Retrenchment in Malaysia: Employer’s Right?

Hamidah Marsono
Faculty of Law, Universiti Teknologi MARA
40450, Shah Alam, Malaysia
Tel: 60-1-3208-8910   E-mail: hamidah_uitmlaw@yahoo.com

Hj. Kamaruzaman Jusoff
Yale University, Yale’s Centre for Earth Observation, 21 Sachem St
New Haven, CT. 06511, USA
Tel: 203-432-1384   E-mail: jusoff.kamaruzaman@yale.edu

Abstract
There are several ways to put a contract of employment to an end. One of them is by way of retrenchment. Termination of employment by way of retrenchment may be relevant when the employer restructuring his business. The focus of this article is to evaluate the application of the principle Last in First Out (LIFO) in the case of retrenchment in Malaysia. This article will also assess to what extent the courts defend the prerogative of the employer to retrench his employee in the case of redundancy.

Keywords: Employment law, Retrenchment, LIFO, Employer’s power, Redundancy, Industrial Relations

1. Introduction
Retrenchment may happen not only during recession but it is also relevant when the economic situation is good. Apparently, termination of service is permitted by law for operational reasons, which is commonly known as redundancy. The word redundant however, is not as simple as it sound as it is, in fact, it is very subjective. Redundancy occurs when the employee is no longer required to work. There are situations where a contract of employment is subject to some inevitable change. Redundancy may happen due to several reasons such as a downturn in production, sales or economy, the introduction of technology, business relocation, a business merger or a business is sold or restructuring of a company.

Furthermore, with the introduction of automation, industries usually employ very few workers. At the same time, as a result of reorganization, scaling down operation or closure of business, an employee’s services may become redundant and thus, his service may be terminated. Thus, in our context, retrenchment means a discharge of surplus of workers. However, retrenchment does not include termination of contract due to other reasons such as illegality or frustration or dismissal on the ground of misconduct (Ayadurai, 1998). In short, retrenchment occurs as a consequence of redundancy. The words of downsizing and retrenchment are used interchangeably. However, the main legislation governing this issue, that is, the Industrial Relations Act 1967, does not define the meaning of redundancy. Thus, for this purpose, reference should be made to common law principles.

In exercising retrenchment, not only must the employer have good grounds to do so, but, the law clearly provides that the employer is required to exercise it fairly. It is the practice that the recognized trade union must be consulted when an employer proposes to make the employee redundant. Section 13(3) of Industrial Relations Act 1967 recognizes management’s prerogatives to employ workers or to terminate them with a proper cause or excuse. While the court generally will not interfere with the bona fide exercise of power given to the management, it is equally important to note that the employer must provide a proper cause or reason before terminating the employees. Due to this reason, it is the employer who decides on the number of employees to be employed or to be retained by considering their viability and profitability of the business. Thus, when the employer is of the view that the number of the employees is too excessive, he is entitled to discharge the excess employees. Similarly, redundancy occurs where the business needs lesser number of employees or where the employer had suffered a business downturn due to its lost of major clients as could be seen inf Stephen Bong vs. FBC (M) Sdn Bhd & Anor (1993) where the court had confirmed retrenchment exercise made by the employer. As there was a clear shrinkage of work, thus, the employees were made redundant. On the same note, in
the Kumpulan Perubatan (Johor) Sdn Bhd vs. Mohd Razi Haron (2000), the Industrial Court held that the massive retrenchment made by the employer was a genuine measure and not done for any ulterior motive to victimize the employees. Further, the court found no evidence that the employer had acted with *mala fide* in the retrenchment process.

**2. Reference to the industrial court**

In redundancy, the retrenched employee has the right to bring the matter to the Industrial Court should he feel his termination of service is unfair and without just cause or excuse (Aminuddin, 2003). However, if the retrenchment exercise is done in accordance with the relevant procedures, then there is a very little chance for the employee to win his case in court. This can be evidenced by looking at the Industrial Court’s decision in Plusnet Communication Sdn Bhd & Ors vs. Leong Lai Peng (2005) where it was held that a redundancy situation did exist in this case as a result of reorganization and downsizing exercise made by the company to minimize losses. In the event the issue of retrenchment is referred to the Industrial Court, it will generally look at the following issues:

(a) whether the retrenchment was justified, that is by looking at the circumstances of the case;

(b) whether the employer is in a position to give the true grounds for the retrenchment; and

(c) whether the retrenchment is made *bona fide*.

On justification of retrenchment, there are matters to be looked at by the employer, such as, is there any surplus of employees to allow retrenchment on the grounds of redundancy? It is important to note that there should be a valid reason for redundancy. The main question the court has to consider is whether there was in fact, redundancy. The court is aware that an employer may restructure his/her business and in order to realise that mission, it may involve reduction or downsizing of manpower, in which case, some of the employees have to be removed as they are no longer required by the employer. In 1998, the Industrial Court in TWI Training and Certification (SE Asia) Sdn. Bhd. v Jose Sebastian ruled that as long as the measure taken by the employer is a genuine commercial and economic consideration, it has the managerial prerogative to decide in the best interest of its business arrangements to identify its own area of weakness and then proceed to discharge its own surplus. On this issue, Gopal Sri Ram JCA in William Jacks & Co (M) Bhd vs. S. Balasingam(1997) on p. 241 said:

“The facts before the Industrial Court showed that the applicant was surplus or redundant which justify retrenchment within the meaning of the test ... Retrenchment means the discharge of surplus labour or staff by an employer for any reason whatsoever otherwise than as a punishment inflicted by way of disciplinary action (per SK Das J in Hariprasad vs. Divelkar 1957 AIR SC 121 at p 132). Whether the retrenchment exercise in a particular case is bona fide or otherwise is a question of fact and of degree depending on the particular circumstances of the case. It is well settled that the employer is entitled to organize his business in the manner he considers best. So long as the managerial power is exercised bona fide, the decision is immune from examination even by the Industrial Court. However, the Industrial Court is empowered and indeed duty-bound to investigate the facts and circumstances of the case to determine whether the exercise of power is in bona fide”.

In Hotel Jaya Puri Blvd vs. National Union of Hotel, Bar & Restaurant Workers & Anor (1980), a dispute arose between the National Union of Hotel, Bar and Restaurant Workers (the union) representing the workers and the employer. In this case, a number of workers employed by the Jaya Puri Chinese Garden Restaurant Sdn. Bhd. (the employer) were retrenched by the company as the business was closed due to losses. The restaurant was carried on in premises belonging to the Hotel Jaya Puri Berhad. Both the hotel and the restaurant had the same managing director. The union claimed that those workers were in fact dismissed and not retrenched as the hotel business is still in operation. The Union sought to have the Hotel joined as a party as it had a view that the workers were in fact the employees of the Hotel. The Hotel contended that it was not the employer of the workers in question and thus, the termination of the workers was a retrenchment. However, they are not eligible to retrenchment benefits from the employer (the restaurant) as none of them had completed three years’ minimum service. On to the issue of retrenchment, the Federal Court confirmed the Industrial Court’s decision in holding that the closure of business was perfectly legal and proper. The termination of service of these workers could not be considered as dismissal and compensation awarded could not be on the basis of dismissal.

In exercising prerogative, the law also prescribes that the employer has the duty to ensure that retrenchment is properly exercised to avoid any claim of wrongful dismissal. It is the rule that if the retrenchment is carried out for collateral purpose such as to victimize the employees for their legitimate participation in trade union activities, such termination is deemed to be made without a just cause or excuse and that termination may be regarded as on *mala fide*. The courts are firm on this point. This stand can be seen in Harris Solid State (M) Sdn.Bhd. & Ors vs. Bruno Gentil Pereira &Ors (1996). In this case, the first appellant (the employer) terminated the services of the 21st respondents (the employees) who were all members of the union and the reason given was that the employer would cease operation with effect from 22 September 1990. The employees contended that the termination of the employment is tainted with *mala fide* and
actuated by victimization and unfair labour practice. Based on evidence, the court found that the employer dismissed the employees purely because of their trade union activities. The court then ordered the employees to be reinstated to their employment within one month of the date of award without loss of wages, allowances, bonus, seniority, service or benefits whatsoever.

3. Law governing redundancy

In the Malaysian context, section 12(3) of the Employment Act 1955 provides that the employees may be terminated from service when such termination is attributable wholly or mainly to the fact that:

(a) the employer has ceased, or intends to cease, to carry on the business for the purposes of which the employee was employed;
(b) the employer has ceased, or intends to cease, to carry on the business in the place at which the employee was contracted to work;
(c) the requirements of that business for the employee to carry out work of a particular kind have ceased or diminished or are expected to cease or diminish;
(d) the requirements of that business for the employee to carry out work of a particular kind in the place at which he was contracted to work have ceased or diminished or are expected to cease or diminish.

The above mentioned section is mutatis mutandis to section 81(2) of the Employment Protection (Consolidation) Act 1978 of England. As the definition of redundancy is not defined in the Industrial Relations Act 1967, the court in Credit Corporation (M) Bhd vs. Choo Kam Sing & Anor (1999) has referred the provision regarding redundancy in England in section 81(2) of the Employment Protection (Consolidation) Act 1978 provides as follows:

For the purpose of this Act, an employee who is dismissed shall be taken to be dismissed by reason of redundancy if the dismissal is attributable wholly or mainly to:

(a) the fact that his employer have ceased, or intends to cease, to carry on the business for the purpose of which the employee was employed by him, or has ceased, or intends to cease, to carry on that business in the place where the employee was so employed, or
(b) the fact that the requirements of the business for employees to carry out work of a particular kind, in the place where he was so employed, have ceased or diminished or are expected to cease or diminish.

In order to exercise managerial prerogatives to retrench employees, the employer must prove that there is an existence of redundancy in the organization. If there are several reasons taken into consideration by the employer for the retrenchment, the employer has the duty establish the principal reason for such decision. Upon considering the reasons, then, the court has to determine whether the termination or dismissal was fairly or unfairly made. This question should be determined in accordance with equity, good conscience and the substantial merits of the case.

It is a rule that an employer, who proposes to terminate his employees on the grounds of redundancy to consult the trade union where the employees belong to. In addition to the above, redundancy must be exercised in conformation to the Code of Conduct for Industrial Harmony 1975 and signed by the Trade Unions and Employer’s Organizations. Section 30(5A) of the Industrial Relations Act 1967 provides that in making its award, the Industrial Court may take into consideration any agreement or Code relating to employment practices between organizations, representative of employers and workmen respectively, in which, such agreement or Code has been approved by the Minister. In addition to the above, section 63A of the Employment Act 1955 imposes a duty on the employer to notify the Director of Labour before any retrenchment can be materialized.

Involuntary termination from employment may affect the employee’s personal well-being and the stabilities of his families. Thus, the effected employee is entitled to a minimum written notice from his employer, regardless of anything contrary contained in the contract of service between the parties. If the contract of employment expressly provides for a specific period of notice, these conditions must be observed by the parties. In the absence of such a term, the minimum notice prescribed by section 12(2) of the Employment Act 1955 must be followed. The said statutory notice provides that if the employee has been employed for less than 2 years on the date of notice, the length of notice is 4 weeks. If the employee has been employed for 2 years or more but less than 5 years, the notice is 6 weeks. For the employee who has been employed for more than 5 years, the minimum notice required 8 weeks. Despite the above mentioned principle, the length of the notice can be waived by a mutual consent of both parties in which the employer will have to pay an equivalent payment in lieu of notice. Failure to give the appropriate notice will make the employer liable for prosecution under section 99 of the same Act.

The Malaysian law clearly recognizes the managerial prerogative of the employer to organize and arrange his business in the manner he considers best including to retrench his employees provided that it is made bone fide for the interest of the employer’s business. Clearly, the retrenchment exercise is a last resort to the employer in reorganization. Before
making decision on retrenchment, the employer should try his very best to minimize the reduction of the number of employees. Perhaps, the employer should take the necessary steps such as by reducing its operational cost and at the same time restructuring his position to suit the current needs. The Industrial Court in Basf (M) Sdn. Bhd. vs. Lee Suan Sim (2001) recognized that when the employer is in difficulties, he should first embark on cutting operational costs such as introducing salary cuts, stopping increments and promotions exercise, reducing traveling expenses and entertainment allowances. In the event that he failed to stabilize the financial position of the business, he has, if unavoidable, to retrench the employees.

It is my submission that the employer has the prerogative to decide whether or not to retrench his workers as long as the retrenchment is made for genuine reasons. Genuine reasons may be interpreted to include proper exercise of discretion in which it is free from mala fide or unfair labour practice. Clearly, the employer’s interest is wider than that of the employee.

4. Procedure of retrenchment

Retrenchment exercise is subject to some governing procedures. The Industrial Court in Rocon Equipment Sdn Bhd & Anor vs. Zainuddin Muhamad Salleh & Yang Lain (2005) emphasized that even if redundancy did exist, another question to be considered is whether the retrenchment is done in accordance with the accepted standards of procedure. Clause 22(a) of the Code of Conduct for Industrial Harmony 1975 (the Code) provides the following measures to be taken by the employer:

(i) to give as early a warning as practicable to the workers concerned
(ii) introducing schemes for voluntary retrenchment and retirement and for payment of redundancy and retirement benefits
(iii) retiring workers who are beyond their normal retiring age
(iv) co-operating with the Ministry of Labour and Manpower to help the workers to find work outside the undertaking; spreading termination of employment over a longer period
(v) ensuring that no such announcement is made before the workers and their representatives or trade union have been informed

In retrenchment, the employer must draw up a plan to decide who will be retained and who will be made redundant. The employer must then inform the affected employees as soon as possible so that they have an opportunity to find alternatives or to apply for other jobs either with the current employer or with another employer. Retrenchment must be conducted fairly and not tainted by any unfair legal practice. Thus, while retrenchment is permissible, a justifiable retrenchment exercise could be declared invalid simply because the selection of the employees for retrenchment is not in accordance with Last in First Out (LIFO) (Anantaraman, 2005).

5. The Malaysian code of conduct for industrial harmony 1975 (the Code)

It is the intention of the government to maintain healthy practice in employment industry. Thus, steps must be taken to maintain what is called industrial harmony in the workplace which essentially involves the employer, the employees and their trade unions. The Malaysian Code of Conduct for Industrial Harmony 1975 (the Code) which was endorsed in February 1975 provides a guideline that the employer must make a proper selection on the category of employees to be retrenched. Clearly, if the Code is followed by the employer, it will be able to reduce the level of dissatisfaction among the parties involved and this will create industrial harmony in the country.

There are several guidelines laid down in the Code prior for retrenchment. If no agreement is reached between the employer and the employee on the criteria for selection, the criteria applied must be fair and objective. Clause 22(b) of the above mentioned Code suggests that the employer should adopted an objective criteria, which includes:

(i) need for the efficient operation of the establishment or undertaking
(ii) ability, experience, skill and occupational qualifications of individual workers required by the establishment or undertaking under (i)
(iii) consideration of length of service and status (non-citizens, casual, temporary, permanent)
(iv) age
(v) family situation; and
(vi) such other criteria as may be formulated in the context of national policies

6. Last in first out (LIFO)

The common method used in the exercise of redundancy is Last in First Out (LIFO). LIFO means the junior employee would have to leave the employment before the senior could be directed to leave (Ramasamy, 2002). This arrangement
has advantages to employees as it reduces the possibility of the management to do selections of terminating employees on the basis of favoritism. If the selection criteria are based on race, religion or gender, the effected employees may claim compensation on the grounds of unfair dismissal. The good point of LIFO is it is easy to administer. At the same time the system rewards employees who have so far been loyal to the employer.

The Industrial Court in Associated Pan Malaysia Cement Sdn Bhd and Kesatuan Pekerja-Pekerja Perusahaan Simen (1986) held that the LIFO principle is subject to two principles. Firstly, it operates only within the establishment in which the retrenchment is to be made. Secondly, the rules are applicable only to the category to which the retrenched employees belong. In Aluminium Company of Malaysia Bhd. vs. Jaspal Singh (1978) the Industrial Court held that the principles of LIFO have to be followed by the employer in the case of retrenchment. Since the claimant’s job was still in existence after retrenchment and the employer has failed to consider that the claimant was the first who joined the company for the post compared to the other two superintendents, therefore the retrenchment was wrongly exercised. The issue of seniority must be considered with reference to the employee working in the same category and not based on the date when they started work for the company (Ayadurai, 1998). In other words, the principle of LIFO is only applicable when other things are equal. Any departure from the principle of LIFO must be objectively justifiable. As to the status of the employees, the Industrial Court in Seong Thye Plantations Sdn Bhd vs. All Malayan Estates Staff Union (1981) reiterated that the employer should take into consideration the status of the employee when it selects employees to be retrenched. The order of selection is non-citizen, casual, temporary and lastly, permanent employee. Thus, in retrenchment, the employer has to first retrench all foreign employees of a similar work capacity before retrenching local workers. On this aspect, reference must also be made to section 60N of the Employment Act 1955 which provides that the employer shall not terminate the services of local employees unless he has terminated the services of all foreign employees employed by him in a capacity similar to that of the local employee.

The Code was implemented more than 20 years. It is respectfully submitted that the Code reflects the government’s policy in protecting workers’ interest in the country. But, to what extent has the Code achieved its objective in protecting the employee’s interest against the employer’s decision to retrench its employee? It is to be noted that LIFO is not the only consideration. In selecting employees for retrenchment, employees with skills or those who occupy a specialized position may be retained and a poor performer may be eliminated. However, selection for redundancy on the grounds of trade union membership or non-membership is clearly unfair. Thus, the employer must show in detail the selection procedure and must show how they picked those unlucky one. The Industrial Court in National Union of Cinema & Places of Amusement vs. Shaw Computer & Management Services Sdn Bhd (1975) held that the court will usually require the employer to show how, by whom, and on what basis the selection for redundancy was made. The burden of proof is on the employer and he must discharge it to the satisfaction of the court. In short, in exercising retrenchment, not only the employer must have good grounds to do so, but he must also avoid unfair labour practice. Even though the ultimate decision is on the employer, he has to observed the proper procedure to avoid legal tussles between him and the retrenched employee which may ultimately undermine the industrial harmony in the country. In the Kesatuan Pekerja-pekerja Perusahaan Logam vs. KL George Kent (M) Bhd (1991), the High Court held that it is the duty of the Industrial Court to consider the provisions of the Code in making decisions relating to retrenchment. In this case, there was a provision in a collective agreement between the employer and employees that they agreed to observe provision of the Code. One of the provisions in the Code provides that the retrenched employees should be given priority of engagement or re-engagement. But, this provision was not considered by the Industrial Court in its decision. The High Court in reversing the Industrial Court’s decision held that it has made a jurisdictional error when it failed to consider the relevant clause in the collective agreement. Should the collective agreement be taken into consideration, the employer should have given priority of engagement or re-engagement to the retrenched employees rather than bringing in new employees.

The principle of LIFO is not rigid. It is a settled law that the Code does not have any force of law. In the 1989 case of Penang & Seberang Prai Textile & Garment Industry Employees Union vs. Dragon & Phoenix Bhd Penang & Anor (1989), the court confirmed that the Code has no legal sanction. However, section 30(5A) of the Industrial Relations Act 1967 speaks in permissive terms in requiring the Industrial Court when making an award, to consider the objective of the Code to inculcate fair and good industrial practice. Even though the Code is merely a moral guideline between the employer and the employees and no penalty can be imposed against the employers for their failure to follow its provisions, yet the Industrial Court in Mamut Copper Mining Bhd vs. Chau Fook Kong & Others (1997) expects employers not only to adhere to the LIFO principle, but also other principles provided for by the Code. Similar stand could also be seen in Weeluk Corporation (Sarawak) Sdn Bhd vs Wee Siak Luan (1998) where the court held that a retrenchment is only justified if it is made in accordance with the accepted industrial relations standards, practices and procedures. Thus, as the Code has provided the procedure to be observed, it is the duty of the employer to follow them in order to meet the standard requirement.

Undoubtedly, another question to be considered is whether the employer is in a position to depart from the Code? The courts recognize the importance of making commercial decisions on the part of the employer. Based on the above
principle, the employer may adopt his own objective criteria in making selection. These objective criteria may include the employee’s ability and expertise, experience, qualification and the business needs. This is in line with the fact that the employer is vested with the prerogative power especially in matters relating to improvement of his business. A clear rule can be seen in Supreme Corp vs. Doreen Daniel & Another (1981) where the employer has been permitted to depart from the principle with a sound and valid reason. In departing from the Code, the employer would surely have his own reason to do so. Thus, it is the duty of the employer to convince the court the factors they have considered in departing from the principle embedded in the Code.

Such departure from the LIFO is also confirmed in the First Allied Corporations Bhd vs. Lum Siak Kee (1996) where the Industrial Court ruled that the principle of the Code is not inflexible and extraordinary situations may justify variations (Industrial Law Reports, 1996). Thus, a junior employee who has special qualifications needed by the employer may be retained even though a more senior employee has to be retrenched. The court however, did not suggest any specific test to determine such criteria. It is open for the employer to decide what is best for his business. However, the decision to retrench certain employee may be declared wrongful if no sensible or reasonable management could reach to such decision in retrenching the employee as decided in Malayan Shipyard and Engineering Sdn Bhd Johor Bahru vs. Mukhtiar Singh & 16 Ors (1991). The burden of proof is on the employer and he must discharge that burden to the satisfaction of the court.

7. Conclusion

The rule on retrenchment is not closed. It would seem that the existing provision of the Code is not necessarily followed by the employer. The matter is always for the employer to decide and not for the court to tell what amounts to justification.

It is my humble submission that a departure from the LIFO principle, will open doors for the employer to abuse his discretionary powers. The possibility of retrenching employees on mala fide will be a much higher if such departure is permitted with very little restrictions. The situation may be worst if the retrenched employee did not bring his dissatisfaction to the attention of the relevant authority.

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