FAQ: Retrenchment & Downsizing During The COVID-19 Pandemic

for LexisNexis Resource Hub – COVID-19

The COVID-19 outbreak and the implementation of the movement control order ('MCO') in Malaysia has caused financial strain on local businesses, especially small-to-medium enterprises. Although the MCO was introduced to 'flatten the curve', this move results in many businesses being forced to cease or reduce their operations significantly. As such, many businesses are now looking at cost-cutting measures to ensure business continuity. This includes, among other things, retrenchment and downsizing.

Retrenchment is the exercise of dismissing of employees who have become surplus to the needs of the organization. Retrenchment or downsizing can happen when the business no longer requires the same number of employees it used to have as the functions of the employee have either ceased or diminished to a significant extent. This could be caused by various factors such as loss of profits, lack of business, change of business direction, outsourcing of functions, or right-sizing exercises.

Can employers retrench employees due to the COVID-19 Outbreak?

Employers are not prohibited from retrenching employees during the COVID-19 outbreak. This position was confirmed by the Ministry of Human Resources in its FAQ No 2 (which can be accessed here). However, employers are required to satisfy all the requirements under law before implementing a retrenchment exercise.

What are the legal requirements for a retrenchment exercise?

Briefly speaking, the employer must ensure:

- There is a genuine redundancy (i.e.: the employee has become surplus to the operational needs of the company);
- The selection criteria are fair and objective (e.g.: using established principles such as Last In First Out or Foreign Worker First Out);
- The employer has taken all reasonable steps to avert retrenchment;
- The employer has, to the extent reasonably possible, complied with fair labor practices such as the Code of Conduct for Industrial Harmony;
- The retrenchment must not victimize a specific employee or be otherwise done in bad faith.

What are valid grounds for retrenchment?

A few grounds may be utilized by businesses to opt for retrenchment such as:

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- A genuine financial impact on the business i.e. loss of profits, lack of revenue, escalating operational costs, etc.;
- There is a surplus of employees that is no longer required by the company;
- Change of business direction which renders some employees redundant;
- Outsourcing of functions; or
- Right-sizing exercises.

What is the process that should be undertaken by employers during a retrenchment exercise?

While there is no fixed procedure that must be complied with, employers are generally advised to take these steps:

- Prior to implementing the retrenchment, the employer should consider all other cost-cutting alternatives if they are viable, such as reducing or eliminating non-essential expenditure, reducing hours of work, retiring employees who have reached or passed retirement age, offering a voluntary separation scheme ('VSS') to employees, reducing or limiting overtime etc.;

- If retrenchment is unavoidable, employers should ensure that the selection process for affected employees is fair and objective. Employers should first terminate the services of foreign workers before considering local employees in the same category (ie Foreign Worker First Out). If retrenchment of local employees is being considered, employers are encouraged to comply with the 'Last In First Out' principle. However, employers can depart from these principles if they have strong justifications to do so;

- Employers should consider conducting 'townhall' meetings with employees to keep them appraised of the financial and commercial situation of the company, and the various cost-cutting measures being implemented by the company;

- The employer must give the employee as much notice as possible about the retrenchment;

- To the extent reasonably possible, the employer should consider whether there are alternative positions for the affected employee, whether in its own company or in other subsidiaries or associated companies.

Does an employer need to pay termination benefits during a retrenchment exercise?

This answer depends on whether an employee falls under the purview of the Employment Act 1955.

1. Employees under the Employment Act 1955 ('**EA Employees**')

Employees who fall within the ambit of the Employment Act 1955 (typically those whose monthly wages do not exceed RM2,000.00 or those who are involved in manual labour) are statutorily entitled to termination benefits pursuant to the Employment (Termination and Lay-off Benefits) Regulations 1980 ('**Regulations**'). Regulation 6 of the Regulations provides minimum termination benefits for employees depending on their years of service:

Length of Employment	Termination Benefits
Less than 2 years	10 days' wages for every year of employment
More than 2 years but less than 5 years	15 days' wages for every year of employment
More than 5 years	20 days' wages for every year of employment

Wages here has the same meaning as that under the Employment Act 1955. However, "a day's wage" for the purposes of computing the termination benefits is based on the employee's "average true day's wages" calculated over the period of 12 months' completed service immediately preceding the date of retrenchment.

To qualify for termination benefits, the employee must also have been under a continuous contract of service for a period of not less than 12 months.

2. Employees not covered under the Employment Act 1955 ('**Non-EA Employees**')

These employees are not legally entitled to the statutory termination benefits under the Regulations. Instead, their entitlement to termination benefits will be dictated by their employment contract or company policy.

If their employment contract or company policy does not provide for termination benefits, such employees are prima facie not entitled to any termination benefits. However, employers are still advised to provide some form of termination benefits to Non-EA Employees in the event of retrenchment or closure of business, since non-payment of termination benefits is one of the factors that the Industrial Court can take into account when deciding whether a retrenchment is unfair.

Does an employer need to pay termination benefits if they are already going through financial difficulties?

As stated above, EA Employees are statutorily entitled to termination benefits in the event of a retrenchment. These amounts are payable regardless of the employer's financial situation.

For Non-EA Employees, the employer can consider an appropriate amount of termination benefits based on their financial capabilities.

Can an employer be sued for unfair dismissal if an employee is retrenched?

Yes, retrenched employees are entitled to sue their employers for unfair dismissal. An employee who wishes to do so must file a representation with the Industrial Relations Department within 60 days from the date of dismissal.

What is the financial exposure to employers in an unfair dismissal claim?

The primary remedy claimed in unfair dismissal is reinstatement. However, reinstatement is rarely granted, and it is more common for the Industrial Court to order payment of back wages and compensation in lieu of reinstatement.

A confirmed employee is entitled to a maximum financial compensation of 24 months of back wages, plus one month of salary for every year of service as compensation in lieu of reinstatement.

For probationers, this is limited to a maximum of 12 months of back wages.

For fixed term employees, the maximum financial compensation is the balance of the unexpired term of their contract.

The above remedies are also subject to discretionary deductions by the Industrial Court, which will take into account post-dismissal earnings, termination benefits already paid, and other relevant factors.

In light of the constantly changing circumstances, this is a general overview and should not be treated as legal advice. The information presented is correct to the date of its publication.

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