still greater than the current maximum, has been fixed having regard to the fact that under the standard long service leave provision in federal awards employees with 10 or more years service whose employment is terminated on account of redundancy are entitled to pro rata payment of long service leave. It would be double counting not to make an allowance for that fact in fixing the amount of severance pay to apply after 10 years of service.<sup>17</sup>*

84. Provisions of the Western Australian *Long Service Leave Act 1958* similarly ensure that retrenchees covered by the Act, with more than 10 years' service, shall receive a pro rata payment of their accrued long service leave if they are retrenched.

85. It follows that to avoid double counting of long service leave credits in the severance pay scale and the inequities that would flow, that the severance pay scale claimed by the TLC should be amended in a complementary manner to the federal severance pay scale.

86. This would also be consistent with the TLC's stated acceptance in paragraph 118 of their outline of submissions of the rationale underpinning severance pay in the federal jurisdiction.

87. The TLC has referred to the decision of the QIRC in August 2003 which extended the severance pay scale applicable in that State, but did not include a step back after nine years of service in support of its claim.<sup>18</sup>

88. However, the QIRC's decision does not provide any assistance or support for the TLC's claim. The QIRC's decision does not accept the arguments put forward by the TLC that there should be no adjustment in the severance pay scale because the issue was not raised in the Queensland TCR test case. This very matter was raised during recent hearings before the QIRC dealing with flow-on of the federal decision as the following exchange illustrates:

*[Mr Nance]: ... The second matter that I would just raise is that as part of that decision, the AIRC decision, it reduced the severance payments for employees employed for longer than 10 years on the basis of the pro rata long service leave which, under Federal awards, kicks in after 10 years.*

*If we're using the same logic then there's merit or it's arguable that the severance payments that this Commission granted originally should also consider the*

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<sup>17</sup> Ibid.

<sup>18</sup> QCU v QCCI [2003] QIRCComm 383 (18 August 2003); 173 QGIG 1417.

*reduction as a result of the pro rata in long service leave after seven years in the Queensland legislation.*

*[Deputy President Bloomfield]: It's a pity no one raised that originally.<sup>19</sup>*

89. It is clear then that the QIRC's decision lends no support or weight to the TLC's claim in respect to an increased severance pay scale. The fact that the QIRC's scale does not step down after long service leave is paid out is due to the fact that this issue was not raised in the original QIRC proceedings. It is not the result of a conscious decision on the merits of the issue by the QIRC.

90. The TLC's outline of submission also refers to table 3 at page 41 of the outline which purportedly demonstrates that the severance pay scale does not completely compensate employees for all the losses they experienced on being retrenched.

91. However, the table demonstrates that there is a significant drop in the losses suffered by retrenched employees after nine years service. Further, this material was before the AIRC and was taken into account when it set the new severance pay scale.

92. The TLC credits the Commonwealth with the figures for 'Accrued untaken personal leave' in Table 3 "Quantifying some of the losses on redundancy'. However, they are not Commonwealth figures. They are figures derived by the Australian Council of Trade Unions (ACTU) which also claimed that it had used data put forward by the Commonwealth in a key federal case reviewing the casual loading in the metal industry (*Metals Casuals Case*)<sup>20</sup>.

93. However, the ACTU made a number of errors in its assumptions when calculating its table that were fatal to its arguments and conclusions. The TLC has unfortunately repeated these flawed assumptions in its Table 3. The Commonwealth made extensive submissions in the federal redundancy test case which illustrated the ACTU's misrepresentations in the table. Attachment B details these submissions.

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<sup>19</sup> Queensland Redundancy Test Case, (B209 and B308 of 2002), transcript, 10 August 2004, lines 14-27.

<sup>20</sup> Metal, Engineering and Associated Industries Award 1998 – Part I, Decision, Munro J, Polites SDP, Lawson C, 29 December 2000, Print T4991.

## ATTACHMENT A

### RETRENCHMENT IN AUSTRALIA

#### THE INCIDENCE OF RETRENCHMENT IN THE WORKFORCE

1. The most detailed information on retrenchments in Australia comes from the ABS's *Retrenchment and Redundancy* survey which has so far covered two three year periods, from July 1994 to July 1997 and July 1998 to July 2001.<sup>1</sup>
2. While use of this survey provides valuable information about specific aspects of retrenchment, its estimates for the number of employed people who were retrenched over each three year period appears to be too low. Within the three year period covered by each survey the number of retrenched workers in the year immediately preceding the survey is much larger than for earlier years.

**Figure 9A.1: Estimates of redundancy and retrenchment numbers – Retrenchment and Redundancy Survey: '000**

Survey Date	Period for the Estimate	Actual Estimate	Full-year Equivalent
	Jul- Dec 1994	70.6	141.2
July 1997	1995	152.8	152.8
	1996	264.3	264.3
	Jan-Jun 1997	194.7	389.4
	Jul-Dec 1998	78.3	156.6
July 2001	1999	138.3	138.3
	2000	208.2	208.2
	Jan- Jun 2001	171.6	343.2

Source: ABS Retrenchment and Redundancy July 2001 and July 1997 (Cat No 6266)

3. Figure 9A.1 shows the estimates of retrenchment numbers for the entire workforce in each year covered by the survey. Full year equivalent values have been calculated by doubling the published estimates for 1994, 1997, 1998 and 2001 as the survey covered only six months of these years. It is clear that in full year terms, the estimated number of retrenchments increases the closer the reference period is to the timing of

<sup>1</sup> ABS Retrenchment and Redundancy July 2001 and July 1997 (Cat No 6266).

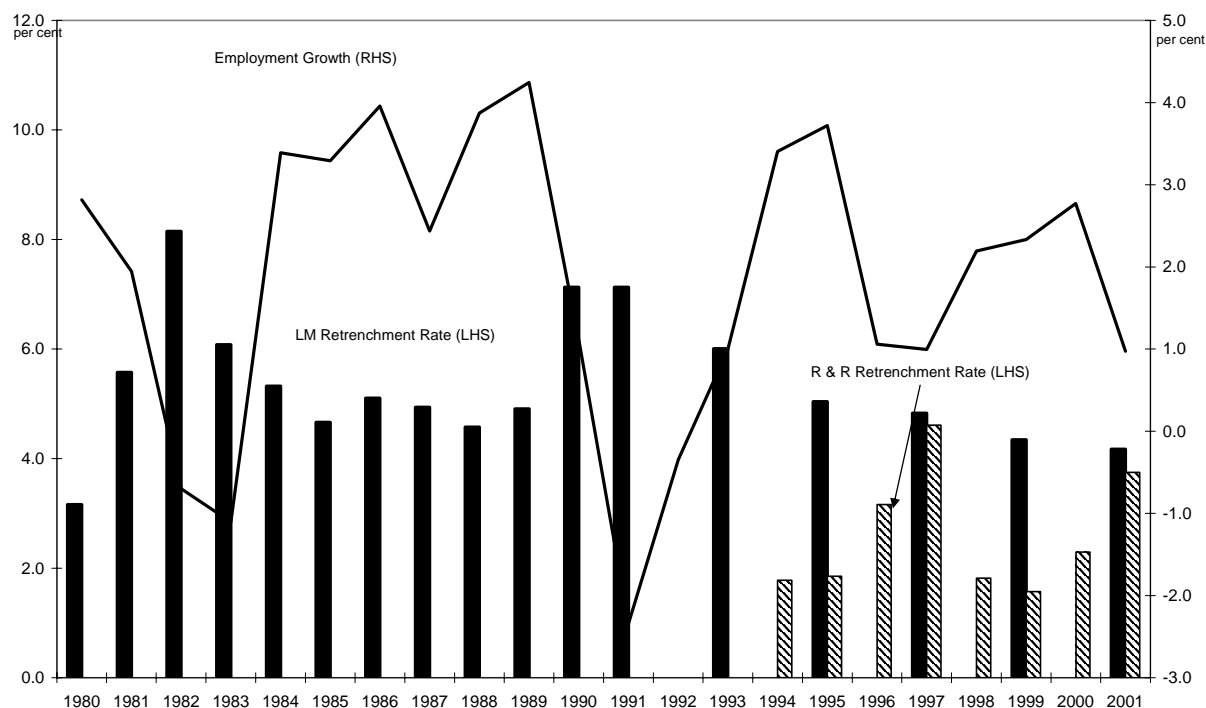
the survey. Perhaps this is due to recall problems on the part of the survey respondents.

4. In the federal redundancy test case the ACTU quoted ABS advice in support of its criticism of our doubling of the six monthly estimates to obtain annual estimates. We agree that in some cases seasonal variations might mean that doubling six monthly estimates might not provide accurate annual figures. However, in this case there is no reason to believe (and certainly no evidence) that seasonal variations in retrenchment rates would have any serious effect. The following analysis strongly reinforces this view.

5. Figure 9A.2 compares the estimates of retrenchments from the *Retrenchment and Redundancy* survey, using full-year equivalents as indicated in Figure 9A.1, with estimates derived from the *Labour Mobility* survey which is conducted biennially. The *Labour Mobility* survey asks respondents only about the previous 12 months and should not be as heavily influenced by recall bias. The figure also shows the rate of growth in average employment levels in each calendar year.<sup>2</sup>

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<sup>2</sup> ABS Labour Mobility (Cat No 6209). The reference period for the Labour Mobility survey is the 12 months to February of the survey year. While the retrenchment rates for this survey has been calculated with employment data over this period, the average employment levels hardly differ from those calculated over the calendar year.

**Figure 9A.2: Retrenchment rates and employment growth rates**

Source: ABS Labour Mobility (ABS Cat No 6209) various issues; ABS Retrenchment and Redundancy July 2001 and July 1997 (Cat No 6266)

6. The figure illustrates three important points:

- The results from the *Retrenchment and Redundancy* survey and the *Labour Mobility* survey correspond only in 1997 and 2001, the years in which respondents were answering the *Retrenchment and Redundancy* questionnaire. In 1995 and 1999 the *Retrenchment and Redundancy* survey shows a very large shortfall. While the ABS states that the results of the two surveys are not directly comparable, it is highly unlikely that the stark, time-based pattern evident in the two sets of retrenchment data is due to simple comparability limitations.
- The retrenchment rate fluctuates inversely with the rate of employment growth. The rate jumped quickly to historical peaks of 8.1 per cent and 7.1 per cent in the recessions of the early 1980s and the early 1990s respectively. Once employment growth resumes, retrenchment rates begin to ease, but this improvement is slower than the rapid pace of the recessionary increases.
- The state of the labour market appears to have very little to do with the growth in the retrenchment rate derived from the *Retrenchment and Redundancy* survey between 1994 and 1997 and again between 1998

and 2001. Judging by the consistent behaviour of the rate derived from the *Labour Mobility* survey, relatively small fluctuations in the rate of employment growth do not have a strong impact on retrenchments. Moreover, the same pattern of growth in the retrenchment rate derived from the *Retrenchment and Redundancy* survey is evident both between 1995 and 1997 when there was some weakening of the labour market and between 1998 and 2000 when a moderate recovery took place.

7. The ACTU's supporting material in the federal test case included a graph showing the annual retrenchment rate derived from the *Labour Mobility* survey from 1979 to 1998. The retrenchment rate shown in this graph matches that depicted in dark bars in Figure 9A.2 which is also derived from the *Labour Mobility* survey. So, the data presented by the ACTU can be seen as confirming the Commonwealth's assertion that the rates derived from the *Retrenchment and Redundancy* survey understate the prevalence of retrenchments except in 1997 and 2001 when the survey was actually conducted.

8. Further confirmation was given in the federal redundancy test case by Professor Webber, one of the co-authors of the relevant ACTU paper, who stated in evidence before the AIRC that the long run retrenchment rate is about 5 per cent in Australia.<sup>3</sup> This figure is consistent with the time series based on *Labour Mobility* survey data which is presented in Figure 9A.2, and is close to the actual annual rates between 1995 and 2001. It is also much higher than the rates derived from the *Retrenchment and Redundancy* survey except in 1997 and 2001.

9. Professor Webber agreed that the *Retrenchment and Redundancy* survey data could be tested against the *Labour Mobility* survey data by comparing the retrenchment rates calculated from each source.<sup>4</sup> If the number of retrenchments for the full three year period (mid 1998 to mid 2001) covered by the 2001 *Retrenchment and Redundancy* survey is converted to an annual average, as the ACTU and now the TLC has done in calculating its costings, the associated annual average retrenchment rate is 2.2 per cent, roughly half the rate derived from the *Labour Mobility* survey.

10. The TLC in this case and the ACTU in the federal redundancy test case seems completely unaware that the retrenchment rate it uses in their costings differs so widely from the retrenchment rate that is referred to repeatedly by the ACTU's expert witness and by the material the ACTU

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<sup>3</sup> Federal Redundancy Test Case, transcript, 27 May 2003 at PN1083.

<sup>4</sup> Federal Redundancy Test Case, transcript, 27 May 2003 at PN1298.

presented to the AIRC. As we have indicated above, the number of retrenchments used by the TLC and the ACTU in its costings equates to a retrenchment rate of about 2.2 per cent (this rate is calculated by dividing the annual number of retrenchments used by the ACTU in its costings by the average level of employment over the relevant period). In stark contrast, the retrenchment rate that is repeatedly cited in material the ACTU provided to the federal commission in Exhibit ACTU 2 and that was given by Professor Webber is around 4 to 5 per cent. The credibility of this widely accepted estimate is reinforced by international evidence - as Murtough and Waite indicate, the rate of retrenchment in other developed countries is close to 5 per cent.<sup>5</sup>

11. Because the TLC and the ACTU use these low retrenchment rates, their costings seriously underestimate true costs. However, it is a simple matter to adjust the TLC's costings to correct this flaw. If the costings are amended using 4 per cent as a conservative estimate of the long run retrenchment rate, then the numbers of retrenched used in the TLC costings increase by a factor of x, and the TLC's cost estimates also increase by this factor.

12. The magnitude of cyclical fluctuations in the retrenchment rate coupled with growth in the workforce means that a very large number of retrenchments would probably occur in the next recession. Average annual employment levels grew by 24 per cent between 1990 (just at the onset of the last recession) and 2002.

13. The ratio of retrenchment rates for 1991 and 2001, based on labour mobility data, is 1.7.<sup>6</sup> If this ratio is applied to the *Labour Mobility* survey count, then the level of retrenchments would increase from approximately 383,200 to more than 650,000 across the entire workforce. The latter number gives an idea of the number of retrenchments which would occur under plausible economic conditions at some point in the future, given a workforce of similar size and composition to that which exists now.

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<sup>5</sup> Exhibit ACTU 2, Volume 2 – Redundancy General, Tab 6 at page 154.

<sup>6</sup> The rates derived from Labour Mobility data are used for both 1991 and 2001 (equal to 4.2 per cent and 7.1 per cent respectively) for the sake of consistency, as there are methodological differences between this survey and the Retrenchment and Redundancy Survey.

**ATTACHMENT B****Critique of TLC's Table 3 'Quantifying some of the losses on redundancy'**

2. Table 3 "Quantifying some of the losses on redundancy" has been adapted from material presented by the ACTU in the federal redundancy test case. The Commonwealth submitted an extensive critique of the ACTU's material regarding the table in the federal proceedings, correcting several errors and misrepresentations made by the ACTU. The TLC has carried those same errors and misrepresentations over into its table 3. This appendix provides details of the Commonwealth's critique of the ACTU's original material as it now relates to the TLC's table.

3. The first error relates to the use of sick leave usage rather than personal leave usage rates. The ACTU's figures that the TLC has also used in column 3 of the table purports to use a Commonwealth figure of 4.4 days per year taken in personal leave and assumes an entitlement of seven days personal leave in the first year of service and 10 days per annum thereafter. The ACTU claimed these figures were derived from Commonwealth submissions made in the *Metals Casuals Case*<sup>1</sup>.

4. However, in the *Metals Casuals Case* submission the Commonwealth did not calculate that employees take an average of 4.4 days of personal leave per year. That figure relates to sick leave usage – it specifically excludes absences due to carers' leave and bereavement leave.

5. At paragraph 10 of Attachment D (Costing of Personal Leave Usage) of its April 2000 outline of submissions in the *Metals Casual Case*, the Commonwealth states:

*For the purposes of this costing, we estimate that around 6 days are taken for personal leave, which includes carers leave and bereavement leave in all industries. While this may overstate the actual rate of absence for paid sick leave purposes, we have chosen the higher rate to be conservative.*

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<sup>1</sup> Metals, Engineering and Associated Industries Award 1998 – Part I, Decision – Munro P, Polites SDP, Lawson C, 29 December 2000, Print T4991.

6. This higher figure of six days per year for all personal leave results when the Commonwealth adds an estimated between one and two days for bereavement leave and/or caring purposes each year. Bereavement leave is infrequently used during the average person's working life and was therefore a very small part of this estimate.

7. As a result of this error the table understates the average rate at which personal leave is taken by about 1.6 days per year, and therefore overstates the rate at which unused personal leave credits are accumulated by the same amount.

8. The second error made by the ACTU in its original table, and repeated by the TLC in table 3, is that unused bereavement leave has been included in the carryover calculations. The table assumes that unused bereavement leave accumulates from year to year. As a result, the table has been calculated on the basis that personal leave accrues at the rate of seven days in the first year and 10 days per annum in subsequent years, less the amount of personal leave taken during the year. This is not the case. The balance of the untaken bereavement leave component of personal leave does not carry over to the next year for the purposes of accrual. The Full Bench's intention in this respect was made clear in its Personal/carers' leave test case – Stage 2 decision which stated "*the bereavement leave component cannot accumulate beyond the 12 month period*".<sup>2</sup>

9. As a consequence of this error, the table overstates the average accumulation of unused personal leave credits by a further two days per year.

10. These errors mean that the table does not accurately portray the rate of accumulation of non-transferable credits. In the federal test case the Commonwealth recalculated the column for 'Accrued untaken personal leave' on the assumption that six days personal leave is used each year and that two days of the personal leave entitlement does not accumulate each year.

11. For instance, in the first year untaken personal leave accrues at five days, less the six days personal leave taken each year which leave a nil balance. In the second year and thereafter, untaken personal leave accrues at eight days, less six days taken each year, leaving two days or

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<sup>2</sup> Personl/carers Leave Test Case, Decision – O'Connor P, Ross VP, Marsh SDP, McDonald & Holmes CC, 28 November 1995, Section 3.4 Summary of Key Points, Print M6700.

0.4 weeks per year to carry over. Correcting the table for this error results in the 'Total' column also requiring adjustment.

12. The TLC, like the ACTU in the federal test case, has supplemented the table with an amount for trauma. The TLC claims that all retrenchees should be compensated by an additional six weeks' pay for trauma suffered on retrenchment regardless of their period of tenure. They do not provide any evidence to substantiate the claim that retrenched employees are unable to function for six weeks, or indeed commence a search for a new job. Rather, the TLC relies on the same footnote relied upon by the ACTU in Webber and Weller's paper which states:

*In the early 1990s, in recognition of the negative consequences of the retrenchment experience, the (then) federal Office of Labour Market Adjustment provided structured programmes in the 6-8 weeks after retrenchment to assist people to work through their initial emotions and commence job search. That could be taken as an assessment of the duration of the initial trauma of retrenchment.<sup>3</sup>*

13. Clearly, this footnote does not provide the evidence necessary to substantiate the TLC's claim that retrenched employees remain inactive for a period of up to eight weeks.

14. The table also assumes that any level of trauma is independent of the length of service of the retrenchee. According to the table it is contended that all retrenchees should be provided with at least a six weeks fully paid holiday by their employer. This should be the case irrespective of whether the retrenchees had been working with their employers for one year or 15 years.

15. Even more significantly, the TLC follows the ACTU and ignores the fact that most employees are already paid full wages for most of the period that they claim the retrenchee is traumatised. All retrenchees are entitled to up to four weeks' notice (or five weeks for employees over 45 years with two years' service) or to payment in lieu.

16. In the federal test case the Commonwealth presented a table based on recalculated figures for 'Accrued untaken personal leave' and which omitted the illogical six week period for the initial trauma suffered by retrenchees. The recalculated table reads:

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<sup>3</sup> Webber, M. and Weller, S., "Retrenchment and Labour Market Change", footnote 11 at Exhibit ACTU 2.

Years of service	Accrued Untaken Personal Leave (weeks)	Accrued Long Service Leave (weeks)	Total (weeks)
1	0	0.9	0.9
2	0.4	1.7	2.1
3	0.8	2.6	3.4
4	1.2	3.5	4.7
5	1.6	4.3	5.9
6	2.0	5.2	7.2
7	2.4	6.1	8.5
8	2.8	6.9	9.7
9	3.2	7.8	11.0
10	3.6		3.6
11	4.0		4.0
12	4.4		4.4
13	4.8		4.8
14	5.2		5.2
15	5.6		5.6

17. The Commonwealth submitted to the AIRC that the ACTU's contention that the current severance pay standard was exhausted for longer periods of tenure in the compensation of personal leave and long service leave, let alone other non-transferable credits, was simply not correct. The Commonwealth's table shows that this does not hold true even if it were intended that severance pay compensate all employees for the unexpired personal leave credits of the average employee. If this were the intention, the ACTU's contention would hold true only for employees retrenched with between seven and nine years' service.

18. But, as the Commonwealth submitted in the federal redundancy test case, it was never the intention that severance should pay all retrenched the full unused sick leave credit of the average retrenchee. The Commonwealth further demonstrated that it was the AIRC's clear position in 1984 that the payout of unused sick leave to retrenched employees was not a principle the Bench was prepared to countenance. The ACTU was in effect asking the AIRC to overturn this long standing principle and agree that unused sick leave ought to be included in severance pay calculations.

19. The Commonwealth contended that sick leave is a highly personalised condition of employment and to attempt to establish 'payout' figures based on national averages is unjust and inequitable. The AIRC has consistently rejected calls to include payout of unused sick leave in awards and the ACTU has failed to bring forward sufficient grounds that would convince the AIRC to do otherwise. For example, when dealing with the making of a new award in 1985 Commission Cox reaffirmed the Commission's established position:

*The payout of accrued sick leave on termination has been an issue that this Commission has consistently declined to insert into awards by arbitration. Simply put paid sick leave is for sick employees, not a cash bonus for enjoying good health.*<sup>4</sup>

20. And in 1990 when asked to approve a structural efficiency agreement Commissioner Smith stated:

*...The concept of paying out unused sick leave has been addressed by the Commission and found to be wrong in principle. ...  
...given that the proposal is misconceived and wrong in principle I am not prepared to include it in an award of the Commission. To do so, in my view, would be against the public interest.*<sup>5</sup>

21. The Commonwealth contended that if the ACTU's approach were to be accepted, the AIRC would have to go far beyond overturning its previous policies on payout of sick leave. The ACTU's approach does not just seek that employees be paid the value of their own unused sick leave credits – it seeks to have all retrenchees paid the unused sick leave credits of the average retrenchee. It seeks to have retrenchees who have used all their sick leave paid for substantial credits. There are no previous decisions of the AIRC to which we can refer where such an approach has been considered by the AIRC. In the past, no-one appears to have made such a claim. The reasons are obvious.

22. The TLC has carried these errors over into its outline of submissions to this Commission, and in particular into table 3. The Commonwealth submits that these misrepresentations mean that the TLC's submission in this regard ought to be rejected by this Commission.

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<sup>4</sup> Re Conditions in Airport Duty-free Stores, Decision – Cox C, 25 June 1985, Print F9013.

<sup>5</sup> Vehicle Industry Award, Decision – Smith C, 21 August 1990, Print J4003.