



The Managerial Prerogative on Retrenchment in Malaysia

Mumtaj Hassan^{1*}, Mohammad Azam Hussain², Md Rejab Md Desa³

¹School of Law, College of Law, Government and International Studies, Universiti Utara Malaysia, 06010 UUM, Sintok, Kedah, Malaysia, ²School of Law, College of Law, Government and International Studies, Universiti Utara Malaysia, 06010 UUM, Sintok, Kedah, Malaysia, ³School of Law, College of Law, Government and International Studies, Universiti Utara Malaysia, 06010 UUM, Sintok, Kedah, Malaysia. *Email: mumtaj@uum.edu.my

ABSTRACT

Retrenchment is a situation wherein the contract of service of the employees are terminated due to surplus in workforce which occurs as a result of economic downturn, reorganization, reduction in production, mergers, takeover, and others. Although retrenchment is to be averted wherever possible, the industrial law recognizes the privilege of an employer to determine the appropriate economic size of its organization. This paper will attempt to discuss the legal aspect of retrenchment in Malaysia as provided in the statutes and guidelines. This paper also focuses on the managerial prerogative in termination of employees in case of redundancy, the recommendations in the Code of Industrial Harmony 1975, the legal effect of last in first out and the remedies for the redundant employees in Malaysia.

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JEL Classifications: K3, L5

1. INTRODUCTION

Retrenchment simply means termination of the contract of service of the employees due to the surplus of the workforce which in turn triggers the redundancy situation (Bidin and Wahab, 2001). Whereas redundancy in an ordinary parlance refer to a surplus of labour as a consequence of a reorganization of a business, reduction in production, mergers, take-over, the economic downturn and as a result of other adverse economic predictors. In 2015 a total of 38,499 workers were retrenched which inter-alia encompasses the normal retrenchments and those opting for voluntary severance schemes in the wake of the economic advent, accentuated by the uncertain economic climate and the volatile financial markets.

Every employer has an entrenched right and privilege to organize his business in the manner fit for the purpose of profit maximization and at his liberty and convenience whatever the strategic business considerations are to be put into actions. Where the employer is implementing a reorganisation scheme for genuine and *bona-fide* reasons of better management and the service of some employees would become excess. The employer is entitled

to disengage that employee and henceforth make them redundant as the overwhelmed size of the workforce is not able to sustain the economic profitability of the employer. However, this right of the employer is limited by the law that he must act *bona-fide* and not capriciously. Hence, when a company goes through retrenchment, it reduces outgoing money or expenditures or redirects focus in an attempt to become more financially solvent.

2. THE MANAGERIAL PREROGATIVE TO TERMINATE THE SERVICE OF EMPLOYEE

Section 13(3) of the Industrial Relations Act (IRA) 1967 recognizes that the employer has the right to terminate the services of employees for reasons of redundancy or by reasons of reorganization of an employer's profession, business, trade or work or criteria for such termination. It is well settled that the employer has the prerogative to organize his business in the way he deems fit for the purpose of the economy or convenience provided he acts *bona-fide* (Ayudurai, 2004).

There are also provisions in the employment act (EA) 1955 in section 12(3) which empowers the employer the right to terminate the service of the employees in the following circumstances: (a) the employer has ceased, or intends to cease to carry on the business for the purpose 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 (Hassan and Ali, 2011).

In the case of *CH Reinforcing Steel (M) Sdn. Bhd. v Abu Samah Abbas* (2001) 1 ILR 903, the Industrial Court explained that an employer has the inherent right to reorganize his business and for the purpose of the economy so to derive the maximum benefits from it. And if this involves reducing the workforce, no arbitration tribunal should interfere unless it could be proven that such reorganization was done *mala-fide* or without reason or was actuated by motives or victimization or unfair labour practice.

Several other discussions also suggest the same as was seen in the case of *Chay Kian Sin v Measat Broadcast Network System Sdn. Bhd.* (2012) 4 ILR 400 wherein the Industrial Court had held that the employer has the right to organize its business in the manner it considers best. However, in doing so the employer must act *bona-fide* and not capriciously or with the motive of victimisation an unfair labour practice.

3. THE STANDARD AND THE BURDEN OF PROOF

The standard of proof that needs to be met by the employer is the civil standard on a balance of probabilities. This standard is said to be flexible so that the degree of probability required is proportionate to the nature and gravity of the issue. Further, section 30(5) of IRA also emphasised that the Industrial Court should not be burdened with the technicalities regarding the rules of evidence and procedure that are applied in a court of law (*Telekom Malaysia Kawasan Utara v Krishnan Kutty Sanguni Nair and Anor* (2002) 3 CLJ 314). This approach was reaffirmed in the case of *K A Sanduran Nehru Ratnam v I-Berhad* (2007) 1 CLJ 347.

In *Bayer (M) Sdn. Bhd. v Ng Hong Pau* (1999) 4 MLJ 361, the court of appeal opined that on redundancy, employer is burden with the evidential proof and to satisfy the court with cogent proof thereof that redundancy was consequential upon actual surplus of workforce. The burden is on the employer to prove actual redundancy on which the dismissal was grounded.

The law put the burden on the employer to prove actual redundancy and the managerial power to retrench was exercised *bona-fide*. *Malaysian Shipyard and Engineering Sdn Bhd, Johor Bahru v Mukhtiar Singh and 16 others* (Award No 165 Of 1991), support the said proposition of law and that the burden of proof is on

the employer to prove with evidence that redundancy was real and that the decision to retrench is not *mala-fide* or actuated by victimization.

In this same parallel, the court in *Chapman and Others v Goonvean and Rostowrack China Clay Co. Ltd.* (1973) 2 All ER 1063 held that the statutory test for determining whether an employee had been dismissed by reason of redundancy was simply whether there had been a cessation of, or diminution in the requirements of the employer's business for the employee to carry out the kind of work for which he had been engaged.

The same tenor was echoed in *Sistem Televisyen Malaysia Bhd. and Anor v Suzana Zakaria* (2005) 1 ILR 53, wherein the industrial court held that:

To prove redundancy the company must prove that there is a surplus of labour or that the requirement of the functions of the employee has ceased or greatly diminished to the extent that the job no longer exists.

4. THE OBLIGATIONS OF THE EMPLOYER AS IN THE CODE OF CONDUCT FOR INDUSTRIAL HARMONY 1975

The code for conduct for Industrial Harmony was introduced in 1975 as guidelines for employers and employees on the practice of industrial relations for achieving greater industrial harmony. The Code provides for matters concerning redundancy and retrenchment of workers (Hassan and Ali, 2011). The Code has been given statutory recognition by section 30(5A) IRA 1967.

In *Mamut Copper Mining Sdn. Bhd. v Chan Fook Kong @ Leonard and Ors.* (1997) ILR 625, the Industrial Court has explained that the employer has to follow other principles concerning retrenchment as in the Areas for Cooperation and Agreed Industrial Relations Practices, annexed to the Code of Conduct for Industrial Harmony 1975 in any retrenchment exercise. The learned chairman said at p. 643.

In this regard, the court's duty is to look at the entire facts and circumstances of the retrenchment exercise and the particular facts of the case of each of the retrenched workman to whether the workman's retrenchment was done fairly and in accordance with the generally accepted norms of industrial relations practice as set out in the agreed practices.

Clause 20 provides that in circumstances where redundancy is likely an employer should take positive steps to minimize reductions of workforce by the adoption of appropriate measures such as: (i) to stop recruitment of new employees except for critical areas, (ii) to limit overtime work, (iii) to limit work on weekly rest days and public holidays, (iv) to reduce weekly working days or reduce the number of shifts, (v) to reduce daily working hours, (vi) to conduct retraining programmers' for workers, (vii) to identify alternative jobs and to transfer workers to other divisions/ other jobs in the same company, (viii) to implement temporary lay-off i.e., temporary shut down by offering fair salary and to

assist the employees affected in obtaining temporary employment elsewhere until normal operation resumes, and (ix) to introduce pay-cut in a fair manner at all levels and to be implemented as a last resort after other cost cutting measures have been carried out.

Clause 21 of the code emphasized that the ultimate responsibility in deciding on the size of the workforce must rest with the employer. However, the above steps should be taken by the employer after consultation with his employees representatives or their trade unions. Clause 22 (a) of the code further provides that if retrenchment becomes necessary, despite having taken appropriate measures, the employer should take the following measures: (i) Giving as early a warning, as practicable, to the workers concerned; introducing schemes for voluntary retrenchment and retirement and for payment of redundancy and retirement benefits, (ii) retiring workers who are beyond their normal retiring age, (iii) assisting in co-operation with the ministry of human resources, the workers to find work outside the undertaking, (iv) spreading termination of employment over a longer period, and (v) ensuring that no such announcement is made before the workers and their representatives or trade union have been informed.

5. SELECTION CRITERIA

Redundancy selection essentially involves two matters, firstly the choice of criteria upon which the selection process will be based and secondly, the application of the chosen criteria to the employees in question. It is essential that during a redundancy process that the employer ensures that fair and transparent criteria for selection for redundancy are identified and applied consistently. This will help employers when explaining to employees the reason for their selection and will help employees to understand the process.

Clauses 22(b) of the code suggest that the employer should select employees to be retrenched in accordance with objective criteria. Such criteria, which should have been worked out in advance with the employees' representatives or trade union, as appropriate, may include: (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 for length of service and status (non-citizens, casual, temporary, permanent), (iv) age, (v) family situation.

6. LAST IN FIRST OUT

LIFO is the golden rule of procedural retrenchment law. The onus of justifying a departure from the LIFO principle is on the employer. The employer must have sound and valid reasons for departure from the LIFO principle (Hassan and Ali, 2011). In *Ganda Palm Services Sdn. Bhd., Teluk Intan v Ng Wah Chiew and 2 others* (Award 40/1986 ILR), the Industrial Court held as follows:

It was well established in industrial law that in effecting retrenchment, an employer should comply with the industrial principle 'last in first out' unless there are sound and valid reasons for departure.

CH Reinforcing Steel (M) Sdn Bhd v Abu Samah Abbas (2001) 1 ILR 903, affirmed that in the exercise the *bona-fide* power of selecting employees to be retrenched, the organization must not only act reasonably but also observe any customary arrangement or code of conduct in conformity with accepted standard of procedure.

The Industrial Court in *Aluminium Company of Malaysia v Jaspal Singh* (1989) 2 ILR 558, the industrial court explained:

The question of the comparative senior or junior status of a workman for applying the principles of "last in, first out" has to be determined with reference to the workmen working in the same category of employment, and therefore, for examples, in retrenching on the employee working as a fitter, at the time of retrenchment, seniority is determined by the strength and length of each workman acting in the category of fitters, and not on the length of service of a workman in a different category.

7. PRE-RETRENCHMENT REQUIREMENTS

In circumstances where the employer has the intention to exercise retrenchment, the steps as herein bellowed spelt must be at all times be complied with:

i. Notice to the labour department

The employment retrenchment notification 2004 obligates the employers to report to the nearest labour office of any planned redundancies. An employer who is proposing to dismiss his employees on the reason of surplus must notify the labour office vide the prescribed Form PK1/98 at least 1 month prior to the retrenchment of the employee. An employer who fails to notify the labour office of the proposed redundancy commits an offence under section 99A of the EA 1955.

ii. Lay-off

Lay-off is an alternative to the retrenchment exercise. Employer is required to practice lay-off first and if he is unable to continue lay-off then retrenchment become necessary. Clause 5 of employment (termination and lay-off benefits) regulations 1980 provides that lay-off means the failure to provide work under the contract of employment for at least a total of twelve normal working days within any period of four consecutive weeks and without any remuneration.

iii. Statutory notice for termination

Employers are also bound by the EA 1955 with respect to termination notice for redundant employees. All employers are required to comply with section 12(2) which require minimum notice must be given to the employees before retrenchment.

iv. Foreign employee

Even though, foreign workers enjoy the same employment perks and benefits as our local employees as far as redundancy law are concerned, but in the event of a reduction in workforce with circumspection foreign employees should be the first to go if they are employed in the similar capacity to that of the local employee (EA, section 60N).

v. Payment of compensation

Not all employees are eligible to make a claim for a redundancy payment. Only employees who are covered by the EA and dismissed for reason of redundancy are entitled to receive the redundancy benefits under employment (termination and lay-off benefits) regulations 1980, Clause 6(1). Clause 11 further requires the redundancy payment be paid by the employer to the employee not later than 7 days after the contract of service of an employee is terminated.

8. VOLUNTARY SEPARATION SCHEME (VSS)

VSS has become popular as a means of reducing the number of the employee. A VSS is a scheme where employees are allowed to leave or resign from their service by receiving severance package or compensation from the company. In designing the compensation package, there are various practices, which are dissimilar from organization to organization as well as industry to industry. It all depends on the financial capability of the company to meet with the employees' aspiration and also the liquidity of the company.

In the case of *A.K. Bindal and Anor v. Union of India and Anor* (2003) 3 LRI 837, the supreme court of India had succinctly laid down the governing principles for VSS thus:

The voluntary retirement scheme (VRS) which is sometimes called VSS... The whole idea of implementing VRS is to save costs and improve our productivity. The main purpose of paying this amount is to bring about a complete cessation of the jural relationship between the employer and the employee. After the amount is paid and the employee ceases to be under the employment of the company or the undertaking, he leaves with all his rights and there is no question of him again agitating for any kind of his past rights, with his erstwhile employer including making any claim with regard to enhancement of pay scale for an earlier period.

Mohamed (2015) outlined the effect of a VSS as follows:

When an employee makes an application for VSS, he is considered as offering his early retirement to the company, subject to the company's acceptance of it. When the company accepts the application for VSS, the contract of employment is said to be terminated by mutual consent and it is not considered a dismissal.

In *Abdul Aziz Ismail and Ors v Royal Selangor Clubs* (2015) 2 ILR 546, the industrial court held that the employees had voluntarily applied to participate in the VSS initiated by the club and when the latter had accepted their VSS applications, it had resulted in a cessation of their employments. Thus there had not been any dismissals.

Recently, the Federal Court revisited the issue of VSS in the case of *Zainon bt Ahmad and 690 Others v Padi Beras National Berhad* (unreported) Civil Appeal No 02(C) 44-44-2011(B) and explained that under VSS, the employee has the option to accept the said scheme or continue to work as usual. In this case, Padi Bernas Berhad (Bernas) invited their employees to leave their employment

under a VSS exercise. The employees would be entitled to a package which included basic compensation, salary in lieu of notice and unutilised leave and medical benefits for a period of 1 year post-termination. The appellants in this case applied for the VSS and were successful in their applications. They were paid their benefits in accordance with the handbook.

Nearly 2 years after they had ceased employment with Bernas and received all the benefits under the VSS, the appellants wrote to Bernas requesting for payment of retirement/termination benefits as contained in the Handbook.

The Federal court agreed with the reasoning of the court of appeal on Section 63 of the contracts act 1950 and held that the rescission of a contract by mutual agreement would result in an extinguishment of all rights and obligations under the terminated contract, even in the absence of an express provision to that effect. Hence, after the rescission of the contract of employment, the employees cannot return and seek benefits contained in their terms and conditions of employment.

9. THE EFFECT OF THE COLLECTIVE AGREEMENT IN RETRENCHMENT EXERCISE

It is to be noted that a collective agreement which has been taken cognizance of by the industrial court shall be binding on the parties to the agreement and on their successors, assignees or transferees. Section 30(5A) IRA 1967 provides that in making its award, the court may take into consideration any agreement or code relating to employment. So it is obvious that if a retrenchment exercise which was carried out without compliance the procedures set in the collective agreement can amount to dismissal. Further, it is provided in section 17 of the IRA 1967 that a collective agreement which has been taken cognizance of by the court shall be deemed to be an award and shall be binding on the parties to the agreement including all workmen who are employed or subsequently employed in the undertaking or part of the undertaking to which the agreement relates.

In *Dunlop Industries Employees Union v Dunlop Malaysian Industries Bhd.* (1987) 1 CLJ 232 the supreme court struck down an entire retrenchment exercise as the company for failure to give notice of retrenchment prior to retrenchment. The court held that the retrenchment was carried out contrary to the collective agreement. In the case of *Golden Plus Granite Sdn. Bhd. v Mohamat Ali Hashim and Ors* (2001) 1 ILR 316, the industrial court found the company had done in contrary and not in accordance with the Article 29 of the collective agreement and therefore ordered the company to reinstate the four employees in their former positions without any loss of service, seniority, wages any other benefits, monetary or otherwise.

10. UNFAIR DISMISSAL

The IRA 1967 applies to all workers and all migrant workers that are, both documented and undocumented workers and they have

the right to pursue their rights if infringed in the Industrial Court. Employers who do not comply with the law and regulations on redundancy may face actions for unfair dismissal. In order for a dismissal to be fair, the employer has to show that redundancy was the reason for the dismissal and that redundancy was handled in a fair manner. Employees may bring an action against their employer for unjustified dismissal under section 20 of IRA 1967. In a successful case of unfair dismissal, the industrial court may award back wages not exceeding 24 months from the date of dismissal, compensation in lieu of reinstatement and other monetary compensation as the court think just.

In *Colgate-Palmolive Sdn. Bhd. v Yap Kok Foong Award 368/1998*, it was held that in a section 20 reference, a workman's complaint consists of two elements; firstly that he has been dismissed, and secondly that such dismissal was without just cause or excuse. It is upon these two elements being established that the workman can claim his relief, to wit an order for reinstatement, which may be granted or not at the discretion of the industrial court. In this regard section 30(5) IRA 1967 provides that the industrial court shall act according to equity, good conscience and the substantial merits of the case without regard to technicalities and legal form.

In *Wee Chee Khoon v Citibank Berhad* (2011) 2 LNS 495, the Court finds that the claimant had not become redundant and the Bank's decision to terminate him was without just cause or excuse. Therefore the court makes an order for compensation in lieu of reinstatement as an order of reinstatement will not be an appropriate remedy. In *Adam Abdullah v Oxygen Bhd.* (2012) 2 MELR 253, the court found that the claimant had been dismissed by the company without just cause or excuse and the company was ordered to pay the claimant back wages in the sum of RM170,448.00 less the retrenchment benefits received by the claimant.

11. CONCLUSION

Retrenchment is a very traumatic exercise and the legal implication can be overwhelming if an employer fails to abide by the law on redundancy. Before taking any action, the employer needs to ensure that the reason for the proposed dismissals is genuinely redundancy. Employers should act prudently in the wake of redundancy situation wherein in most instances what trigger same is within the foreseeable contemplation of the employer. As redundancy is a form of dismissal, the question as whether the dismissal is unfair or fair is for the court to decide. If the retrenchment exercise is tainted with *mala-fide* or amounted to unfair labour practice then the employer must face the consequences of a legal action. In cases of reinstatement of the employee which is not possible, the court will order by the employer to pay back wages and other monetary compensation. Further, the IRA imposes a duty upon the Industrial Court to have regard to substantial merits of a case rather than to technicalities. It also requires the Industrial Court to decide a case in accordance with equity and good conscience.

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