FAQs on Retrenchment

1. What is retrenchment?

Retrenchment is the action taken to terminate the employment relationship which is justified on the basis that the roles of the employees concerned have become redundant. A redundancy situation arises where there is a surplus of labour such as where there is a cessation of job functions, re-organisation, merger of work units or outsourcing.

2. What are the laws and guidelines applicable to retrenchment?

In Malaysia, the Industrial Relations Act 1967 provides statutory protection against dismissal except if there is "just cause and excuse" to terminate an employee. A retrenchment when carried out in accordance with proper procedures, is just cause for dismissing an employee. The burden of proving that the retrenchment was carried out fairly lies on the employer.

The Code of Conduct for Industrial Harmony issued jointly by the Ministry of Human Resources and trade unions, contains principles and guidelines for retrenchment exercises. While not legally binding, the Industrial Courts may take its compliance into account in determining whether the dismissal was with just cause or excuse.

3. What are the key requirements for retrenchment? Is approval of government agency or labor union required?

The key requirements to retrench employees is to ensure that the retrenchment exercise is that the roles of the employees concerned have become genuinely redundant and not done for an ulterior motive. As employees' livelihood are affected by the exercise, courts have also interfered where it can be shown that good labour practice was not followed.

Approval from a government agency is not necessary. The Company is required however to **notify** the government authorities of the impending retrenchment by submitting a Form PK to the nearest Labour Office 30 days before the actual retrenchment date. Employers are required to disclose information such as the reasons for the retrenchment, number of workforce and others in this form.

As for notifying unions, if there is collective agreement governing the relationship between the employer and the employee to be made redundant and it requires consultation or notification of the union before a retrenchment exercise, the employer must comply with this requirement. Otherwise, there is no obligation to consult or notify the unions.

4. What can be legitimate reasons to support the argument that there is a redundancy? Can cost cutting to reduce losses due to Covid-19 be a legitimate reason?

The law recognizes that a business has the right and prerogative to manage its workforce, subject to fair labour practice being adopted. Therefore, if a company is legitimately facing financial difficulties or losses as a result of Covid-19 and decided to restructure its business, it has *prima facie* legitimate grounds to reduce its workforce and retrench employees who are surpluses. This is subject to the company being able to prove and justify that to the Courts the retrenchment was carried out to reduce costs due to the Company's poor financial performance impacted by Covid-19 (in the event a claim for unfair dismissal is being brought).

5. When will the Courts hold that the requirement of a genuine redundancy was not satisfied?

A redundancy exists when an employee's position becomes a surplus to the employer. If there is no basis or no evidence to support that the employee's position is redundant, the Court may reject the employer's contention that there is a redundancy. For example, if an employer says it is restructuring its business due to financial hardship by reducing its workforce but the employer is not actually facing financial hardship or unable to prove that it is facing financial hardship, the Court may hold that there is no genuine redundancy. Also, it would not be a genuine redundancy if the employer after retrenching the employee hires a new person to fill the position held by the employee who was retrenched. Furthermore, if the functions of the person who was retrenched were transferred or discharged by one or more other employees and did not cease to exist, the Court may also find that there is no redundancy.

6. What is the "Last In First Out" (LIFO) principle?

The LIFO principles is a common industrial practice to retrench employees whereby, all things being equal, the most junior employee (i.e. "the most recently-hired employee(s)) should be selected for retrenchment first. The operation of the LIFO rule is limited to within

the establishment in which the retrenchment is to be made and the category to which the redundant employee belongs.

7. Can the employer select employees for retrenchment based on capability?

Although the LIFO principle is the most common industrial practice to retrench employees, the Code of Conduct of Industrial Harmony does recognise other criteria including the employees' ability, experience and skills and qualification that employers may consider when selecting employees to retrench. However, if an employer wishes to depart from the LIFO principle, the employer must have sound and valid reasons for the departure which must be supported by cogent evidence.

8. Should the employer retrench foreign employees before local employees? What if foreign employees have higher positions than local employees?

The Employment Act 1955 requires that foreign workers occupying posts similar to that of local employees in a particular category selected for retrenchment be terminated first.

If the foreign employee concerned is not part of the particular category selected for retrenchment, their services do not have to be terminated first.

9. What is "good labour practice"? Is the compliance with the practice mandatory?

"Good labour practice" refers to compliance with the Code of Conduct of Industrial Harmony and any other principles determine by case law.

In brief, the Code stipulates the following:

(a) That employers should try to avert or minimize reductions in workforce by adopting cost reduction measures;
(b) Employees and any recognized trade union should be consulted;
(c) If retrenchment becomes necessary despite measures to avert it is taken, employers should undertake certain measures including giving early warning, retiring employees who are beyond their normal retirement age, assisting the employee to find alternative employment and payment of retrenchment benefit; and
(d) In selecting employees for retrenchment, the employer should use objective criteria.

The Code is not legally binding but a failure to comply may be a factor that courts take into consideration in determining whether the retrenchment exercise was carried out in a fair manner and whether the ensuing dismissal was with just cause or excuse (see also FAQ 2).

10. Does the law require employers to pay severance or retrenchment benefits? If so, how much?

The Employment (Termination and Lay-Off Benefits) Regulations 1980 which is only applicable to employees coming within the purview of the Employment Act 1955 (EA) sets out the **minimum** compensation payable to EA employees if retrenched as follows:

Length of Service	Termination Benefits
Less 2 years	10 days' wages per year of service
2 years or more but less than -5 years	15 days' wages per year of service
5years or more	20 days' wages per year of service

For the avoidance of doubt, employees who fall within the purview of the EA are those:

- whose monthly wages is RM2,000 or less;
- whose monthly wages exceeds RM2,000:
  - engaged in manual labour;
  - engaged to supervise or oversee manual labourers employed by the same employer;
  - engaged to operate or maintain any mechanically propelled vehicle or in the operation or maintenance of a mechanically propelled vehicle; or
  - employed in certain positions on sea-going vessels.

For employees who do not fall within the purview of the EA, compensation payable to them (often referred to as retrenchment benefits) would depend on the terms of their employment contract. In the **absence** of a contractual obligation to pay retrenchment benefits, according to case law, they are still entitled to receive fair compensation if they are retrenched, provided the financial position of the employer permits.

11. What happens if the requirements for retrenchment are not met? Any administrative or criminal sanctions on the employer or its directors?

If the requirements for retrenching employees are not met, the employee can bring a claim for unjust dismissal against the employer. If the employee is successful, he or she is entitled to either:

(a) reinstatement and backwages (at a maximum of 24 months of the employee's last drawn salary); or
(b) compensation in lieu of reinstatement (1 month for every year of service) and backwages.

Failure of the employer to submit the PK Form to the Labour Office within the stipulated time frame carries a punishment of a fine of RM10,000.00.

12. Can the employer first negotiate with employees for mutual separation before retrenchment?

The Company may make an **offer** of a mutual separation package to the employees concerned before undertaking a retrenchment exercise. It is important to bear that the consent from the employee to mutually separate must be free from vitiating factors (e.g. harassment, compulsion, misrepresentation, duress, coercion, etc).

It is also important to note that even if the employee promises not to bring a claim for unjust dismissal, the Industrial Court is not prevented by the promise in the mutual separation agreement from hearing the employee's complaint if he/she alleges she was coerced into signing the agreement.

13. Are there any practical suggestions for companies who want to retrench employees due to Covid-19?

Following the declaration of the Covid-19 pandemic and the implementation of the Movement Control Order in Malaysia, the Ministry of Human Resources released a set of FAQs which covers the issue of retrenchment of employees in such times. The FAQs reinforces the principle that retrenchment of employees is the prerogative of the employer but the employer must still need to comply with the usual requirements before retrenching employees. In the FAQs, the Ministry specifically mentioned the following requirements:

- There must be a genuine financial impact on the business;

- Employers must exhaust other means first before opting to retrench employees such as reducing working hours, reducing or freezing the hiring of new employees, reducing or limiting overtime, limiting employees from working on weekends or on public holidays, reducing employees' wages or laying-off their employees temporarily.

- If retrenchment is unavoidable, foreign workers should be considered before local employees and the "Last In First Out" principle should be followed (unless there are strong justifications to depart from these principles).